

Saving, not spending, is the key to salvation

The Bank of England's 1.5 percentage point interest rate cut was a shock. It looked like a panic measure. The trouble is that such violent, surprise action causes people to draw in their horns in fear, and thus tends to counteract the desired effect.

But how sensible is it to encourage borrowing for personal consumption? Keynes, it is true, wanted people to spend in a downturn and loathed the idea of increasing savings at such a time. But he was not visualising a society that was already seriously over-indebted.

The Government has been spending well beyond its income, and the economic stability for which it claims credit has been based on this. But individuals have been borrowing and spending lavishly too.

Credit card and mortgage indebtedness has increased remorselessly. In the past 10 years outstanding mortgage debt has increased from £450bn to £1,200bn while consumer indebtedness has risen from £100bn to more than £230bn, making the UK population the most highly indebted in Europe. Most of this has been financed by credit markets fed by the savings of workers in Asia.

The accent has been on consumption and the message now is, apparently: let this continue. However, although consumption is the purpose of all economic activity, the problem is that if everything produced is at once consumed and nothing saved, trouble is bound to follow. Gordon Brown, the prime minister, not long ago called for an end to the 'age of irresponsibility', but now the signals are for yet more borrowing.

If this downturn is to be avoided by boosting consumption, financed by borrowing and unmatched by increased production, the present difficulties may be mitigated but there will be trouble ahead. For if demand based on borrowing is increased, with sterling battered, the hideous spectre of inflation looms once again two or three years ahead.





By Sir Martin Jacomb
Chairman, The Share Centre

I wrote this article in mid-November. Everything that has happened since has underlined the validity of the message. The reduction in the Bank of England Bank Rate has hit savers again and the Government's borrowing plans are outrageous and will impoverish us for years to come. The VAT reduction shows that the Treasury's thinking is pathetically misguided. But I am rather encouraged by the fact that while in November my views were contrary to all accepted opinion, now many people are tending to agree, realising that we must save to create our own capital, and cease to live on the savings of workers in the Far East. It's called living within our means.

industry and commerce so as to increase investment in productive capacity and build something for the future? Publicly funded infrastructure projects could be brought forward. As another example the non-fossil fuel energy drive - one of the sectors that is currently favoured—is worth looking at. Whether with wind or nuclear energy, virtually all the relevant equipment has to be imported. Should we not start to develop our own (non-estuary) tidal energy capacity, benefiting from a devalued sterling? There are many other areas where productive government-assisted investment could be directed.

There are already different forms of tax relief available for personal saving for retirement. The complex rules for both individual savings accounts and self-invested personal pensions (SIPPs) were relaxed in 2006. But more needs to be done. Incentives must be substantial and complexity needs to be avoided. A scheme for savings accounts, with fully tax-deductible contributions, without maximum limits, could be the basis. The contributions would be investable in financial assets (as with SIPPs) and income from these would be tax-free. Withdrawal would be allowed at any time and would be taxable at that point. The requirement to delay withdrawal and buy a pension could be abolished; this would reduce complexity and increase attractiveness.

Action to control unemployment is obviously essential, for both societal and fiscal reasons; but a policy that is so blinkered that the importance of personal saving is disregarded is doomed, in the end, to failure. We should convert this catastrophe into an opportunity to rebalance our economy.

The above article was published in the Financial Times on 17 November 2008 and was written by Sir Martin Jacomb in a personal capacity. A week later, on 24 November 2008, the Pre-Budget Report 2008 was released that included plans for the launch of a new savings scheme in 2010, aimed at up to 8 million workers on low incomes, whereby the Government will add 50p for every £1 saved up to a maximum of £25 saved per month. On 4 December 2008 a 1% point cut in the Bank of England base rate to 2% was announced followed in January 2009 by a further 0.5% point cut to 1.5%.

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Meanwhile, the UK savings record is pathetic. Household savings as a percentage of disposable income have declined from 7 per cent (not an impressive figure anyway) to zero over the past 10 years. The Government has been encouraging this and has undermined saving over the past decade.

The destruction of private-sector defined benefit pension schemes, once the envy of the world, was an early example. The emphasis put on house ownership is another. The belief that an owner-occupied house is an 'investment' has been fostered. But to treat it as if it were all investment is a seductive misapprehension. It is an investment

only in so far as the occupants produce more at work (or in their gardens) or their children become better educated. Apart from this, the comfort and warmth of a home are a form of consumption. The house needs repairs, maintenance and heating. The idea that houses go on increasing in value so that everyone can sell at a profit and live happily in retirement is cruelly false in the long run. Yet people have been encouraged to believe that everyone should buy houses and that it is a safe investment that they can sell at a higher price, to provide for old age.

A new blow has now been delivered by this interest rate cut. The interests of savers should not be so lightly disregarded. A different emphasis is required. With interest rates falling, other incentives are called for.

One of the difficulties, however, is that such a change requires action from ministers and civil servants, who enjoy index-linked pensions that obscure the need for the rest of us to save for retirement. Increased saving obviously means less consumption, and it also means fewer jobs in house-building and retailing. But this is happening anyway.

The current crisis engenders fear and that increases the propensity to save. Why not encourage this, and focus on the extension of credit instead towards