

# Lessons from Across the Atlantic: Asset-building in the UK<sup>1</sup>

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## Introduction

The last few years have witnessed a flurry of asset-based policymaking in the United Kingdom, inspired by the development of the assets approach in the US. But inspiration does not mean duplication, and though there are important similarities, there are also significant differences from policies in the US with respect to scale and policy design, and with a firm emphasis on developing a regular saving habit rather than saving for particular ends. What lessons can be learnt from UK experience? This paper aims to contribute to cross-Atlantic dialogue and learning. It sets out the suite of progressive asset-building policies that have been developed by the Labour government since 1997, and considers the effects these policies have had: on saving, opportunities and self-efficacy. These are still early days for asset-based welfare in the UK, but we examine whether the evidence thus far supports the existence of an ‘asset effect’. We then go on to look at the policy challenges for the future. Although asset-based welfare is arguably more advanced along the policymaking path than in the US, we argue that we cannot rest easy: the path is not yet well-trodden, and with future directions yet to be forged.

## The development of asset-based policies in the UK

In recent years, conceptions of the welfare state have undergone significant change on the centre-left in the UK. No longer is the welfare state simply about income assistance and public service delivery, but it is seen as an empowering force, enabling people to bring about change in their own lives and opening up opportunities. This dominant paradigm of a “social investment state”, in which people are empowered to build their own capacities in order to make them more self-sustaining, is key in New Labour thinking and policy development (Pearce, Paxton and White 2006). Asset-based welfare is seen as playing an important role in realising this vision, with the Labour government suggesting that it could become a fourth strand of welfare policy in addition to the three existing pillars – improving work and skills, income assistance and public services (HM Treasury 2001a).

Perhaps unsurprisingly then, asset-based welfare has represented a new policymaking frontier since 1997, when Labour came into office. It was back in 2000 that a seminal ippr paper made the case for an asset-based complement to the traditional functions of the welfare state (Kelly and Lissauer 2000). This was followed by the release of two government consultation documents on two flagship asset policies, the Child Trust Fund and Saving Gateway (HM Treasury 2001a, HM Treasury 2001b).

It is important to realise that the *principle* of government support for asset-building was not new to the UK in 2000 – like in many other countries, including the US, it has in fact enjoyed a

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long, established tradition with respect to short- and medium- term savings, long-term pensions savings and homeownership. What was radically different, however, was that for the first time, these proposals were for support in a *progressive* form: providing more support for those on lower incomes. Before this century, almost all state support for asset-building was provided through tax relief<sup>2</sup>: tax relief interest on a suite of short- and medium-term saving products; income tax relief on pensions; tax relief on mortgage payments from 1920 to 1998; and exemptions from capital gains tax for homeowner's main residences. Tax relief is intrinsically regressive, offering the greatest saving incentives to those who pay the most tax – in other words, higher earners.

### *The Child Trust Fund (CTF)*

Perhaps the boldest of the two recent policies was the Child Trust Fund: the first “baby bond” on the international policymaking scene, and the only truly national progressive asset-building policy in the UK. All children born in the UK since 2002 have been entitled to a £250 (\$470<sup>3</sup>) deposit, with children from families with annual household income of less than £14,000 (\$26,300) receiving an extra £250. Parents receive a voucher on the birth of their child to this amount, which they can use to open a Child Trust Fund account with one of 40 providers on the open market. If the voucher is not used within one year, the government automatically opens an account on the child's behalf. Family and friends can save up to £1,200 (\$2,260) each year in the accounts, and the Government has recently announced that it will top-up the funds with an extra £250 (£500 (\$940) for children from low-income families) when the child reaches age 7. The funds accumulate interest tax-free, and are locked until the child reaches their 18<sup>th</sup> birthday, at which point the funds mature in the young person's name. The young person is free to spend the funds as they wish without restriction.

There are three account types: cash-based accounts, shares-based accounts, and stakeholder accounts, which are based on shares, but have low-risk lifestyling options and a maximum management charge of 1.5 per cent per annum, regulated by government. All accounts that are automatically opened by government are stakeholder accounts. The first vouchers were issued from January 2005, and the first account opened from April 2005.

This policy is similar to the Savings for Education, Entrepreneurship and Downpayment (SEED) initiative in the US, but there are some important differences on use restriction and matching. The SEED initiative is seeking to test a children's saving account for the US. Maturing SEED funds will only be available to spend on certain purposes: education, small business development, home purchase or retirement. Funds saved into SEED accounts will be progressively matched, but in the CTF, there is no incentive to save beyond the deposits at birth and age 7, and tax relief on interest earned on the accounts. SEED accounts are also delivered by community-based organisations, in contrast to CTF accounts.

### *The Saving Gateway*

The government has also sought to open up saving incentives to more people through piloting the Saving Gateway. The Saving Gateway is a matched saving account targeted at those on low incomes, loosely based on Individual Development Accounts (IDAs) in the US. Its stated aims are to kick-start a saving habit amongst those with the lowest levels of saving, and to help them make better-informed decisions about saving (HM Treasury 2001b). Eligible

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<sup>2</sup> One important exception is the “Right to Buy” policy of the 1980s, which offered tenants of council housing the right to buy their homes at a significant discount. Although this policy did offer thousands a helping hand onto the housing ladder, it was accompanied by expenditure cuts which limited capital investment in social housing, and limited the supply of council properties for future tenants who could not afford to buy their home even at a discount.

<sup>3</sup> All figures in pounds have been converted to dollars using the exchange rate published on [www.xe.com](http://www.xe.com) on 7 September 2006, of \$1.880 to the pound.

individuals can save into accounts of a fixed term, up to a monthly maximum. Government matches savings left in the account until maturity.

There have been two rounds of pilots – the first was completed in November 2004, and the second round is currently underway. The first pilot was very small-scale, with around 1,500 accounts opened in five areas in England. Eligibility was restricted to working age individuals, either in work and with annual household earnings of less than £11,000 (\$20,700) (or £15,000 (\$28,200) if they have children or a disability), or out of work and receiving a qualifying state benefit. The account length was 18 months. Individuals received a £1 match for every pound they saved into their account, added to the account balance on maturity, up to a maximum of £25 (\$47) per month, and £375 (\$705) over the duration of the 18 months. They were free to withdraw their savings at any time, but at the cost of forfeiting the match. Accounts were provided by the Halifax Bank (now the Halifax Bank of Scotland). In four out of the five areas, the Saving Gateway was delivered alongside a government initiative to promote community delivered financial education, and local community-based organisations were involved in recruitment, providing assistance with account opening and the provision of financial education. In the fifth area, there was no community- organisation involvement – instead, participants were recruited through letters to all those eligible in the area, and accounts were opened directly with the local Halifax branch.

In the second pilot, which is much larger-scale (21,500 accounts), several changes have been made to eligibility, match rates, and delivery. Eligibility has been widened up the income distribution, to working age individuals, in work and with individual earnings of less than £25,000 (\$47,000) and household earnings of less than £50,000 (\$94,000), or out of work and in receipt of a qualifying state benefit. This represents a very significant expansion. In 2005, UK median individual earnings were £19,000 (\$35,700), and earnings at the sixth decile were £22,400 (\$42,100) (National Statistics 2006, Table 1.7a). Some of these earners will be in households with household earnings of more than £50,000, but the second pilot's eligibility criteria would extend to many more of the working age population than those of the first pilot, were they to be applied nationally.

The match rate varies across the six areas involved in the pilot, from 20p for every pound saved, to the 1:1 match rate of the individual pilot. The saving maximum varies from £25 (\$47) to £125 (\$235) per month – areas with lower match rates have correspondingly higher maximums. There is also no partnership delivery with community-based organisations. Participants were recruited through a range of methods, including through random telephone calling, random letters, and letters to benefit claimants. Free adult financial education courses are available to all participants.

As for the CTF, the Saving Gateway differs from IDAs in that there are no restrictions on the use of maturing funds. The match rate also tends to be lower than that of IDAs, which ranges from 1:1 to 7:1 in the American Dream Demonstration, a collection of fourteen IDA schemes run from 1997 to 2001 in the US (Zhan 2006). The second pilot also has no community-delivered element.

## **The impact of asset-building policies on saving: early evidence**

One of the primary objectives of these policies is to increase saving rates, particularly amongst those who may have had low levels of saving before. Matched saving schemes have come under criticism from some in the UK with respect to this objective: Emmerson and

Wakefield (2001) argue that they can carry significant deadweight costs and fail to encourage new saving if individuals borrow to save in order to take advantage of high match rates, transfer existing assets into matched saving accounts, or if schemes simply attract those who would have saved anyway<sup>4</sup>. They also argue that finite matching may not, in fact, change saving patterns in the long term, and that other interventions, such as financial education, could have a greater impact on saving. Monitoring the impact of the Saving Gateway on saving rates in order to counter these criticisms is thus critical: and the evidence from the first pilot is that, through careful scheme design, deadweight costs need not be too high.

### *The Saving Gateway*

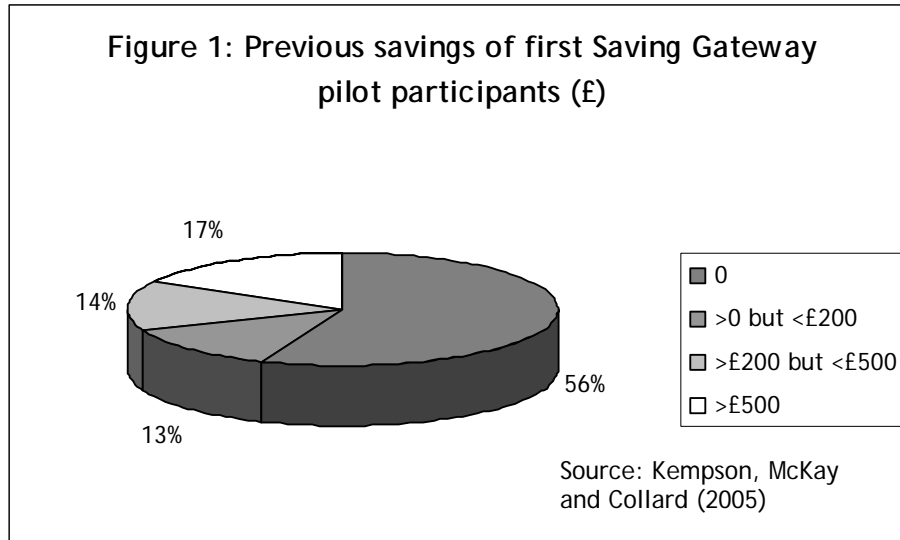
Most of the evidence we have on the impact of the Saving Gateway on saving rates is from the first pilot, evaluated by the Personal Finance Research Centre at the University of Bristol (Kempson, McKay and Collard 2005). Although interim findings from the second pilot evaluation have been published (IFS and Ipsos MORI 2006), they need to be treated with caution as they relate to accounts that had only been open for three to four months. The evidence thus far is very positive. Much of the analysis that follows is based on the findings reported in these two evaluation reports.

In the first pilot, there is no evidence that a ‘cream-skimming’ effect occurred, with the most affluent or highest-saving individuals from the eligible group disproportionately taking part. In fact, Saving Gateway participants had lower incomes than the eligible population as a whole, with three in ten living on incomes of less than £100 (\$188) per week, compared to two in ten of the reference population. Compared with the eligible population, larger proportions of women, lone parents, minority ethnic groups and social housing tenants, and a smaller proportion of homeowners, opened accounts.

This is reflected in past levels of saving reported by participants. While half of participants or their partners said they already had a savings or credit union account before they opened their Saving Gateway account, 32 per cent said they only saved informally with no such account, and 18 per cent said they had no money put by at all. With respect to *levels* of past saving, 56 per cent of participants said they had no money in a saving account before opening their Saving Gateway account, 13 per cent had less than £200 (\$376), 14 per cent between £200 and £500 (\$940) and 17 per cent £500 or more (see Figure 1 below). These breakdowns are very similar to those for a reference control group, suggesting that the first pilot did not disproportionately attract those with higher previous levels of saving or account-holding.

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<sup>4</sup> We have included borrowing to save as a deadweight cost because if individuals take on debt in order to make deposits into their Saving Gateway account, their net savings will be zero (excluding the government match), or less than zero taking into account interest repayments.



However, Saving Gateway participants were 70 per cent more likely than the reference control group to describe themselves as rainy day savers – perhaps suggesting that the scheme attracted a disproportionate number of those who wanted to save, but who had not actually been doing so.

The first pilot suggests that matched saving schemes can indeed have a positive effect on rates of saving. Participants’ average monthly saving levels almost doubled from £8.85 (\$16.64) to £16.14 (\$30.34), and average balances at the end of the scheme before the government match were £282 (\$530) – just over three quarters of the possible maximum of £375. Individuals, on average, made a deposit in seven out of ten months that their account was open – four in ten said they regularly paid in money by standing order or direct debit, and a further four in ten by cash or cheque. So eight of ten described themselves as saving regularly at the end of the scheme, compared to only 17 per cent at the start. The two most common amounts saved were £25 (\$47) and nothing, suggesting that the monthly £25 maximum acted as a target that participants aspired to meet. Those groups that were less likely to have saved the maximum amount were those living on lower incomes, lone parents and single people with no children.

Very few participants withdrew funds from their account during the 18 months: on average, less than one in a hundred made withdrawals each month. This reflects the intention of almost all participants (97 per cent) at the start of the scheme to leave the money they saved in the account. People who did make withdrawals tended to do so because of financial difficulties. The depth interviews with participants reveal that account-holders tended to be reluctant to break the savings habit that they had developed.

We have limited evidence on the *long-term* impact of the scheme, as the evaluation only ran for three months after the accounts were wrapped up. But the evidence that we do have is positive. Three months after account maturity, 91 per cent of participants still had a savings account of some kind, and 41 per cent were still saving fairly regularly. The scheme seemed to be successful in changing attitudes towards saving. Of the 18 per cent who said that they did not really save at all at account opening, two thirds said they saved for some reason by the end of the scheme, a shift which did not happen to the same extent in the control group. The depth interviews also suggest a fundamental shift in attitudes among some participants:

*It's changed my financial habits so I'm not spending as much, I've got saving in mind...it's changed my personal habit of saving.*

*We now realise the importance of saving for a rainy day or an emergency...it's definitely made a difference. Because we don't have so much stress you see.*

Participants in the first Saving Gateway pilot (Kempson, McKay and Collard 2005)

The second round of pilots is being evaluated by the Institute for Fiscal Studies and Ipsos MORI. This evaluation is comparing the effect of the Saving Gateway on those who are *offered* accounts, rather than those who actually opened them, compared with a reference control group. The interim findings do need to be treated with caution, as the second pilot accounts had only been open for four months at the time. However, they suggest that for those offered a Saving Gateway account, there has been an increase in saving into cash deposit accounts, compared to levels of saving by a control group not offered the accounts. The evidence is less clear when total asset holdings are analysed, which may reflect that accounts are available to those with much higher household incomes than in the first pilot, and so participants may be more likely to transfer existing assets into Saving Gateway accounts early on. Given this, the observed effects on saving, particularly on total asset holdings, could increase after a further fourteen months.

What about deadweight costs? The first pilot, at least, suggests that deadweight costs do not have to be prohibitively high – they can be minimised through careful scheme design. As discussed above, the scheme doubled average monthly saving rates, and this increase in saving appears to have been *new* saving. Very few participants borrowed in order to save into their accounts: only five per cent transferred money from another savings account, only three per cent borrowed from friends or family and less than 0.5 per cent borrowed commercially. In contrast, 94 per cent of account-holders saved from their regular income. The design of the scheme probably had a role in keeping deadweight costs down. It was closely targeted on those on low incomes, least likely to already have financial savings that they could transfer into a Saving Gateway account. These are also those who are least likely to have access to affordable credit from commercial sources or friends and family that might make borrowing to save worthwhile. Moreover, the monthly saving maximum made borrowing to save less practical than if there had just been one maximum for the length of the account's term. It remains to be seen how high deadweight costs will be in the second pilot, which has a much wider eligibility range than the first.

The biggest research gap remains on the long-term effects of matching on saving. Does a high match rate for a finite time period kick start a regular saving habit in the long term? Does supporting medium-term savings increase savings into pensions in the long term? Further work is needed to establish whether these effects do, in fact, exist, and whether the shift in attitudes towards saving observed in the first pilot are permanent.

#### *The Child Trust Fund*

We currently have much less data on the impact of the Child Trust Fund on parental saving. In the absence of more comprehensive data at this early stage, we have collated data on parental saving, based on a sizeable market share of all CTF accounts.

Two thirds of all vouchers issued by May 2006 (2,486,000) had been used by parents to open accounts (HM Revenue and Customs 2006). Some commentators have picked up on this as a cause for concern, suggesting that this implies a low level of parental engagement with the

policy. While all children will have accounts opened automatically by government after one year, parents actively using the vouchers to open accounts may well be a better foundation for parental saving.

However, vouchers are valid for a year before they expire, so some of these unused vouchers will still be active, and some parents may be intending to use the vouchers in the months to come. A much better indication of takeup is the percentage of vouchers for those children born between September 2002 and April 2005 that have been converted into accounts, as all of these had expired by May 2006. 75 per cent of these vouchers (1,330,000) had been converted into accounts by May 2006 (HM Revenue and Customs 2006). Given that it has been less than two years since the first vouchers were issued in January 2005, parental engagement has arguably been very high – and we might expect that when the policy becomes more embedded, parental take-up rates in the first year might be even higher.

Focus groups with parents have suggested that for those parents who have not used vouchers to open accounts, reasons for not doing so include finding information about the accounts confusing and overwhelming, and not having the time to look into accounts during the first year of their baby's life (Prabhakar 2006).

At what level has saving into CTF accounts occurred, and how has this varied by income level? We surveyed five of the largest providers to collate data on saving in the first year. The following data are based on 625,239 accounts; around 40 per cent of market share in May 2006. They need to be treated with caution: they are all from providers of equity and stakeholder accounts, not cash accounts, so may not be fully representative of the whole market. Accounts have only been open since May 2005 at the earliest, and saving patterns may change considerably until 2020, when the first generation of CTF account-holders will turn 18.

We have used the extra £250 government payment that children from low-income families receive to distinguish between the accounts of children from 'higher-income' families (with annual household income greater than £14,000 (\$26,300)) and those from "lower-income" families (with annual household income less than £14,000). Of the accounts that we consider here, 74.6 per cent are higher-income accounts, and 24.4 per cent lower income. This compares with an estimated national ratio by HM Treasury of 60 per cent higher-income accounts to 40 per cent lower-income accounts, implying that higher-income parents may be more likely to use their vouchers to proactively open accounts in the first year.

As we might expect, the data also show that higher-income parents tend to be saving more than lower-income parents. Out of the accounts we have considered, 33 per cent of higher-income accounts, and 19 per cent of lower-income accounts, are attracting regular monthly saving through direct debit. The average monthly direct debit for is £24 (\$45) for higher-income accounts, and £16 (\$30) for lower-income accounts. So on average, across all accounts, higher-income accounts are attracting £8 (\$15) per month in regular monthly savings, and lower-income accounts, £3 (\$5.64).

Saving by lump-sum deposit is less popular. Only 10 per cent of higher income accounts have attracted a lump-sum deposit, and six per cent of lower income accounts. The percentage gap between higher-income and lower-income accounts is much smaller: the average lump-sum deposit for higher-income accounts is £334 (\$628); for lower-income accounts, it is £286 (\$538).

Unused vouchers have only been automatically converted into accounts since May 2006, so we do not yet have a measure of saving into these accounts. In coming months, it will be interesting to see whether monthly saving into these accounts is lower than accounts that have been proactively opened by parents, or whether there are similar levels of parental engagement.

Unfortunately we do not currently have a baseline against which to measure these saving levels, although the government will be publishing the results from a baseline survey of parental saving for children later this year. However, the focus group research conducted by Prabhakar (2006) gives us a window into the effect on parental attitudes, although it should be noted that this research took place with a small number of parents (58) and is therefore indicative rather than representative. About two thirds of parents had not made deposits into their CTF. But some parents who had reported that the CTF had changed the way they thought about savings:

*And now, when her birthday comes I've said to the godparents, I don't want any more toys or clothes. I've given them the account and told them to do what they want. And that's it.*

*Because I'm not good at saving money but I've had that incentive to start saving for it and so I've started saving for it. Somebody's helped me out by putting an amount in an account for them, I'm not just going to leave that account.*

Focus group participants, Prabhakar (2006)

## **Wider impacts: security, opportunities and individual self-efficacy**

Proponents of asset-based welfare argue that financial assets represent more than simply a store of future consumption or investment-earning potential. They are thought to bring wider benefits, including increased security, self-efficacy and opportunities (Sherraden 1991, Paxton 2001). Analysis of the National Child Development Study in the UK has shown that owning a small asset of £300-£600 (\$564-\$1,128) in 2001 prices at age 23 is associated with certain positive outcomes at age 33 controlling for other factors, such as improved employment and mental health outcomes (Bynner 2001). To what extent can we observe these effects as a result of the Saving Gateway and Child Trust Fund?

After the first Saving Gateway pilot, 60 per cent of participants said they feel more financially secure as a result, 39 per cent that they felt more in control of their own lives, and 32 per cent that they were more likely to control for their own retirement as a result (Kempson, McKay and Collard 2005). Depth interviews with participants probed these effects more deeply:

*It's made me more organised with my money... it has made me think about my money a lot more, whereas before I wasn't in control with what was going on with my money as I should have been.*

*It's made life a little bit more tolerable because I know I've got it, in the back of my mind now, I know I have got that little bit there if I desperately need it.*

Saving Gateway participants (Kempson, McKay and Collard 2005)



Account-holders were asked how they were intending to use the funds in their account at account maturity. Two thirds said they intended to continue to save some or all of the money in their account, and 23 per cent said they would spend it all. The most popular use for the money was to save it for a rainy day (41 per cent of participants said they would use some of the money for this), followed by day-to-day expenses (18 per cent), a holiday (18 per cent), something for the home (18 per cent), and something for children (13 per cent). Relatively few participants said they would use the funds for education or for retirement saving (Kempson, McKay and Collard 2005). This is perhaps reflective of the design of the scheme: to help participants build up a relatively small asset buffer in the region of £700 (\$1,316), rather than to save more substantial amounts for a particular purpose.

It is too early to tell what kind of effects the Child Trust Fund will have on opportunities and psychologies: we can only speculate about the impacts that it might have as the babies and toddlers who now have accounts grow older. As noted above, there are no restrictions on how young people can use their funds when they mature, which of course means that some young people may not spend their asset wisely. However, focus group research with young people today suggests, promisingly, that young people themselves would take having an asset at age 18 seriously (Gamble and Prabhakar 2006). In order of popularity, young people said that they would spend an asset on higher education, buying a car, starting a business, and saving for a deposit on a house. Female participants also cited childcare as a possible use.

### **The importance of delivery by community-based organisations**

One significant difference between asset-based policies in the US and in the UK is that US schemes have involved community-based organisations more heavily. Both IDAs and the SEED initiative are delivered by intermediaries in the community. In contrast, there is no local delivery element for the CTF. Although four out of the five areas in the first Saving Gateway pilot did have a significant community-based delivery element, this has been dropped in the larger second pilot.

However, evidence shows that the financially excluded in the UK tend to have very low levels of trust in financial institutions (Collard et al 2001). Many of those at whom the Saving Gateway is targeted at will have had no or very limited previous contact with financial institutions: four out of five of those without bank accounts (2.24 million people) have annual incomes of less than £9,900 (\$18,600), and half of those without bank accounts (1.4 million) have been on state benefits for longer than five years (National Consumer Council 2005). Low levels of trust in government may also be a problem. Local and community-based organisations can help to overcome these barriers because they tend to be more trusted and familiar; to be not-for-profit and have a value-based commitment to reach out to all people in their communities; to have greater links and knowledge of their local communities which they can use to help and engage people; and to often have a physical presence in even the most disadvantaged communities (Regan and Paxton 2003).

Perhaps unsurprisingly then, the community partnership element of the first pilot was important in ensuring its success. The most effective recruitment methods were local – through word of mouth and local newspaper articles. The personal contact that the housing associations involved in the first pilot had with social housing tenants was particularly significant in recruiting individuals with social problems, and those marginalised from financial services (Kempson, McKay and Collard 2005). Three out of four participants said it was important to them to be able to open an account through a local organisation, and some would not have opened an account without the assistance that these organisations could

provide. Four out of ten liked the fact that they did not have to deal directly with a bank or building society (Kempson, McKay and Collard 2005). The first pilot disproportionately recruited more marginalised groups: those on lower incomes, lone parents, social housing tenants and those from minority ethnic groups – but this was largely accounted for by the four areas with community-based partnerships. In Hull, the only area without community-based delivery, those who were recruited were more similar to the eligible population. However, the other four areas did find it more difficult to recruit those in low-income work.

In the second pilot, which lacks a community partnership delivery approach, recruitment has tended to be more successful amongst groups with higher levels of education and financial literacy, and is significantly associated with already holding an investment, or being a homeowner. It is also higher for better-off participants: 24 per cent of those in the highest family income quintile who were offered an account opened one, but only 9 per cent of those in the lowest family income quintile. However, it appears that this effect is accounted for by the higher education and financial literacy levels in the highest quintile (IFS and Ipsos MORI 2006).

The evidence from the two pilots suggests the importance of a twin strategy of community partnership delivery, with workplace recruitment for those in low-income work, if the Saving Gateway is to be successful at targeting those at whom it is really aimed: those on low incomes with no or very low levels of past saving.

## Implications for future policy development

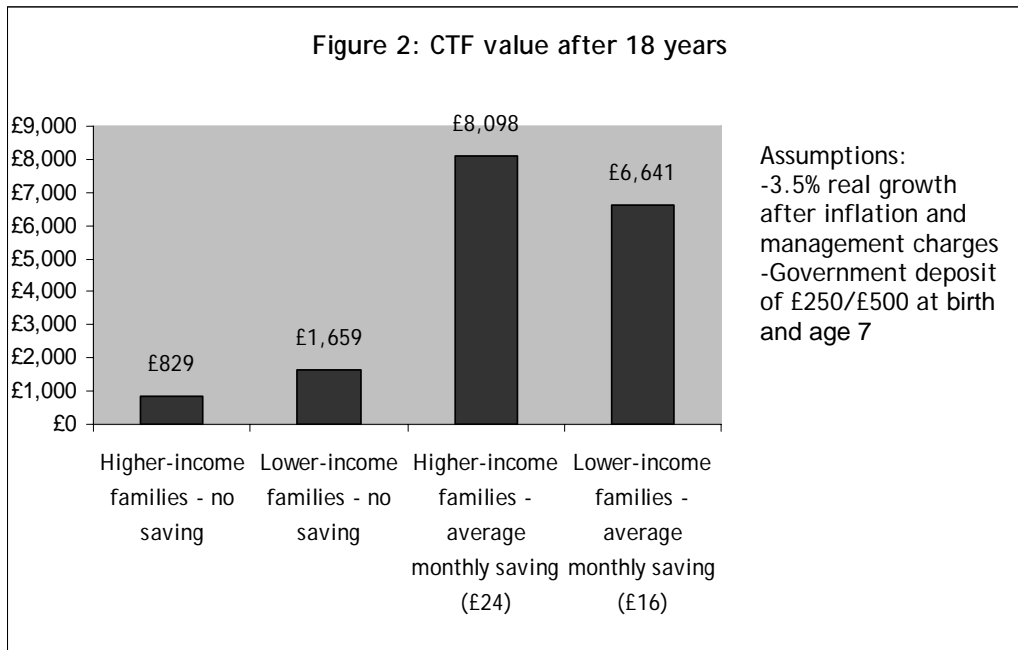
In these two policies, the foundations have been laid for a welfare state that recognises the contribution that assets make to well-being. But given the freshness of the approach, the continual emergence of new evidence, and the fact that there are many policy parameters are still left open, proactive policy development needs to continue. Below we discuss the main challenges that lie ahead for the Child Trust Fund and Saving Gateway.

### *The Child Trust Fund*

The Child Trust Fund, with almost two and a half million accounts open at May 2006, is the more developed of the two policies. However, a number of important policy challenges remain: minimising the inequality in fund values when young people reach age 18; and ensuring that as far as possible, funds are used responsibly when they mature.

It is clear that children whose parents and families regularly save into their CTF will have access to a much larger fund value when they are age 18. In projecting forward what funds might look like from the data on saving in the first year collated from providers, we need to exercise caution not to over-extrapolate, as saving patterns may change in the future. However, assuming that some accounts continue to receive steady monthly deposits, but that others do not, we may observe considerable inequality in the value of CTF funds at age 18. Figure 2 below shows the value of a young person's CTF at age 18 under four different scenarios: a higher-income account with no extra deposits, a lower-income account with no extra deposits, a higher-income account with the average higher-income monthly direct debit of £24 (\$45.12), and a lower-income account with the average lower-income monthly direct debit of £16 (\$30). The difference between those accounts that attract regular saving and those that do not is considerable, and more significant than the difference between higher- and lower-income accounts with average amounts of monthly saving. If a higher-income family saved the maximum of £1,200 (\$2,256) each year, a young person's CTF would be worth

£31,300 (\$58,800) at age 18 assuming real growth of 3.5 per cent per year after inflation and management charges, and government deposits of £250 (\$470) at birth and age 7.



To what extent should we be worried about inequality in endowments at age 18? There are two mitigating factors. First, those from higher-income families are much more likely to have had access to parental assets at age 18 had the CTF not been in existence – so the CTF may have a stronger effect in *highlighting* existing inequalities, rather than adding to it.

Second, we are interested in relative rather than absolute inequality, and the difference that the CTF makes to children from poorer families may be greater in its *real* impact than looking at the nominal figures might suggest. Starting adult life with the £1,700 (\$3,200) that government deposits for children from lower income families would have accumulated into at age 18 may make much more difference to these children than the extra £8,000 (\$15,000) children from higher income families would receive if their families have been saving an average of £24 per month.

So overall, the CTF will certainly improve equality, rather than reduce it. But the policy could become still more egalitarian, by directing more money into the CTFs of those children whose parents are least likely to be able to make deposits themselves. ippr has recommended elsewhere that there should be further government top-ups to the accounts at ages 12 and 16, and that the top-ups should become more progressive as children grow older, with larger top-ups going to children from the poorest families (Maxwell and Sodha 2005). Local authorities should also make annual deposits of £50 (\$94) into the CTFs of children in their care, who form one of the most disadvantaged groups in society and are the least likely to receive parental deposits (Maxwell 2005).

Government deposits will never come close to the growth potential of regular parental saving, however, unless they are very large (Maxwell and Sodha 2005). We therefore need to think more creatively about leveraging in money from other sources. One option would be to encourage private philanthropy through creating local community funds, which would be

annually distributed to all local children in need, for example, children in the care of the state. Individuals and corporations would be able to make tax-free charitable donations to these funds. This is a model already embraced by the Share Foundation, which is making deposits into the CTFs of children in state care in four local authorities.

Another option would be to match saving by low-income families into their child's CTF. Matching would be expensive – a government match of 50p for every pound saved up to a maximum of £60 (\$113) per year for those families that receive the extra £250 (\$470) deposit could cost up to £300 million (\$564 million) per year, depending on parental take-up (Pearce, Paxton and White 2006). There may also be questions over whether a match would distort parental financial decisions to the detriment of children – some have argued that a match might encourage parents living in poverty to make long-term savings that they cannot afford, negatively impacting on their child while growing up because these funds cannot be accessed until the child turns 18 (Child Poverty Action Group 2005). But matching, particularly through better integration with the Saving Gateway, should be considered as an option – particularly if there is some way of maintaining liquidity for some period of time. Low-income savers could be given a choice between attracting a government match for saving into the more liquid Saving Gateway, or the less liquid CTF. Additionally, Saving Gateway savers could be given the option, both at the start of the account and when the account matures, to have either the match or their whole account value transferred into their child's CTF on account maturity.

The second challenge is to ensure that funds are used responsibly, in order to open up opportunities, when young people reach age 18. Formal restrictions on use have already been rejected by government, partly because of the administrative complexities involved, and partly because if parents have made regular savings into the accounts, the ratio of parental funds to government funds will be very high. In the absence of formal restrictions, young people need to be encouraged to use their funds responsibly as far as possible. The use of CTF funds should form a part of the educational curriculum, just as the government plans to integrate the mechanics of the CTF into financial education at school, and advice should be delivered to young people through already-established national advice services (Paxton and White 2006). More intensive support could be targeted at the most vulnerable young people through mentoring schemes. Although 2020, when the first funds will mature, may seem far off now, it is possible that concerns about how responsible use will be encouraged may be affecting saving rates *now*. In focus groups with parents, some parents suggested that they were not making deposits into the CTF because there is no element of parental control in how funds are spent (Prabhakar 2006). Parents tended to be keener on parental control rather than state-imposed restrictions on use.

### *The Saving Gateway*

The biggest remaining policy challenge for asset-based welfare in the UK lies in developing the Saving Gateway from its pilot status to a sustainable, affordable national scheme. The Saving Gateway offers the potential to radically change the medium-term regressive savings framework, offering progressive saving incentives to those for whom assets can have the greatest impact on financial security and opportunities. But this depends on the Saving Gateway being able to reach more people, on a national scale.

There are three important issues to consider when considering how to roll out the Saving Gateway into a national scheme: minimising deadweight costs, making the delivery model as effective as possible, and incorporating recent insights from behavioural economics as to how people make financial decisions.

As we have already seen, the first pilot did not seem to carry the high deadweight costs that some commentators feared: it appeared to encourage saving, and, moreover, saving that would not have occurred without the scheme. It remains to be seen whether the second pilot, with its much wider eligibility criteria, will have higher deadweight costs. At any rate, when the scheme is expanded, it should remain closely targeted, as it was in the first pilot. There is also some evidence that the pound for pound match rate may have been higher than necessary to encourage new saving. Eight out of ten participants said they would have saved just as much money had the match rate been 50p for every pound saved (Kempson, McKay and Collard 2005). It may well be possible, therefore, to both reduce deadweight costs and improve overall affordability by reducing the match rate to 20p or 50p for every pound saved. The second pilot, in which match rates vary from 20p to £1 for every pound saved, will provide more evidence on appropriate match rates for a national scheme. It is worth noting though that the interim evaluation reported that the vast majority of account holders are positive about the match rate, regardless of its value (IFS and Ipsos MORI 2006).

Second, there are differences in delivery model in the first and second pilots, with the first pilot having a much greater emphasis on delivery by local community-based organisations, and therefore more successfully reaching marginalised groups. Relying solely on local community-based organisations to deliver a national Saving Gateway would be unsustainable, as the capacity of these organisations simply does not exist to the extent to which it would need to, but it seems clear that in order to reach the groups at whom the scheme is targeted, there needs to be some element of community partnership delivery. A national scheme would therefore work best as a hybrid of the first and second pilot delivery models (Sodha, forthcoming). Eligibility would work on a national basis, with all individuals eligible for an account sent an invitation to open one. On top of this, organisations in the community, such as housing associations, Citizens Advice Bureaux, financial inclusion charities and job search centres, would be contracted to recruit and assist with opening a set number accounts in each local area.

Third, any policy that seeks to change people's behaviour through financial incentives needs to make use of recent insights as to how people make decisions from behavioural economics. Behavioural economics is a relatively recent branch of economics, which relaxes the central rationality assumption of neoclassical economics, and replaces it with lessons from psychology as to how people behave (see for example Kahneman and Tversky 1979; Kahneman 2002). Two lessons are particularly relevant here:

- The way in which choices are framed can have a significant impact on the decisions that people make. People tend to be guided in their decision making by 'anchors' – arbitrarily-chosen fixed points (Bateman et al 1997). Quite often, this will just be the status quo, reflected in people's *inertia*, their tendency to stick with the default option. At other times, it will be an externally-fixed target. Experiments have shown that people tend to adjust their behaviour to these targets, even if there is little rational reason to do so (Epley and Gilovich 2001).
- How people choose to use their money may also be affected by where it comes from and the purpose people attach to it, a phenomenon known as *mental accounting* (Thaler 1999). This theory posits that people tend to attach psychological labels to different pots of money, just as different headings are attached to various sources of income/expenditure in business accounting. So people might have different 'mental accounts' for different purposes – such as food, rent and entertainment. For example, there is evidence that child benefit income in the Netherlands is less likely to be spent on adults' clothing than income from wages (Kooreman 2000).

Public policy that makes use of these insights can have very powerful effects. For example, Save More Tomorrow is a retirement saving scheme in the US that makes use of people's inertia and the fact that many people find it easier to commit to save out of future income increases rather than today's income (Thaler and Benartzi 2004). People are auto-enrolled into the scheme, but have the option to opt-out. They are also given the option of saving out of future income increases. Average contribution rates in one company where the scheme was piloted increased from 3.5 per cent of income to 13.6 per cent of income over four years (Thaler and Benartzi 2004).

While it would be inappropriate to use auto-enrolment for a saving scheme targeted at those on low incomes, as it may not always be appropriate for those living on low incomes to save (Lister, forthcoming), people's inertia should be countered by making it as easy as possible to save – not just by monthly direct debits and standing orders, but directly from paycheques and state benefit payments if people so wish. Saving Gateway accounts also automatically roll over into saving accounts, but people should be given the option to easily transfer their whole account value, or the government match, into a pension or their child's CTF.

If the accounts are being delivered by local organisations on an individual basis, it should also be possible to make use of people's tendency to adjust to targets by using personalised target-setting for account holders. While the monthly maximum clearly acted as a target for many savers in the first pilot, it may be too high a target for others. Personalised saving targets could help to increase saving amongst this group.

Saving Gateway accounts should also assist people in their mental accounting. People can be encouraged to save up for their own personal goals by allowing them to save into different pots within the same account. For example, an individual could have a 'CTF fund', a 'pension fund' and a 'holiday fund', and designate a certain proportion of their saving to be allocated to each fund. When their fund matures, they would not be obliged to spend each fund on a particular use: the aim of the scheme would be rather to *empower* individuals to save towards their own desired ends.

Indicative costings suggest that a national Saving Gateway, based on the hybrid delivery model outlined above; eligibility criteria similar to the first pilot; and a 50p match rate would cost in the region of £176m (\$331m) in the first year, assuming a 30 per cent take-up rate, with a third of these accounts delivered by local organisations (Sodha, forthcoming). This is only a tenth of the £1.75bn (\$3.29bn) that the UK government spends each year on tax-based saving incentives for medium-term savings (HM Treasury 2006).

## Conclusions

These are exciting times for asset-building in the UK. In the space of six years, the progressive assets agenda has become mainstreamed in policymaking. Every child born in the UK is now entitled to government deposits that will be worth at least £1,000 (\$1,880) at age 18, and in the Saving Gateway, a major matched-saving scheme is currently being piloted. The evidence thus far is very positive: the first Saving Gateway pilot appeared to encourage significant amounts of new saving amongst those on lower incomes, and parental take-up of the Child Trust Fund in its first year has been very good.

Momentum must not be lost, however. The foundations have been laid and the embedding of asset-based welfare as a complement to the traditional welfare state has begun. But challenges – policy and political – still remain.

The main policy challenges that remain are questions of how to minimise the inequality in CTF endowments that young people come into at age 18; how to ensure that these endowments are used responsibly to further opportunities; and, perhaps most significantly, how to roll out the Saving Gateway into a national scheme so that for the first time everyone, not just the better-off, will be able to benefit from progressive saving incentives. Lastly, there is a longer-term challenge: how to integrate the suite of innovative policies that have been developed into a convincing savings narrative that operates across the whole lifecycle.

On political challenges, asset-based welfare is almost unique in being an area of consensus between the two main political parties. Its future status as an established element of welfare policy thus seems assured. But assets are not the panacea to the inequality we see today, and there are limits to what they can achieve. The right place for assets is as a complement, not a replacement, for traditional welfare-state income assistance and public service delivery (Glennerster and McKnight 2006). Thus while championing the complementary role of assets, we need to resist ideological calls from the right (for example Murray 2006) to capitalise existing welfare provision.

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