Asset Accumulation in Focus: The Challenges Ahead

By James Lloyd

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About this Report

This policy report is based on, and responds to, research published simultaneously by the ILC-UK entitled: *Asset Accumulation across the Life Course*[1].

The purpose of this report is to provide accompanying policy analysis and discussion to the *Asset Accumulation across the Life Course* research, for both a general and specialist readership. Its primary purpose is to provoke discussion.

Acknowledgements

This report and the *Asset Accumulation across the Life Course* research would not have been possible without the generous support of *Prudential*[2] and *Partnership*[3].

The analysis for *Asset Accumulation across the Life Course* was undertaken by Richard Boreham of the *National Centre for Social Research* (NatCen)[4].

The author sincerely thanks all parties for their time, support and enthusiasm.

All opinions expressed in this report are the author's own, and should not be attributed to any of the aforementioned organisations.

[1] The report of the *Asset Accumulation across the Life Course* research can be downloaded from the website of the ILC-UK at: http://www.ilcuk.org.uk
[2] http://www.prudential.co.uk
[3] http://www.partnership.co.uk/
[4] http://www.natcen.ac.uk

Foreword

Nick Prettejohn
Chief Executive, UK and Europe
Prudential plc

An ageing population and increased life expectancy present significant challenges for Government, the private sector and for society as a whole. Prudential welcomes this paper as an important contribution to the debate about how we all might adjust to the changes taking place in society.

The issues covered by this study are significant for retirement income providers such as Prudential because they highlight the need for providers to be able to respond if individuals are unable to rely on the state for support. As specialists in the field of retirement income we look forward to taking up this challenge.

The report also highlights the role that good financial education has to play in helping people to manage their finances in the current and future environment. Financial capability has been at the heart of Prudential's corporate responsibility work for many years so we particularly welcome the recommendation that the ability of individuals to manage their finances should remain a key target of Government policy.

We believe that the paper's call for a greater focus on debating 'decumulation policy' is timely, particularly in terms of the increasingly important role that the decumulation of housing wealth in later life is likely to play.

This is an important and sometimes challenging study. The insights into the changes taking place around intergenerational wealth transfers highlight key challenges that policymakers need to address. Prudential hopes that the report will find resonance with key policymakers and stakeholders, and that the results will be used to influence policy development and stimulate further debate.

Foreword

Ian Owen
Chairman
Partnership

A major examination of how people plan and save for the future is of crucial importance at this time of rapid societal change. Without investigations of this kind, the task of developing appropriate policy around issues such as the provision of long term care in response to increased life expectancy would be almost impossible. Partnership is therefore pleased to support this timely study, which provides valuable insights into the changes that have taken place over the past decade in the ways households have accumulated assets, and presents helpful recommendations as to the focus of further discussions and the possible shape of relevant policy.

The report's focus on asset accumulation has brought to light a population with an increasing reliance on property as a means of saving for retirement, which in turn has served to highlight the urgent need for focusing on asset decumulation: e.g. how can the Government and the financial industry make it easier for those with most of their assets in the form of property to exploit this resource in retirement? Regardless of whether this reliance continues to grow, however, Partnership believes that, as the report recommends, studying the ways in which people exploit or plan to exploit in retirement the assets built up over their lifespan is crucial to the development of appropriate policy.

Partnership also welcomes the study's call for an even greater emphasis on improving the quality and availability of financial advice and education, especially in relation to people approaching retirement. As a specialist provider of financial solutions for people with health conditions, Partnership is particularly cognisant of the challenges people in this age group face in finding sound advice from qualified advisers on the wide array of financial solutions available to them.

The issues raised in this examination of household finances and assets across the life-course are relevant to all of us, and represent challenges to which the Government and other stakeholders must respond. Partnership hopes that the report will provide policymakers with key focus areas for further discussion, investigation and policy development, which will help them to meet these challenges.

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Executive Summary

This policy report accompanies the publication of research by the International Longevity Centre – UK (ILC-UK) entitled *Asset Accumulation across the Life Course*. The purpose of this report is to discuss this research in the context of important contemporary challenges for public policy.

In light of evidence that the retirement asset-building of younger cohorts is being skewed toward property, the Government must continue to explore the development of new financial advice services, adapt 'decumulation policy' to the increasing role of property in household asset portfolios, and monitor how living in debt affects the behaviour and choices of younger cohorts.

Given evidence of the growing financial burden confronting those at the peak age for family formation, there is a clear risk that these trends will undermine the Government's family-friendly policies such as extended rights to paternity leave and flexible working. The Government needs to ensure there is a proper evidence base of research about how variations in asset accumulation are impacting family formation and related child-rearing decisions. Private sector lenders should explore extending the availability of payment holidays to focus on those starting a family, and the Government should review measures that could reduce the financial stress associated with family formation, such as extending the Sure Start Maternity Grant up the income scale.

Significant increases in net wealth have been experienced by older cohorts in retirement, in contrast to the common presumption that retirement is a time when assets are gradually run-down. These increases in wealth have resulted from rising property prices and suggest that despite objections to the use of means-testing toward older people in principle and in practice, the Government should continue defending this principle, while simultaneously improving the mechanisms involved. Furthermore, the Government should review the case for extending the use of means-testing in further welfare transfers to older people.

The increasing value of mortgages held by the young and the rising property wealth of older cohorts indicate a transfer of wealth has taken place: the current and future income and wealth of younger cohorts has been transferred to older age groups in the form of illiquid property wealth. The magnitude of this transfer poses a risk to the principle of intergenerational solidarity that underpins various functions of the state, such as the NHS and state pension. A new language of wealth inequality is required to cope with these changes and enable public debate and discussion. The Government should focus on protecting intergenerational solidarity in society, in particular, by exploring how societal risk sharing in public policy can take place across cohorts, rather than between the generations.

For example, an important and growing economic cost associated with an ageing population is the cost of providing long-term social care for older people. Proposals for meeting the required increase in spending on this form of care usually involve the state funding all, or the largest share of, this increasing cost. In light of wealth transfers that have taken place from younger to older cohorts via the housing market, the Government should explore alternative forms of risk-pooling which are cohort-based, and would enable older people to use their housing wealth to buy into a cohort-specific risk-pool to insure against the costs of requiring long-term care.

At present, the static real incomes of older cohorts during 1995-2005 indicate that they are not actually experiencing any real benefit from their rising property wealth. After several years in which 'accumulation policy' has taken centre stage in policy debate, the time is now right for all stakeholders to focus their attention on 'decumulation policy', in particular through downsizing and equity release. The Government should explore providing extra incentives to downsize for older people, without actually penalising older people for remaining in the homes

of their choice. The Government should also focus on achieving the right housing stock, which will make downsizing a more attractive option. The Government needs to look again at the market for equity release products and review how this market can be improved, deepened and extended. Finally, the Government should continue to explore new forms of provision of financial advice, which is an essential third plank of an improved 'decumulation policy'.

In conclusion, it is clear that significant changes to patterns of asset accumulation across the life course have occurred and require a response by policymakers and other stakeholders. Younger cohorts have benefited from rising real incomes. However, where these increasing incomes are used to obtain and pay off increasingly large mortgages, it is debatable as to who is actually receiving the benefit of these increases; the housing market enables others to capture the benefit. Yet, given the static real incomes of older cohorts, despite their ballooning property wealth, it is not clear who really benefits from rising property prices, aside from the small minority owning two or more properties. Although it is common to believe that property is a good way of saving for retirement, today's younger cohorts, forced to skew their retirement saving toward property, may find themselves in the same position as today's older cohorts, with large volumes of illiquid wealth that are failing to contribute to any extra income in retirement. Indeed, the evidence suggests overall that rising property prices are in fact detrimental to retirement income.

More generally, the wealth transfers that have occurred create acute dilemmas for Government in developing public policy. Can older cohorts expect to rely on the young to pay for them in retirement and, more generally, the costs of an ageing population? If not, how can the Government create greater awareness that older cohorts will have to use their housing wealth to fund retirement? But, if the Government encourages society to see property as an investment in this way, does this risk exacerbating the same tendencies that have created the current predicament? Finally, evidence indicating increasing wealth transfers downwards within families represents an important new trend. Researching, understanding and responding to these wealth transfers remains an important task going forward.

Introduction

Over their lifetimes, individuals possess numerous different types of assets and 'negative-assets', i.e., debt. An asset's 'liquidity' refers to how easily it can be converted into cash. Liquid assets comprise money in deposit accounts or investment vehicles, as well as negative liquid assets, such as credit card debt or personal loans. Illiquid assets include property and mortgage debt.

At different stages of the life course, individuals can be expected to have very different levels of assets and debt. For example, younger age groups might be expected to have loans to pay for university education or mortgages on their first homes. At retirement, individuals might be expected to have little or no loans, but to have accumulated assets after they or a partner has been active for many years in the labour market.

A Life Course Analysis of Asset Accumulation

The 'Life Course' approach to asset accumulation that has most influenced economics and other academic fields is the 'Life-Cycle Hypothesis of Consumption'[5]. It argues that households will seek to 'smooth-out' their consumption in the context of - potentially large - variations in their household income during their life. It argues that over the life course, households will accumulate assets when income is high, in anticipation of reducing assets in retirement when income is low, in order that their level of consumption is not forced to fluctuate in line with life-stage variations in income.

The 'Life-Cycle Hypothesis of Consumption' has been subject to much debate and research, and inevitably, numerous qualifications can be conceived. In particular, households are still likely to undertake precautionary saving in old age, not least because individuals approaching the end of life simply do not know how long they will continue to need an income. Nevertheless the Life-Cycle Hypothesis of Consumption has strong intuitive force, and should hold true in most cases[6]. Indeed, it is the assumption that individuals will want and need to smooth-out consumption across the life course that underpins the design of pension systems and various financial products.

Life Course Analysis of Asset Accumulation in UK Public Policy

In recent years, a life course approach to 'asset accumulation' has taken centre-stage in UK political debate, as policymakers have devoted significant attention to the reform of the UK's private and public pension systems, and the need to ensure adequate saving to meet expectations of retirement income. The Pension Commission made a number of recommendations in 2005, many of which have subsequently been taken forward by the UK Government.

However, simultaneous to UK pension reform, enormous changes have taken place in patterns of non-pension wealth and asset holdings by UK citizens. How the Government, financial industry and citizens themselves respond to these changes in non-pension accumulation will have enormous bearing not only on today's savers and retirees, but on those retiring decades from now. Many of these changes are without precedent, create new challenges, and require debate and reflection by all stakeholders.

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[5] The Life-Cycle Hypothesis of Consumption is usually credited to Franco Modigliani (1986).

[6] For example, an academic study by Disney R et al. (1998) of UK households around the early 1990s found that financial and savings behaviour was broadly in line with what the Life-Cycle Hypothesis of Consumption would predict.

For these reasons, the ILC-UK undertook research exploring non-pension household assets in the UK, and how patterns of asset accumulation over the life course among different cohorts are changing. The resulting research is called *Asset Accumulation across the Life Course*[7].

The Research

The *Asset Accumulation across the Life Course* research analysed data from the British Household Panel Survey (BHPS). The BHPS is a longitudinal panel survey that has been carried out annually since 1991. The BHPS is household-based, and covers the entire age-range from 16 years upwards. The research involved cross-sectional analysis of the data from Waves 5, 10 and 15 of the BHPS when detailed questions on wealth, assets and debt were included. These Waves relate to the years 1995, 2000 and 2005 respectively. The sample size of the BHPS is around 10,000 individuals[8].

The Average Household across the Life Course

The *Asset Accumulation across the Life Course* research focuses on an individual's net non-pension 'household wealth' at different ages. 'Net non-pension' wealth simply refers to the balance of total net liquid assets plus total net illiquid assets, excluding any pension wealth.

However, during the life course, an individual's 'household' will change in composition, i.e., partnership status, number of children, etc. For example, in their 20s, individuals might be single and sharing rented accommodation. In this situation, an individual's 'household' comprises just them. Subsequently, an individual may form a partnership. In this case, an individual's household includes their partner. In subsequent years, if an individual has children, they will also form part of an individual's household. In later life, it can be anticipated that children will leave home, and an individual's household might once again comprise an individual and their partner.

Clearly, the composition of an individual's 'household' may vary significantly over the life course, and household composition will also affect household assets, income, spending and saving. However, for *Asset Accumulation across the Life Course*, changes in household composition across the life course do not impact significantly upon the use and interpretation of the research findings.

This is because the *Asset Accumulation across the Life Course* research analyses the period 1995-2005. In this period, the average composition of households for individuals in different age-groups has not changed significantly, despite long-term trends of later marriage and fewer children. For example, the composition of an average 40-year old individual's household in 1995 was not significantly different to a 40-year old individual's household in 2005. This means that we can make reasonable comparisons of changes to average household wealth in the period 1995-2005 for individuals - referred to in the BHPS as 'household representative persons (HRP) - at different stages of the life course.

[7] See Boreham R and Lloyd J (2007).
[8] For more information see http://www.iser.essex.ac.uk/ulsc/bhps

Asset Accumulation across the Life Course: The Findings

The main findings of the *Asset Accumulation across the Life Course* research are summarised below. Analysis for this research was undertaken by Richard Boreham of the National Centre for Social Research. The research used the consumer price index to adjust all figures for inflation, making all amounts equivalent to 2005. All the amounts used have then been rounded off. Detailed figures and analysis can be found in the original research report.

Liquid Assets

This part of the analysis explored changes in total liquid assets, which comprise savings, cash and investments[9]. In the 25-55 years age-range, there has been a consistent pattern across the period of a steady accumulation of assets, reaching around £20,000 of household liquid assets for individuals aged 55 in 2005.

Cohorts aged 60-70 have seen household liquid assets slightly above this trend; individuals aged around 70 in 2005 had household liquid assets of around £40,000. The oldest cohorts saw lower levels of liquid assets, but with no consistent pattern of increases or decreases in retirement.

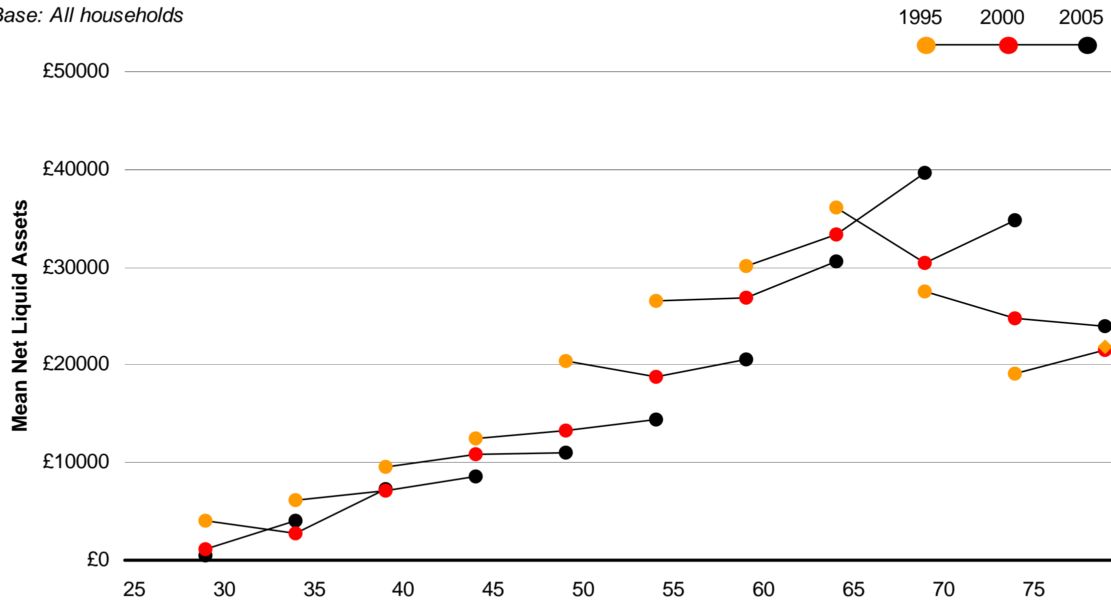
Liquid Debt

Liquid debt can be a loan, a credit card or some other form of personal debt. Volumes of household liquid debt have increased over the period in question for everyone aged 60 or below in 2005. The biggest increases have been among the youngest groups. Those aged over-65 in 2005 had mostly seen their household liquid debt reduce during the period, with those in retirement typically having less than £1000 in liquid debt.

Net Liquid Assets

Adding together liquid assets and liquid debt gives a picture of the net liquid assets of households at different stages of the life course. The picture that emerges is complex.

[9] Liquid Assets included in the BHPS are savings accounts, ISAs, National Savings Certificates, Premium Bonds, Unit Trusts, PEPs, Shares, National Savings Bonds and other investments.



Among younger age groups, net liquid assets are low. Even at the age of 50, individuals typically have net household liquid assets of only £11,000. In 1995, an equivalent 50-year old had net liquid assets of around £20,000.

The picture among older cohorts is particularly complex. Those aged 65-70 years have seen larger increases in their net liquid wealth over the period. Individuals in the oldest age groups have seen their household liquid wealth both increase and decrease over the period, although the overall change for any of these cohorts is not more than £10,000.

Illiquid Assets: Property Ownership

The proportion of households in different age groups owning a property has remained largely the same during the period 1995-2005. It is around 70% in the 30-39 age group, and remains at a plateau of around 80% from ages 40-65[10]. Among older cohorts, the proportion of households owning property within each cohort is less than 80%, and declines with each successive cohort to around 60% among those over-75[11].

The number of households owning a second property has also seen little change over the period 1995-2005. The peak age-group for owning a second property was consistently 50-59, at a rate of 15% of all households in 2005.

The average value of property assets has increased across all age-groups for all cohorts. However, as described, the percentage of households owning a property across any cohort is never more than 80%. By analysing only those households that own a property, and setting aside those renting or in social housing within all cohorts, the change in the value of property assets becomes much clearer.

[10] The wide-age bands used in this analysis may mask small marginal increases in the average age of a first-time buyer. Detailed on information on this for the period 1995-2005 can be obtained from the website of the Council of Mortgage Lenders: www.cml.org.uk

[11] Analysis showed that among those in the 16-24 age group in the BHPS sample, an decreasing proportion lived in a household with a 'household representative person' aged 16-24 in the period 1995-2005, suggesting that a growing proportion of those in this age group continue to live with parents.

Among property owners, those aged 30-39 in 2005 had total household property assets of around £190,000; ten years previously, property owners in this cohort had household property assets of £57,000. The cohort with the most valuable household property assets in 2005 were aged 55-64, with property assets worth on average around £240,000; an increase of around £98,000 for this cohort from a decade before. Individuals just above and below this cohort saw similar increases.

Illiquid Debt: Mortgages

As with trends in property wealth, the changes in average household mortgage debt over the period are most clear when analysis is limited to only those households with a mortgage. Among younger and middle-aged cohorts, there has been an increase in the value of household mortgage debt:

- An average 35-year old in 2005 had household mortgage debt of £88,000. In 1995, the average household mortgage debt of this cohort was £46,000.
- An average 40-year old in 2005 had household mortgage debt of £78,000. In 1995, the average household mortgage debt of this cohort was £50,000.
- An average 45-year old in 2005 had household mortgage debt of £62,000. In 1995, the average household mortgage debt of this cohort was £50,000.

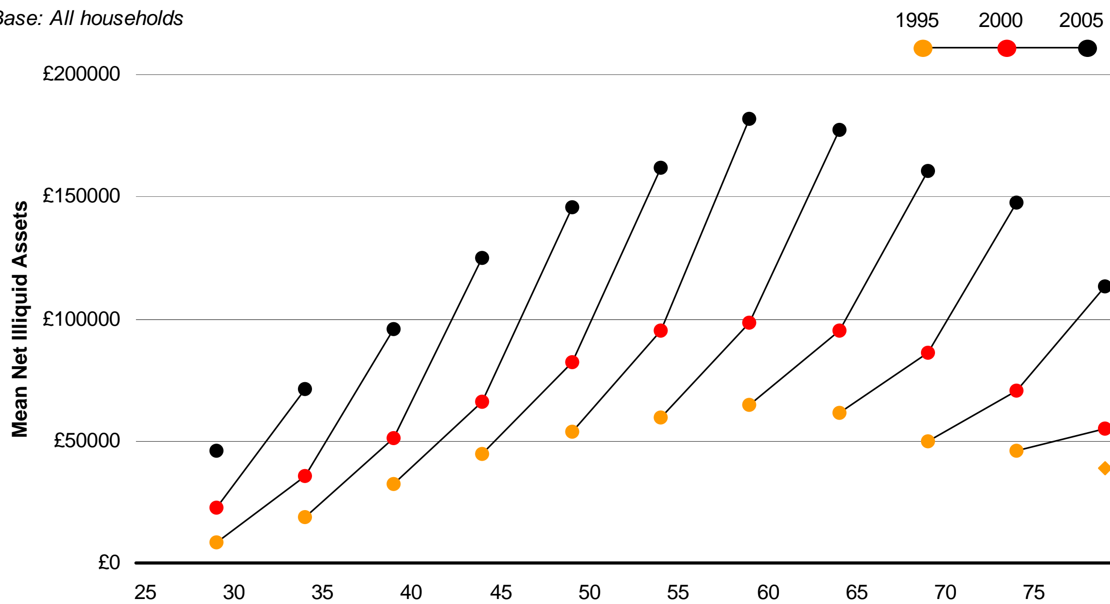
Concurrent with this trend, the average household mortgage debt that individuals posses in different stages of the life course has increased. For example, in 1995 a typical 30 year old property owner had household mortgage debt of around £50,000; the equivalent amount for a typical 30 year old in 2005 was £94,000. Among property owners in the 20-29 age range in 2005, the average household mortgage debt was £97,000. The equivalent figure for this age-range in 1995 was £46,000.

Unsurprisingly, individuals have seen their household mortgage debt decline as they approach and pass the age of retirement. The cohort aged around 55 in 2005 was the youngest to see their household mortgage debt decrease over the period, from £37,000 in 1995 to £34,000 ten years later.

Interestingly, some individuals in retirement still have mortgage debt to pay off, which may or may not be the result of an active choice. For example, individuals aged 70-79 in 2005 still on average had around £2500 of household mortgage debt.

Net Illiquid Assets

Adding together total illiquid assets and debt for all age-groups shows a strong upward trend for net illiquid assets.



The above chart shows changes in household illiquid wealth for all individuals. These findings are particularly noteworthy for the fact that although older cohorts have seen the greatest net increase in their household illiquid assets by amount, as a ratio to their equivalent assets in 1995, it is in fact younger cohorts that have seen the biggest increase proportionally.

However, by limiting analysis to only those individuals who are owner-occupiers, increases in net illiquid assets are shown to be even more pronounced:

- An average 40-year old in 2005 saw their household net illiquid assets increase to around £128,000 from £15,000 a decade before.
- An average 50-year old in 2005 saw their household net illiquid assets increase to around £179,000 from £43,000 a decade before.
- An average 60-year old in 2005 saw their household net illiquid assets increase to around £215,000 from £70,000 a decade before.

Those in retirement during the period in question also saw significant increases in their household net illiquid assets.

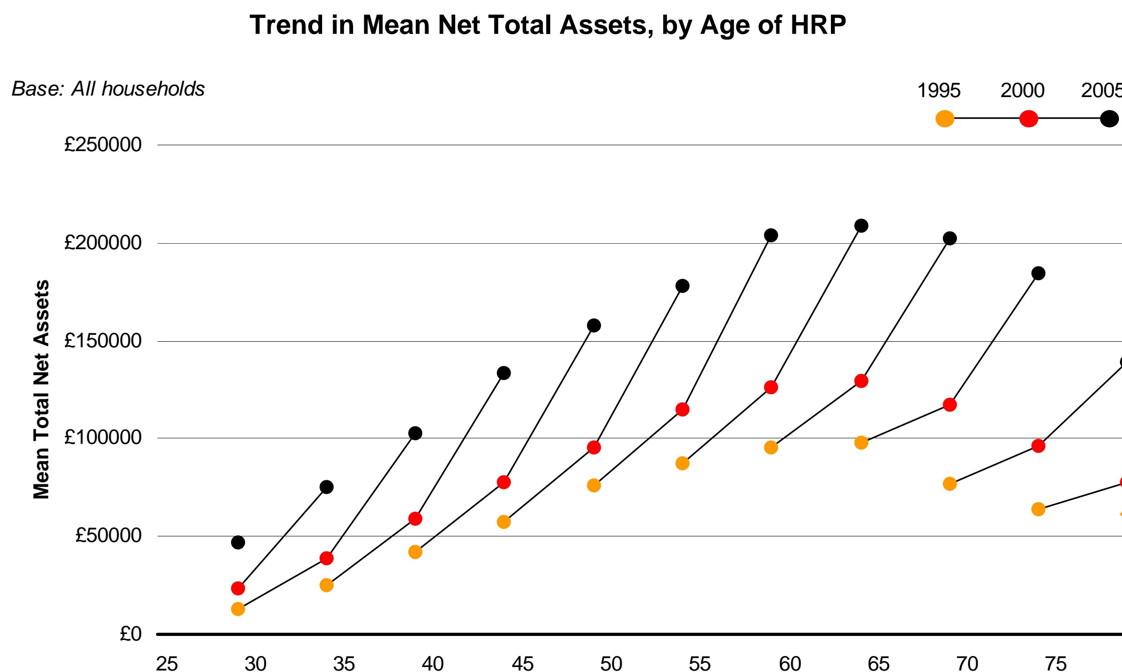
- An average 70-year old in 2005 saw their household net illiquid assets increase to around £215,000 from £88,000 a decade before.
- An average 75-year old in 2005 saw their household net illiquid assets increase to around £205,000 from £87,000 a decade before.

Much of these increases in illiquid wealth can be accounted for by increases in property prices. However, for younger age groups, it is likely to be a combination of both house-price inflation and the receipt of capital from parents or other family members to use as a deposit on property purchases. For example, among the declining proportion of those in the 20-29 age range that own property, those in this category in 2005 had on average around £50,000 of illiquid wealth. However, existing evidence that the median age of a first-time buyer in 2005 was 30 (Source: Council of Mortgage Lenders) suggests that illiquid wealth in this age group is not solely the result of asset price inflation, but may also result from parental gifts[12]. It is likely that once individuals in this cohort join the property-ladder, parental help combined with rapidly increasing property prices in the period have ensured their net illiquid assets also jump rapidly in value.

12 Indeed recent evidence indicates that in London, an assisted young first-time buyer had an average deposit of £57,000 compared to £12,500 for unassisted young first-time buyers. See Council of Mortgage Lenders (2007).

Liquid and Illiquid Assets: The Net Position

Adding together changes in liquid and illiquid assets, what has happened to asset accumulation across the life course in the UK?



Across all households and for all age-groups, total net household wealth has increased over the period 1995-2005. Again, although older cohorts have seen the biggest increases in their net household wealth, younger cohorts have seen the biggest increase as a ratio to their net household wealth in 1995.

***Asset Accumulation across the Life Course:* Further Findings**

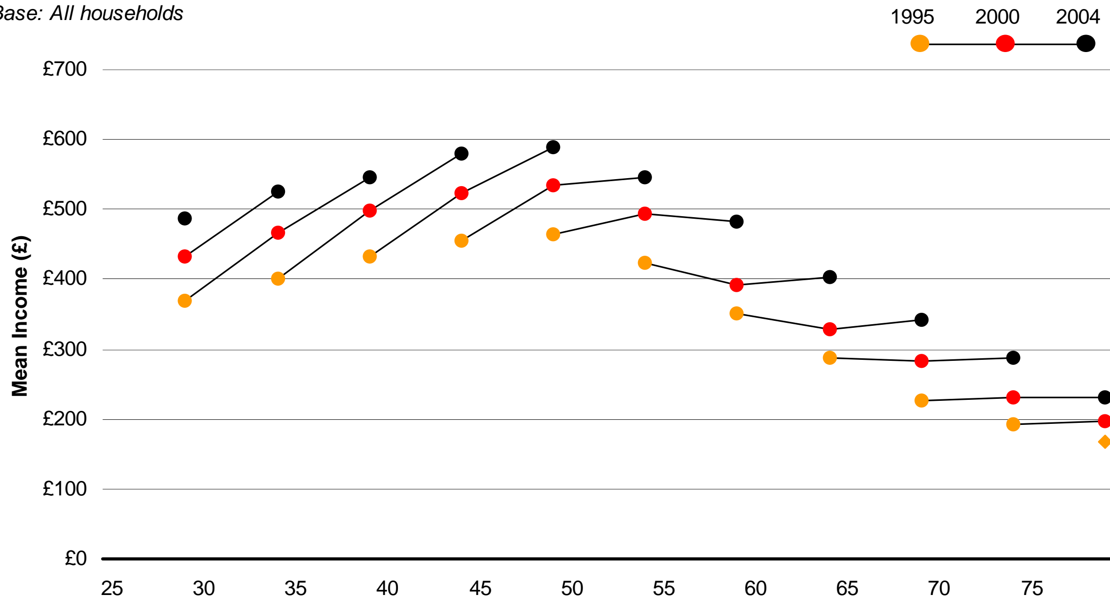
In addition to the main analysis of changes to household liquid and illiquid wealth, the *Asset Accumulation across the Life Course* research contains further findings which merit review.

Income

Among those of working-age, weekly household income typically increased. Everyone aged 60 and below in 2005 saw their weekly household income increase over the period 1995-2005, by around £200-£250.

In contrast, individuals aged over 60 in 2005 saw either no change or slight reductions in their weekly household income over the period. Nevertheless, each older cohort saw higher incomes than those preceding it experienced at a similar age.

Trend in Mean Weekly Household Income, by Age of HRP



Saving

Changes to patterns of household saving are complex, and can be best understood by referral to the original research. For all households across the age range among all cohorts, the rate of monthly saving was between 4-8%.

Broadly speaking most cohorts aged 60 or below in 2005 marginally increased the proportion of their monthly income saved. Those aged 65 and above saved the same proportion of their monthly income or slightly less.

Private Pension Contributions

Trends on rates of contribution to personal pensions were uniformly negative. All cohorts saw declining proportions of households contributing to a private pension over the period 1995-2005.

***Asset Accumulation across the Life Course* and Public Policy**

This brief description summarises the principal findings of the *Asset Accumulation across the Life Course* research. However, other important findings have not been described here, and deserve review by the reader in the original research report.

Having outlined changes to patterns of asset accumulation, the remainder of this report situates these findings in contemporary UK policy debates, and formulates relevant recommendations for policymakers.

Living with Debt: Asset Accumulation and the Young

The prevention of income poverty in retirement begins when individuals are in their 20s. The savings, debt and asset accumulation of individuals in this age-group are of significant interest to policymakers, the financial industry and older people's charities. What has happened to the asset accumulation of individuals at the start of their working-lives and what does it mean for public policy?

Background

In order to ensure an adequate income in retirement, individuals must build up assets prior to retirement during their working-life. One mechanism to do this is a pension: individuals can accumulate wealth in a pension and then use it to buy an annuity at retirement. However, despite the attention given to UK pension reform in recent years, pensions are not the only form of asset accumulation available to fund retirement income. Property, savings and investments can also be used as vehicles to accumulate assets to provide a retirement income. This point has been absorbed into Government thinking on what constitutes 'saving' for retirement. In the 2004 Pre-Budget Report, the Government recognised that saving can take multiple forms, and commits itself to enabling individuals to choose from a range of mechanisms to accumulate assets:

> "The Government is committed to a policy framework that enables people to choose how and when to save across the full range of asset-building activities. Traditional measures of aggregate saving, such as the saving ratio, often fail both to reflect this variety and to highlight the positive impact asset growth has had on households' balance sheets in recent years. Broader measures, for example including capital growth, indicate that saving behaviour has been more robust in recent years than is often appreciated." (*HM Treasury: 2004: 96*)

Clearly, ensuring that younger cohorts have sufficient assets to provide for an adequate retirement income involves recognising that saving for retirement can take many forms. It also requires an examination of what has happened to trends in non-pension household assets among younger cohorts in recent years, and how these trends will impact upon their retirement income.

Asset Accumulation across the Life Course

Trends in liquid asset accumulation among younger cohorts were virtually unchanged during 1995-2005. In contrast, trends in liquid debt show greater usage of debt products. For example, those in the 25-34 age range in 2005 had -£4500 of household liquid debt. The figure for this age range in 1995 was -£2400. This trend may result from relatively low interest rates during this period, the increasing volume of personal loans accumulated in higher education, as well as rising incomes simply making greater volumes of personal debt available to younger groups.

Among property-owners in the 25-34 age group the average value of property assets has increased over the period, as has the average value of mortgage debt. For example, although a property-owner in the 25-34 age range in 2005 had on average net household illiquid wealth of £73,000, they typically possessed £97,000 of household mortgage debt. A property-owner in this age group in 1995 typically had £15,000 of household net illiquid assets and £50,000 of household mortgage debt.

The number of individuals in the 20-29 age range who own a property is relatively low and appears to have declined over the period in question; nevertheless, a similar trend can be seen. In 1995, an individual owning a property in this age range had £46,000 of household mortgage debt, and £12,000 of net household illiquid wealth. In 2005, an individual in the 20-29 age range who owned a property had £97,000 of household mortgage debt and £50,000 of net household illiquid wealth.

The value of net illiquid wealth among younger cohorts has increased more, proportionally, than the value of mortgages. However, the proportional increases in mortgage debt are higher than proportional increases in real income. As mentioned previously, the levels of net illiquid wealth among younger cohorts suggest the external financial investments in their illiquid wealth, i.e., parental help with deposits for property purchases.

On the one hand, younger cohorts have greater net illiquid wealth, resulting from brief exposure to rising asset prices, and parental contributions to their illiquid wealth. However, younger cohorts have less net liquid household assets and bigger mortgages, which means a greater proportion of their current and future income is being used to purchase property. Younger cohorts have seen their weekly household income increase by around £200 over 1995-2005. However, the proportion of younger household contributing to a personal private pension has declined.

The Challenge

The Government's challenge is to respond appropriately to the trends that exist in non-pension household asset accumulation to ensure that younger cohorts have sufficient retirement income, and more generally, to mediate the effects that these trends will have on their lives.

Younger cohorts have seen remarkable increases in wealth over the period 1995-2005. But this wealth is property-related and illiquid, and results in part from one-off cash transfers from family members. This growth in wealth has been coupled with much larger mortgages that have drawn increasing amounts of younger people's current and future income and wealth into illiquid form. Larger mortgages also mean that during a period of higher interest rates, mortgage repayments for younger cohorts may consume such significant portions of their household income as to seriously reduce their scope to save through non-property accumulation vehicles, such as a personal pension. In fact, the proportions of younger households contributing to a personal pension have already declined. It may be more efficient, or individuals may be more concerned with, paying off debts, before undertaking retirement saving via a pension or other savings vehicle.

In addition, income used for interest payments on liquid and illiquid debt is at the expense of possible retirement saving, even though many erroneously view mortgage payments as 'saving'; in the early stages of a mortgage, the bulk of repayments go toward meeting the cost of the loan, not reducing the debt. For younger cohorts, the total costs during their life course of interest repayments will exceed that experienced by older generations.

This creates questions, and potential challenges, about how different forms of asset accumulation will impact upon each other over the life course of younger cohorts.

Recommendations

- *Prioritise financial advice and financial capability*

  Given that the average debt of younger households has increased, and many confront a lifetime characterised by a volume of debt of a magnitude unknown to previous cohorts, this increases the importance of younger people making good financial decisions at every opportunity. Given evidence of low levels of 'financial

capability' in the UK[13], this underlines the importance of the availability of good financial advice. Policy and research in this field remains critically important; for example, the Thoresen Review into generic financial advice[14].

In addition to financial advice, financial capability must remain a key focus of public policy, as set out by the Government[15]. As individuals confront the management of more debt over a longer portion of their lives, good financial education is vital. Policymakers must continue to encourage financial education of the young[16].

Adapt decumulation policy to the increasing role of property in household asset portfolios

Average household mortgage debt has grown in value significantly among younger cohorts. The Government has recognised that different forms of asset accumulation, such as property paid for with a mortgage can represent a form of retirement saving. However, the money used by households to repay increasingly large mortgages cannot be used to pay into a pension or other savings vehicles; retirement saving in the form of property may thus be at the expense of retirement saving in other forms.

This means that almost by default, much of the younger population is being forced to use property as a form of retirement saving, potentially at the expense of other more flexible and suitable retirement saving vehicles, such as pensions. Different forms of retirement saving are not interchangeable in terms of their suitability for providing retirement income. Over the last decade, trends in life course asset accumulation have become skewed away from pensions toward property, despite the clear advantages that pensions have as a source of retirement income. This increases the urgency with which policymakers and the financial industry must address the challenge of 'decumulation policy' - set out more in detail in the penultimate section of this report - to respond to the fact that the 'retirement savings' of the young will increasingly be tied up in illiquid property assets. In particular, if the asset accumulation of younger cohorts is to be skewed toward property, it suggests that these cohorts must be able to generate an income from these property assets upon retirement; something which today's older cohorts are failing to do.

Monitor how living in debt affects the choices and behaviour of younger cohorts

Asset accumulation is not an independent process within a person's life, but is deeply enmeshed and intertwined in the decisions and choices they make. Life choices affect asset accumulation and asset accumulation affects life choices.

As the average size of household debt possessed by younger cohorts has grown, relatively little is known about how this may impact upon the choices and actions of these individuals. It is important to consider both the effect on younger cohorts currently, but also the effect on the expectations of future cohorts, for example, how the expectation by a 20-year old of a large mortgage at the age of 30 will affect current choices and decisions. This applies to 20-year olds now and to those who will be aged 20 a decade from now.

It might be presumed that younger individuals would increase saving in response to rising debt levels. However, this relationship is not clear. For example, research has shown that consumption among the young is most affected by swings in house-price inflation, suggesting that the positive economic conditions that lead to rising house

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[13] See Atkinson A et al. (2006)
[14] See http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm
[15] See HM Treasury (2007).
[16] Multiple policy initiatives are emerging in this field. For example, pfeg - an educational charity - has, with the support of the Financial Services Authority, launched 'Learning Money Matters', which seeks to provide a comprehensive range of resources for providing financial education in schools.

prices also affect younger people's expectations about future income, and hence decisions on how much they can afford to spend and save[17].

This means the Government must pay close attention to how younger cohorts respond to changing patterns of assets and debt, especially in the light of inevitable changes in the economic cycle, or potential stagnation or falls in house-prices. The 'debt-burden' on younger cohorts may not significantly affect their behaviour while their expectations are of continued income and asset growth. However, if these expectations change in response to lower or negative economic growth, this debt-burden may influence detrimentally the choices and behaviour of younger cohorts.

More generally, the Government must monitor the effect of debt on the behaviour of younger cohorts. Actual or expected debt, which is of a higher magnitude than that experienced by previous cohorts, may affect important decisions involving productive risks. An important example is decisions surrounding the personal investments that individuals are willing to make in their education and skills. It could be anticipated that, depending on individual income and employment expectations, increasing actual or expected debt in early adulthood may reduce investment in such 'human capital', particularly as a result of lower tolerance for the risks involved in personal investments in education. This has implications right across the economy, particularly in light of the 'skills gap' identified by the Leitch Review[18].

Alternatively, it may be that expected or actual debt will influence career decisions. Individuals may gravitate toward higher paying sectors, such as finance, at the expense of lower paid sectors, such as engineering. Although such an effect represents the functioning of the labour market, there are nevertheless significant implications for the economy, as key sectors may experiences shortages in particular or specialised skills. Increasing actual or expected debt will affect, and ultimately change, how individuals evaluate the risks and rewards associated with different careers[19].

The changes identified by *Asset Accumulation across the Life Course* have important implications for individuals. Policymakers must monitor carefully how different cohorts respond, and explore appropriate policy responses. However, of even more urgent interest to society and policymakers is the impact that relative financial circumstances, increasing debt-holdings, changing expectations and the challenges to owning a home may have on decisions around family formation.

[17] See Attanasio O et al. (2005)
[18] See Leitch (2006)
[19] For example, the non-financial rewards associated with lower-paid public sector jobs, such as teaching, will change in their relative perceived value to individuals who expect to have difficulty in affording their own home.

Asset Accumulation and Family Formation

Among the numerous factors that determine the decision to start a family, a household's financial situation and relative economic security can play a critical role. What has happened to the typical financial position of those around the peak age for family formation, and what does this mean for public policy?

Background

The decision to start a family is both highly complex and personal. Many factors are involved, including age, strength of relationship and employment situation. Expectations are also important, such as future income and health status.

Trends in family formation over recent decades demonstrate two characteristics. First, the average age for women to have their first child has increased. In 2005, the mean age of women having their first birth was 27.3 years; a rise of 3.6 years from 1970 (Source: ONS).

Second, the total fertility rate (TFR), i.e., the number of children born per woman has declined in the long-term. In 2005, the TFR was 1.79 children per woman. This was above the low of 1.63 in 2001, but well below the 1960s peak of 2.95 children per woman in 1964 (Source: ONS). Most importantly, it is also below the population 'replacement rate' of around 2.1 children per woman. This trend has been a major contribution to the ageing of UK society. Indeed, the 'elderly support ratio' - the population of working age divided by population of pensionable age - is projected to fall from 3.35 in 2002 to 2.53 in 2031 (Source: Government Actuaries Department: 2003).

Although starting a family is a highly personal decision, society - and therefore the Government - has an enormous interest in this decision. Changes in the UK 'elderly support ratio' have already contributed to major policy upheavals, such as the need to increase the state pension age. Quite besides wider social policy and normative considerations, demographic change gives the Government a keen interest in creating conditions favourable to child-rearing. This is reflected in efforts by the Government to implement 'family-friendly' policies, such as extending statutory rights to maternity and paternity leave, flexible working, and tax relief for childcare.

Among the factors affecting the decision to start a family, financial circumstances are highly important. Raising a child is enormously expensive in terms of both outgoings on clothing and food, as well as the income that individuals forego when they reduce their level of activity in the labour market or change the nature of their paid work in order to balance the responsibilities and work involved in child-rearing and paid employment.

Various aspects of a household's wealth and finances will affect the decision to start a family, including income, volume of assets and debt, and whether a household occupies rented accommodation or is an owner-occupier. These factors will also affect further decisions about child-rearing such as using child-care.

Asset Accumulation across the Life Course

Analysis shows a number of significant changes in the wealth and economic circumstances of households around the peak age for starting a family. Individuals around this age in 2005 typically had less household liquid assets than those of a similar age in 1995, providing less cushioning against unexpected expenditure 'shocks' associated with starting a family and child-rearing, and potentially creating a greater reliance on debt. In particular, individuals in

the critical 25-34 age-group on average had net household liquid assets of £4000 in 1995. In 2005, the equivalent figure for individuals in this age-range was £430.

The household net illiquid assets of owner-occupiers in the 25-34 age range have increased dramatically. In 1995, an individual in this age-range had household net illiquid assets of £12,000. A decade later, the equivalent figure for the 25-34 age range was £50,000. However, this was matched by an increase in the mortgage debt for owner-occupiers in this age-range. In 1995, average household mortgage debt was £50,000; in 2005, the equivalent figure was £94,000. Average household illiquid wealth and mortgage debt in the age-ranges above and below saw similar changes.

The Challenge

Financial security is a significant factor influencing the decision to start a family. Although the effect that household finances have on this decision will be mediated by changing expectations among different cohorts and adaptation to circumstances, it can be expected that a worsening financial situation, both in real terms, but also relative to previous cohorts, might act as a deterrent to family formation.

The UK Government has gone further than ever before to extend 'family-friendly' policies in recent years, imposing significant costs on employers through regulations relating to parental rights. However, trends in asset accumulation risk undermining such policies. The Government must reduce this risk by exploring what policies could lessen the deterrent effect of the actual and expected increases in household debt on those around the peak-age for family formation.

Recommendations

- *Ensure a proper evidence base of research about how variations in asset accumulation are impacting family formation, and related decisions*

  New families are experiencing a volume of debt exceeding anything experienced by preceding cohorts. Although fertility rates have increased slightly since a low in 2001, and net household illiquid wealth for this age-group has increased, this does not mean that the burden of debt is not acting as a disincentive to family formation currently. A large household debt-burden on younger cohorts also increases the risk that in the event of an economic downturn, with resulting lower expectations of future income and ability to cope with debt, the actual and expected debt-burden on younger cohorts may have a critical effect on decisions around family formation, and the fertility rate. Reliable evidence is needed on these issues to better prepare public policy against these risks.

  In addition to evidence on family formation, the Government must monitor the effect that larger actual and expected debt levels have on decisions around the raising of children. Although low interest rates in the period up to 2005 have allowed the proportion of household income consumed by mortgage repayments to remain relatively low, over the medium to long-term this may change.

  Household income that is consumed by debt repayment may be at the expense of consumption for the purposes of child-rearing, such as the purchase of clothing, books and toys. Analysis by economists of household 'discretionary income' after housing costs can sometimes lead policymakers and commentators to overlook the fact that parental discretionary income directly influences the 'life-chances' of children and their outcomes across the entire life course.

  More generally, larger actual and expected debt may determine how much time parents can dedicate to parenting versus earning income. For example, two-parent

households with an actual or expected large mortgage debt may find it necessary for both parents to be in full-time paid employment.

Private sector lenders to extend the availability of payment-holidays

The private sector potentially has a role to play in reducing the financial stress associated with family formation. The Government could encourage lenders to provide automatic penalty-free payment-holidays for mortgages and personal loans for families after child-birth. In this way, the financial industry could collectively be more confident that the usage of debt products from which it benefits are not having a negative effect on UK demographic trends. In addition, the Government could work with the private sector to offer interest-free loans to cover the costs of new children.

Reduce the financial stress associated with family formation

The Government must go further in efforts to minimise the deterrent effect of financial pressures associated with starting a family, and must target the perception that family formation can be prohibitively expensive. At present, families on low incomes (i.e., income support) are entitled to a Sure Start Maternity Grant. However, many of the costs of child-rearing, such as nappies, are relatively constant for families across the income and wealth scale, and it is not always the case that families with higher incomes and wealth have more discretionary income to cover such costs. The Government must review the case for extending the scope of benefits associated with child-rearing beyond those on low incomes. There may be a case for raising the threshold used in means-testing up the income and asset scale among younger families. Indeed changes in patterns of asset accumulation create a need to re-evaluate the use of means-testing across the life course.

Means-testing among Older People

Means-testing remains a controversial part of the Government's welfare programme for older people. What do trends in asset-accumulation mean for this debate? What is the way forward for the policy of means-testing?

Background

Pensioner poverty in the UK is a problem. In 2005/06, there were 1.8 million pensioners living in households with incomes below 60% of median income, on an 'after housing costs' basis[20]. This represents 17% of the pensioner population. However, the long-term trend for pensioner income poverty is positive. In 1996-7, there were 2.9 million pensions in poverty on this measure, representing 29% of the pensioner population[21].

Means-testing is the evaluation of an individual's or household's assets and income to determine their eligibility for a benefit or welfare payment. Policymakers opt for means-testing mechanisms in the context of limited welfare budgets, to ensure resources are targeted on those that most need help. Since 1997, the Labour Government has become associated with the use of means-testing as a key lever in the distribution of benefit payments. Pension Credit Guarantee, housing benefit (for rental costs) and Council Tax benefit are all important benefit payments for low-income pensioners, and are all means-tested.

Means-testing of older people is controversial. Older people's charities argue that means-testing can be intrusive and embarrassing and that, as a result, some older people deliberately forgo the welfare payments they need and are entitled to[22]. Others have argued that the complexity of the means-testing process is such that some pensioners do not claim their full entitlement.

Whatever the causes, it can be reasonably argued that there are problems with the current system of welfare payments for pensioners using means-testing. For example, the Government itself estimates that around £2 billion in Pension Credit goes unclaimed each year[23].

Others have argued that means-testing of pensioners functions as a disincentive to saving among younger groups. The Pensions Commission argued against the Government's policy of using means-testing in relieving poverty among pensioners, because this could act as a deterrent to saving for retirement[24]. The Commission argued that individuals would not bother to save if this could result in disqualification from entitlement to pension credits.

Critics of means-testing of pensioners therefore have two arguments: means-testing is wrong *in principle* and wrong *in practice*. What do changes in patterns of life course asset accumulation mean for the debate on means-testing of pensioners?

Asset Accumulation across the Life Course

Means-testing involves the evaluation of income and wealth. In relation to income, those aged 55 and over in 2005 saw no real increase in their weekly household income in the decade

[20] See Brewer M et al. (2007a).
[21] However, previous reductions in the prevalence of poverty among pensioners does not guarantee continued reductions. For example, see Brewer M et al. (2007b)
[22] For example, a survey undertaken by Help the Aged (Spotlight: 2007) suggested that as many as 47% of pensioners failed to claim the Council Tax benefit to which they were entitled.
[23] See DWP (2006).
[24] See Pensions Commission (2005).

after 1995. By contrast, all younger cohorts typically saw real increases in weekly household income.

However, despite failing to see improvements in their real income, a central finding of the *Asset Accumulation across the Life Course* research is the wealth accumulated by older generations during 1995-2005, particularly through housing ownership. Among those before or at retirement in 2005:

- The average 55-year old in 2005 had seen an increase in their net non-pension household assets from £57,000 to £178,000 during the previous decade.
- The average 60-year old in 2005 had seen an increase in their net non-pension household assets from £76,000 in 1995 to £204,000 during the previous decade.
- The average 65-year old in 2005 had seen an increase in their net non-pension household assets from £87,000 in 1995 to around £209,000 during the previous decade.

Among those in retirement, across the period 1995-2005, there have also been increases in net non-pension household wealth, despite most in this age range not participating in the labour market:

- The average 70-year old in 2005 had seen an increase in their net non-pension household assets from £95,000 in 1995 to £203,000 in 2005.
- The average 75-year old in 2005 had seen their net non-pension household assets increase from £98,000 in 1995 to £185,000 in 2005.

These results are particularly significant because they run counter to general expectations of retirement as being a period in which net wealth is significantly run down. If the findings are limited to those households owning a property, these trends are even more pronounced.

The Challenge

In the context of the dramatic changes in net-wealth among different older age groups, the challenge for policymakers is to develop the right policy on means-testing and welfare payments to pensioners that is effective and fair across all age groups.

Recommendations

- *Improve the mechanism of means-testing*

  Critics of means-testing of pensioners argue that the mechanism of means-testing fails *in practice*, because of the complexity involved, and the associated embarrassment, and indeed, shame, which may cause some older people not to claim their entitlements. For as long as these behavioural effects occur, the policy of means-testing can be fairly described as failing. However, this is a problem of policy design and implementation rather than principle. Policymakers must therefore look urgently to improve the mechanisms used in means-testing, whether through changes in data-collection procedures, greater computerisation of personal records, simplification of evaluation processes, or the use of tax-credits.

- *Defend the principle of means-testing*

  Although it is argued that means-testing provides a disincentive to saving, it can be seen that over the last decade, the ‘wealth-multiplier’ effect of property ownership has greatly increased the net assets of the average household that is now around retirement age. Growth in the average net property assets of older cohorts has exceeded any saving that could be undertaken by these cohorts, with or without the

disincentive effect of means-testing[25]. Thus, this objection to the principle of means-testing has limited validity when means-testing incorporates measurement of property wealth. More generally, in light of the growth in wealth among older cohorts, and the limited resources available for welfare transfers toward older people, the Government must continue to defend the principle of means-testing.

Review the case for extending the role of means-testing in welfare transfers to older people

Given changing patterns of asset accumulation among older cohorts, it could be argued that the use of means-testing in welfare payments to older cohorts should be extended further to other universal transfers. Despite the fact that, unlike younger cohorts, older cohorts have not seen increases in their weekly household income, some universal welfare entitlements aimed at pensioners appear anachronistic when set against growth in net household assets. For example, free TV licenses currently worth up to £135 are available for those aged over 75. Winter fuel payments of around £200-£300 are available for those over 60. Older people living in London are entitled to 'Freedom Passes' providing unlimited free transport. Set against the unchanging real incomes of older cohorts, these welfare payments appear consistent. But when set against the real increases in assets of older cohorts, such universal welfare entitlements seem incongruent.

Question marks already hang over some universal welfare entitlements for older people. For example, winter fuel payments - as the policy is currently implemented - have been shown to be an ineffective policy solution to the ongoing and shocking problem in the UK of winter deaths among older people[26]. Conversely, welfare payments to older people often have public expenditure benefits that may not be immediately apparent. For example, 'Freedom Passes' for older London residents encourage 'active ageing' and social contact, which over the long-term reduce the costly incidence of problems requiring services from the health and social care sector. More generally, they are a vital life-line for many low-income pensioner households in London.

Nevertheless, given the increases in net household wealth experienced by older cohorts, some could argue that universal welfare transfers to older people cannot be justified in all cases. For example, when a typical 70-year old has seen their net household wealth increase by £107,000 in the decade to 2005, it could be questioned why such a household is entitled to £300 each year as a notional payment toward winter fuel costs.

The appropriate response may therefore be for policymakers to both tackle the problems of means-testing in practice, and if - and only if - successful, to review the scope for extending the scope of means-testing to other welfare payments. Although such an argument runs counter to the strong feelings and beliefs of many stakeholders involved in advancing older people's interests, this perhaps represents the failure common among many observers to recognise the wealth transfer and inter-generational inequality that has developed in the UK over the last decade.

[25] Indeed, rather than a disincentive to saving, it seems more likely that means-testing will have an effect by incentivizing those at the threshold to transfer wealth to children, mirroring the behavioural incentives introduced by inheritance tax.
[26] See http://www2.warwick.ac.uk/about/warwickmagazine08/coldcomfort

Wealth Transfers and Intergenerational Solidarity

The principle of intergenerational solidarity underpins various functions of the state. However, wealth transfers in society that have occurred between the generations require us to reconsider conventional notions of 'inequality' and the role of intergenerational solidarity in public policy.

Background

When 'intergenerational solidarity' is discussed, it is usually conceived of at the level of an individual family. Intergenerational solidarity is said to be reflected in the time, money and contributions (transfers) which different generations within a family make to each other.

However, intergenerational solidarity does not just exist in families; it exists between different cohorts within the population. The manifestation of this intergenerational solidarity across society can be found in multiple functions and activities of the state.

For example, the UK health system is a classic example of intergenerational solidarity. The NHS is funded in large part by taxes on the working age population. However, usage of healthcare is significantly associated with proximity to death, which for most people is in retirement[27]. Implicit in the continued existence of the NHS is, therefore, an intergenerational contract that sees younger healthier individuals contribute through general taxation to the costs of the NHS, on the understanding that in old age, when retirement from the labour market reduces their contribution to general taxation, younger generations will fund the NHS and the costs of their healthcare in old-age.

A second example is the state pension. When working-age individuals make state pension contributions through labour taxes, their contributions do not in fact go into specific allocated pension accounts, but instead contribute to the cost of paying a state pension to older generations. Again, implicit in this policy is a contract between the generations that each generation will pay for the state pension of the previous generation through general taxation, on the expectation that subsequent generations will do the same for them.

Such intergenerational contracts rely on a continued sense of intergenerational solidarity among the population, and this sense of solidarity relies in turn on a perceived equity between the generations.

Asset Accumulation across the Life Course

Two important findings from the *Asset Accumulation across the Life Course* research are the dramatic increases in the net non-pension assets of older generations in the decade after 1995, and the significant increase in the average household mortgage debt of younger generations.

These two findings are linked. The major driver of the increase in asset holdings of older generations has been inflation in the prices of their property assets. This price inflation has been driven by dramatic increases in the average value of mortgage debt held by young and middle-aged cohorts.

[27] For example, see Seshamani and Gray (2004).

The *Asset Accumulation across the Life Course* research shows that during 1995-2005, through the transfers of wealth that occur in the property market during a period of rising prices, younger cohorts have seen a growing proportion of their current and future income and wealth transferred to older cohorts as illiquid property wealth. Future young cohorts are also likely to confront volumes of mortgage debt not experienced by older cohorts.

This fact should not be overstated. First, some - but by no means all - younger households have received transfers from older cohorts to help with property purchases. However these transfers are typically one-off, far from universal, and are considerably less in value than the average net increase in household wealth experienced by older cohorts. Second, older people have not 'grabbed' the bulk of wealth in society nor, in fact, do they now have a radically larger share of the wealth in society. An interesting finding of the *Asset Accumulation across the Life Course* research is that the relative proportion of total wealth held by different generations has not changed dramatically[28].

The Challenge

The transfer of wealth from young to old, and its consequent inequality, represents a challenge to the contract between generations embodied in various functions and policies of the UK state that rest on the principle of intergenerational solidarity.

The wealth transfer from young and middle-aged cohorts to older cohorts that has occurred via the housing market has not gone unnoticed by professional commentators[29]. Among the wider public, many people have also become aware of growing wealth imbalances between the generations, albeit mediated through expectations of individual family wealth transfers down different generations of a family.

For policymakers, the challenge is how best to respond to this transfer of wealth. A number of current major public policy challenges require the balancing of the interests of different generations. Policymakers must carefully navigate issues of intergenerational solidarity, intergenerational equity, and the income and wealth needs of different cohorts at different life-stages.

Recommendations

- *A new language of wealth inequality*

  Traditional methods of measuring and discussing inequality, such as the 'Gini coefficient', ignore age, life-stage and differences between cohorts. The result is that in both 'professional' and 'lay' debate, the implications of changing patterns of asset accumulation across the life course have been relatively unnoticed and lacked discussion. However, inequality across generations (horizontal) and increasing inequality between generations (vertical), require a new approach and discourse for discussing and debating inequality. This is important for enabling politicians and policymakers to consider the appropriate response to these societal changes, and forge consensus. Stakeholders must now recognise that inequality between the generations is as important as traditional measures of inequality.

- *Protect intergenerational solidarity*

  If changes in the housing market and resulting wealth transfers have weakened the legitimacy of the intergenerational contract that is embodied in various functions of the

[28] See Figure 5.3 Distribution of Net Assets across Age in *Asset Accumulation across the Life Course*.
[29] For example, Weale M (2007) writes that what has seemed 'manna from heaven' for older homeowners is "in fact financed by the younger people to whom they sell their houses."

state, policymakers must monitor and evaluate when the challenge to this legitimacy becomes so severe as to warrant a response.

Debate exists as to why property price inflation has increased so remarkably in recent decades. As a result, it is unclear what policy measures would be most effective at reducing UK house price inflation. However, for as long as the housing market continues to function as a mechanism to redistribute wealth from younger to older cohorts, policymakers will need to monitor this redistribution, its implications for intergenerational solidarity, and evaluate whether public policy must be directed explicitly at slowing or halting this redistribution.

Risk sharing across - not between - generations

Through mechanisms such as the NHS, the state applies the principle of intergenerational solidarity to pool risks between generations. In light of wealth transfers from young to old, the Government must now review the case for increasingly pooling risk across generations (horizontally), not between generations (vertically), in the development of future policy.

This is important because it suggests a new approach as the UK contemplates its ageing population. Demographic change, and the transition of the 'baby-boomer' generation into old-age, poses the risk of significant economic costs to both families and the state. However, recognising the wealth transfers that have taken place, the Government must mediate the extent to which it seeks to share the economic risks created by the UK's ageing population between generations. Protecting the existing functions of the state that rely on solidarity between the generations may mean limiting the use of further policies that rely on implicit intergenerational contracts. It may be necessary to pool risks across generations, not vertically, via the state and general taxation. A good example of where this may be necessary is funding long-term care for older people.

Funding Long-term Care in the UK

As the UK population ages, society confronts a growing demand for long-term care by older people, which will be provided both 'formally' and as unpaid care. How society pays for formal long-term care for older people is one of the key strategic dilemmas confronting UK policymakers. New patterns of wealth holdings in the UK suggest certain approaches to solving this problem.

Background

The UK confronts a growing demand for personal care by older people, resulting from increasing longevity and demographic change. As described above, the UK also confronts a declining 'elderly support ratio'.

The Wanless Review (2006) explored a 'baseline scenario', which assumed that patterns of social care services and outcomes in the future will be the same as now (even though, as the Review recognises, there is widespread consensus that current social care spending is insufficient, resulting in morally unacceptable outcomes for many older people requiring care). Using this baseline scenario, the Wanless Review projected total costs of £10.1 billion in 2002 rising by 139% between 2002 and 2026 to £24.0 billion. This would represent an increase from 1.1% of GDP to 1.5%. More 'pessimistic' scenarios project the cost of social care as a proportion of GDP being even higher. Increasing the amount that society spends on long-term care for older people to simply maintain existing levels of inadequate provision represents a major challenge for policymakers.

Different funding models for enabling an increase in this spending have been proposed. The Royal Commission on Long-Term Care recommended free nursing and personal care to be available for all; an approach that was subsequently taken up in Scotland. The Wanless Review recommended a 'partnership model' in which everyone needing care is entitled to an agreed level of free care, after which individuals' contributions would be matched by the state up to a defined limit. Individuals on low incomes would be eligible for benefits to help fund their contributions.

Asset Accumulation across the Life Course

All age-groups have seen an increase in their net assets in the decade up to 2005, and older age-groups, even in retirement, have not been exempt from this trend. For example, an individual in the 70-79 age-range in 2005 had net household assets of around £185,000, up from £98,000 in 1995. The key driver of these changes has been house-price inflation. Among older owner-occupiers:

- Individuals aged 75 in 2005 had seen an increase in net household property wealth of around £118,000 in the previous decade.
- Individuals aged 70 in 2005 had seen an increase in net household property wealth of around £127,000 in the previous decade.
- Individuals aged 65 in 2005 had seen an increase in net household property wealth of around £149,000 in the previous decade.
- Individuals aged 60 in 2005 had seen an increase in net household property wealth of around £146,000 in the previous decade.

Younger cohorts, particularly owner-occupiers, have also experienced significant increases in illiquid wealth in the decade up to 2005. However, these increases have resulted in part from one-off transfers among some families for house purchases, and have been matched by increasing volumes of mortgage debt. For example, an average 30-year old in property-owner

in 2005 had household net property wealth increase of £73,000, compared to an equivalent figure of £15,000 for someone in this age-group a decade earlier. However, mortgage debt for this age range has also increased to £94,000 in 2005 from £50,000 a decade before.

The Challenge

Changing patterns of asset accumulation among different cohorts have significant implications for the debate on long-term care funding. To date, consensus has typically formed around possible solutions involving the state funding all, or the largest share of, the increasing cost of funding long-term care.

However, for the increasing cost of age-related long-term care to be funded by the state through general taxation would involve a transfer of wealth via the state from those of working-age to those in retirement. Arguably, such a transfer of wealth has already taken place via the housing market. Those currently approaching or in retirement have experienced a significant increase in their net property wealth, funded by larger mortgages among younger cohorts. Policymakers must therefore develop a fair and equitable policy on long-term care funding in the context of the UK's ageing population, which takes account of recent changes in patterns of life course asset accumulation.

Recommendations

- *Think again about the role of the 'state'*

Debate on reform to the funding of long-term care in the UK thus far has usually been characterised by a simplistic distinction between 'the individual' and 'the state'. This ignores the fact that 'the state' does not possess capital of its own, but draws the bulk of its income from general taxation. The largest component of general taxation is income taxes paid by those in employment.

Continued usage of this simplistic notion of 'the state' in discussion of different long-term care funding models has resulted in a limited debate that has failed to take account of intergenerational inequality, and the transfers to today's older cohorts that have occurred via the housing market. In public debates on long-term care funding, all stakeholders need to move beyond this simple depiction of 'the state' in order to ensure discussion reflects these important societal changes.

- *Explore alternative forms of risk-pooling*

The cost of age-related long-term care has the potential to consume most or all of an individual's accumulated assets. The fact that everyone confronts the risk of needing some form of expensive long-term care, and the arbitrary nature of who is unlucky enough to actually require it, has generally lead debate on new solutions to the funding of long-term care to invoke various models of risk-pooling, as demonstrated by the Wanless Review and Royal Commission.

The most direct mechanism for risk-pooling across an entire population is via general taxation and the state, as demonstrated by the UK's NHS. However, given the wealth transfers from younger to older cohorts that have occurred during the last decade resulting from changes to the housing market, there is now a compelling argument to explore models enabling cohort-specific risk-pooling in relation to the funding of long-term care.

Cohort-based risk-pooling and housing wealth

Various mechanisms can be conceived of which would increase the amounts spent on long-term care funding, while pooling the risk of needing long-term care across older cohorts, rather than across the entire population.

Such cohort-specific risk-pooling could involve the private sector, for example, through compulsory long-term care insurance for those aged over 65 with vouchers for those with few assets and low incomes. Alternatively, the state could raise extra revenue, for example, through a new hypothecated-tax on private pension income[30].

However, the relatively low incomes of many in retirement, under-funded personal pensions, and the increasing proportion of older people's net non-pension wealth comprised by property wealth, suggest a different way forward for debate on long-term care funding.

Indeed, these changes suggest that in order to increase the amount that society spends on long-term care funding, the Government should implement a mechanism that enables older cohorts to access their housing wealth in order to buy into a cohort-specific risk-pool to insure against the costs of long-term care.

Within such parameters, various models for long-term care funding are possible. The Government could back the development of equity-release products that provide direct contributions to private long-term care insurance or national social insurance fund; or are used to purchase an impaired-life annuity[31]. Alternatively, the Government could introduce a hypothecated capital gains tax on primary homes for those above the state pension age, linked to a social insurance fund for long-term care[32].

The Government should explore and evaluate these options as it seeks to forge a new societal settlement on long-term care funding for older people. Such funding models would not preclude the development of other sustainable long-term care funding models for younger cohorts, such as the creation of long-term care insurance 'personal accounts', mirroring the National Pension Saving Scheme that is currently at the heart of UK pension reform.

For the most effective policy change, the options available to Government should not be considered in isolation, but in the context of broader measures to enable older cohorts to use and access their housing wealth, as part of an improved decumulation policy from the Government.

[30] At the time of the Royal Commission on Long-term Care, the British Bankers Association proposed that the tax-free status of the lump sum that can be taken from an occupational or personal pension on retirement could be made conditional on part of it being used to purchase long-term care insurance.

[31] The Wanless Review argued that there is a significant minority for whom private insurance mechanisms, even allowing for equity release schemes, would be unaffordable, suggesting the need for some element of social insurance as part of long-term care funding, i.e., to allow some measure of wealth redistribution in risk-pooling.

[32] A similar approach has been proposed elsewhere; see http://www.the-actuary.org.uk/pdfs/06_04_06.pdf

Decumulation and the Life Course

Today's 'young-old' and 'old-old' have experienced an unprecedented accumulation of assets over their life course, driven by changes to the housing market in the last decade. Limited options and poor availability of mechanisms for decumulation are reflected in the fact that a corresponding increase in older people's incomes has not taken place. What does this mean for policy?

Background

From the perspective of a 'life course' approach, if individuals are not decumulating their assets in retirement, then something is amiss. However, the reality is more complex. Numerous reasons can be posited as to why individuals do not decumulate their non-pension assets in retirement. For example:

- *The bequest motive* – individuals wish to maximise the assets available to transfer to younger family members[33].
- *Precautionary saving* – individuals know neither how long they will live nor what their end-of-life health and social care costs will be, so continue to save throughout retirement rather than decumulate assets.
- *Poor financial advice* – individuals may not know the value of their assets, nor how to effectively convert assets into retirement income.
- *No requirement* - previous research has shown that wealth inequalities among those in the pre-retirement stage reinforce as opposed to offset each other, i.e., those with higher levels of non-pension wealth also tend to have higher levels of pension wealth[34]. As a result, some individuals in retirement may not decumulate non-pension assets simply because they have no need to generate further income.
- *Contentment* – individuals in retirement may have no desire to consume more in order to decumulate, even though this failure to maximise their 'utility' may appear irrational.

For policymakers, the failure to decumulate assets among older people is most problematic when it is accompanied by income poverty among retirees, i.e., when individuals are 'asset-rich but income-poor'. Research using data from 2002 found that among the UK retired population, 10.2% had an income below Age Concern's 'Modest but Adequate' standard (£157 per week before housing costs) and owned equivalised housing equity of over £100,000[35].

Asset Accumulation across the Life Course

As outlined above older cohorts have experienced significant increases in their net non-pension household wealth during the decade after 2005. This tremendous growth in asset wealth has been accompanied by static real incomes among these cohorts, resulting in average income in this group falling behind younger cohorts; a tendency which may be exacerbated by increasing longevity.

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[33] For example, De Nardi (2002) shows that voluntary bequests can explain the emergence of large estates among older households, while accidental bequests alone cannot.

[34] A study by Banks et al. (2005b), found that among UK individuals aged between 50 and the state pension age in 2002-3, one in-ten individuals have wealth worth more than £1,000,000 and one-in-ten have wealth worth less than £110,000. It was found that the composition of total wealth varies considerably across the wealth distribution. Mean total family wealth for the poorest 10 per cent of individuals over-50 is just £66,000, about £57,000 (87%) of which is state pension wealth. In contrast, among the richest tenth of the population, only 7% of total wealth is in the form of state pension wealth, with 37% being held in private pensions, 21% in owner-occupied housing and 34 per cent in other private wealth.

[35] See Sodha S (2005).

The Challenge

Problems in enabling older people to achieve decumulation reflect in part the conflicting agendas and interests regarding, what is for most people, the largest part of their non-pension asset wealth in retirement: their house. Several competing policy agendas have an interest in the housing wealth of older people. For those concerned with problems in the pension system, this housing wealth is a potential source of retirement income that will compensate for pension shortfalls. For those interested in long-term care funding, it is a potential source of revenue to fill the future gap in long-term care funding. For local planners, housing occupied by older people, much of it family accommodation, represents a potential solution to the crisis of insufficient family-sized accommodation in the UK. For older people themselves, their house is usually the prize asset they hope to leave as a bequest to their offspring.

Given the significant increase in the value of older people's property wealth and the different public and private interests relating to it, the future of older people's property wealth may turn out to be one of the most fiercely contested areas of public policy in the coming decades. The challenge for Government is to develop the right decumulation policy; one which increase the scope for decumulation among older cohorts; respects the rights, aspirations and income needs of older people, but which also recognises the needs of other generations and is not blind to transfers of wealth that have taken place across generations.

Recommendations

- *Put 'Decumulation Policy' centre-stage: start the debate*

The last five years have been dominated by debate among policymakers and the wider public about 'accumulation policy'. The result has been an increase in 'financial education' within schools, growing awareness of the need to save for retirement and a comprehensive suite of reforms to the UK pension system. However, the time is now right for all stakeholders to focus attention on 'decumulation policy'. This means that related NGOs, charities, the financial industry, as well as political parties, must all address decumulation policy, formulate positions and enter the debate.

This point is particularly important because of the growing role property has in household asset portfolios. Indeed, young and middle-aged cohorts have in recent years confronted: an inflating property market that encourages them to see property as an investment; a Government that recognises saving can take different forms, including property; and a tax regime for primary homes that makes property an efficient investment.

However, despite the range of factors encouraging younger cohorts to accumulate assets in the form of property, and the rising property wealth of older cohorts, policy discussion to encourage and enable effective decumulation of property wealth remains removed from the mainstream political and policy agenda.

- *Twin-track decumulation: equity release and downsizing*

As described above, decumulation of housing wealth can occur via both downsizing and the use of equity release products. However, one form of decumulation does not preclude the other, even though this fact is often overlooked in policy debates relating to equity release or downsizing. Both of these forms of decumulation should be promoted and enabled by Government policy.

Decumulation via the housing market: providing incentives

As outlined, many older people will continue to occupy family accommodation long into retirement. Older people must not be penalised for continuing to occupy their homes. However, the Government can go further in incentivising down-sizing among older people; for example, by waiving stamp-duty for those in retirement moving to smaller accommodation[36]. The full range of policy options available must be explored and tested.

Decumulation via the housing market: achieving the right housing stock

A lack of suitable accommodation is a major barrier to downsizing among older people, and making improvements to housing supply is an important step in encouraging downsizing. However, it must be recognised that this remains an immense challenge, quite besides the usual difficulties associated with new house-building and planning restrictions.

This is because changing the housing supply to incentivize downsizing means developing properties which are cheaper, smaller yet more desirable than the larger and more expensive properties which many older people occupy as they enter retirement. Size and quality of accommodation are determinants of price in the housing market, but downsizing implies individuals making compromises in these dimensions in order to release capital. However, the preference of many older people is precisely to use the capital they have to live in the home of their choice, and this may therefore inhibit downsizing. This is particularly the case when declining mobility associated with ageing makes size and type of accommodation an even more important factor in quality of life. The importance of achieving the right housing stock to enable decumulation is therefore matched only by the challenge in doing so.

Achieving the right housing stock in this context also means properties suitable to the potential future requirements that older people might have in terms of mobility and access. This means, for example, taking account of initiatives such as the 'Lifetime Homes' agenda[37].

The Government must therefore ensure that its plans to increase new house-building is not just targeted at first-time buyers; it must oversee the development of properties aimed specifically at older people. This will help to prevent the problem that may result if more downsizing by older people is achieved: older cohorts competing with young or first-time buyers for smaller properties.

Decumulation through equity release: getting it right

The usage of equity release products in the UK - although high by international standards - remains significantly below its potential. The various reasons for this have been extensively explored elsewhere[38], but include: insufficient financial advice; low product awareness; the legacy from previous product mis-selling; and potential loss of benefit income to those on the cusp of welfare entitlements.

Much has already been written about the potential of the equity release market in the UK[39], the value of equity release products[40] and obstacles to equity release[41]. There is not space here to make detailed recommendations for the development of this market. Nevertheless, it important for the Government to now dedicate significant time and

[36] See Harding E (2007).
[37] The design and promotion of so-called 'Lifetime Homes' has been spearheaded by organisations such as the Joseph Rowntree Foundation; see: http://www.jrf.org.uk/housingandcare/lifetimehomes
[38] For example, see Terry R and Gibson R (2006); or Equity Release Working Party, Actuarial Profession (2005).
[39] See Bramley G (2004).
[40] See WhichOnline (2006).
[41] See Terry and Gibson (2006).

resources to exploring how this market can be developed, for example, through addressing disincentives in the welfare system to undertake equity release. In particular, the Government should not rule out taking radical steps to support the market, for example, by underwriting segments of the market.

Promote financial advice

Decumulating assets, and doing so effectively, is difficult if older people do not have the financial skills required. Crucial research in recent years has shown the extent to which the ageing process is associated for many older people with declining numerical capability which inevitably impacts upon financial capability[42]. In fact, in addition to changing cognitive capacity, academic research suggests that ageing is associated with changes to the way in which individuals make decisions[43]. This underlines the importance of the current financial advice agenda and the Thoresen Review of Generic Financial Advice. The Government must ensure that sufficient and appropriately designed financial advice is available for older people to enable decumulation. Alongside changes to the equity release and housing markets, financial advice is the third-plank of an improved decumulation policy.

[42] For example, see Banks J and Oldfield Z (2007); Finucane M et al. (2002).
[43] See Lockenhoff C and Carstensen L (2004).

Conclusion

Patterns of asset accumulation across the life course have changed. Like most significant societal changes, policymakers and other key stakeholders need to respond. This report has sought to provoke discussion, and make some initial tentative recommendations across a range of relevant policy domains.

The approach deployed in this paper has deliberately considered real wealth transfers in the housing market alongside other kinds of wealth transfer around society, principally via the state. This approach is unusual, and some will find its implications uncomfortable. However, simply ignoring changing patterns of asset accumulation and wealth transfer is neither tenable nor legitimate.

The real story behind *Asset Accumulation across the Life Course* is the spectacular growth in UK house prices during the period in question. There is growing awareness that the functioning of the housing market has lead to a transfer of wealth around society, which some have characterised as a transfer from 'young to old'.

In truth, the notion that rising house-prices have caused a wealth transfer from young to old is overly simplistic. The process of wealth transferral via the property market is complex, involves transfers of wealth upwards to cohorts who would not qualify as 'old' and is determined, in addition, by socio-economic factors: possession of significant property wealth is a function of income and existing wealth, not just age. It is clearly wrong to assume that all those in retirement live in highly valuable properties and, in fact, rates of property ownership decline among older cohorts. Nevertheless, it can be seen that by volume, older cohorts pre and post-state pension age have on average benefited significantly from inflation in the value of their property assets, and this has been matched by growth in the value of mortgage debt held by younger cohorts.

Younger cohorts have been the beneficiary of real increases in incomes that have not been matched among older cohorts. However, where these increasing incomes are used to obtain, and pay off, increasingly large mortgages, it is debatable as to who is actually receiving the benefit of the increasing incomes of young cohorts. House prices rise, in part, as a reflection of rising real incomes, but it is not necessarily those actually earning rising incomes that enjoy the gain from these rises; the housing market enables others to capture the benefit. Conversely, when wealth is tied up in illiquid property, is not even clear that those enjoying inflation in the value of their property assets are truly profiting[44].

Who Really Benefits?

The Government therefore confronts a curious situation. On the one hand, younger cohorts have seen increasing real incomes but, with rising real and expected mortgage debt, many young people do not feel better-off; they are forced to pay more to live in the same houses as previous cohorts. These rising incomes contrast with the static real incomes of older cohorts who have watched in amazement as their homes have ballooned in value, but have mostly been unable to meaningfully access this wealth without making other unpalatable compromises in their choice of accommodation. In the context of income and wealth, such is the conundrum posed by rising UK property prices: who really benefits?

The answer is, perhaps, the middle. Those property owners aged around 50-55 in 2005 have seen little or no increases in mortgage debt, hefty increases in their illiquid household wealth, while continuing to enjoy rising real incomes.

[44] Clearly such an argument may not apply to those owning two or more properties. However, as *Asset Accumulation across the Life Course* showed, the numbers of second home owners are not necessarily as high as some would expect.

For other cohorts, despite the ‘feel-good’ factor associated with rising house prices, such price inflation has arguably done little for the retirement income of neither the young nor the old. Just as today’s older cohorts find themselves possessing valuable property assets but are unable or unwilling to significantly access this wealth, today’s younger cohorts, forced to skew their retirement saving through the ‘vehicle’ of property, may find themselves in exactly the same predicament when they reach old-age, or worse. Despite the common belief that property is a good investment for old-age, even during a period of rising house prices, it is difficult not to conclude that high house-price inflation does in fact undermine retirement income. This is one of the key conclusions to be drawn from the *Asset Accumulation across the Life Course* research.

Public Policy across the Generations

The Government’s key dilemma is how to balance the interests of young and older cohorts in light of wealth transfers that have taken place. Having seen such dramatic asset accumulation, can older cohorts expect to rely on the young to pay for them in retirement, and more generally, the costs of the UK’s ageing population? If not, how can the Government create greater awareness that older cohorts will have to use their housing wealth to fund retirement? How can the Government go about changing attitudes which are often entrenched against such an idea?

Perhaps the most effective mechanism for encouraging older people to use their housing wealth to generate a retirement income will be for the Government to let the incomes of older people be squeezed. Yet such a strategy seems morally unacceptable to deploy in relation to those in the latter years of their life, unable to participate in the labour market, and experiencing the various aspects of physical decline associated with the ageing process.

Nevertheless, the case for relieving younger cohorts of paying for older generations is compelling if their retirement income is to be sufficient. It is also important to be clear that when younger cohorts are forced to take on increasing mortgage debt with their associated repayment costs, they are not just forgoing income being available for holidays, entertainment and luxury goods. Some younger cohorts are seeing less income available to spend on child-rearing, such as for food and books. In this sense, wealth accumulated through the housing market is at the expense of children, who will potentially see correspondingly lower outcomes over the rest of their life course. This aspect of house-price growth receives remarkably little comment.

Clearly there is a powerful argument for the Government to encourage older people to see their housing as just another investment they have accumulated and which, like a pension must fund their retirement. This policy would inevitably affect the attitudes of younger cohorts, who are already highly likely to see property as an investment. However, herein lays another dilemma for the Government. With so much of the nation’s wealth tied-up as illiquid property wealth, it could be argued that the Government needs to change society’s attitudes about the supposed benefits of house-price inflation, and the virtues of other investment-vehicles over property, i.e., to not see property as an investment. There are profound arguments in favour of such an approach, but they are at odds with the need for the Government to improve policy enabling decumulation.

The Next Wealth Transfer

While the Government has been slow to respond to changing patterns of asset accumulation, families have been much quicker to respond and act. *Asset Accumulation across the Life Course* pinpointed enormous wealth transfers between entire cohorts via the housing market; however, the levels of illiquid wealth among the - albeit declining - proportion of younger cohorts that own property does indicate some wealth transfers downwards within families. Indeed, there has been growing evidence that families are busy transferring available liquid

wealth among different generations of family members to where it is most needed and useful: frequently the youngest members.

The unprecedented accumulation of assets by older cohorts may yet be followed by an unprecedented transfer of assets by older cohorts, albeit mediated by the messy circumstances of family relationships, individual circumstances and existing inequalities. It is important to emphasise that not all families have sufficient liquid wealth to transfer downwards, and when considered across entire cohorts, such transfers are significantly less than those that have occurred upwards via the housing market. Nevertheless, such family wealth transfers do appear to be growing and may continue to do so as the baby-boomers enter the decumulation phase of their lives. Researching, understanding and responding to this next wealth transfer is perhaps the most important task going forward.

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