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LONG-TERM SAVINGS IN AN ENTERPRISE ECONOMY: A CASE STUDY OF THE PRINCIPLES AND PRACTICE OF UK ECONOMIC POLICY.

JACK WISEMAN

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THE AUTHOR

Professor Jack Wiseman was the first Director of the Institute of Social and Economic Research at the University of York. Over his 20 year period of office from 1964 he was largely responsible for establishing the international reputation which the Institute now enjoys. He is now a Professor Emeritus.

Professor Wiseman is internationally recognised as an expert on public policy questions, as indicated by his election as President of the International Institute of Public Finance (1975-78). He is now an Honorary President of the Institute and a member of the Advisory Council of The David Hume Institute.

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FOREWORD

The David Hume Institute has already paid some attention to the problem of the accumulation of claims against future resources represented by long-term savings. Hume Occasional Paper 2. consisted of two essays on the philosophical and economic problems governing provision of retirement income, with poorer people in mind. A particular point made in these contributions by Norman Barry and myself was the lack of clarity in government policy concerning the financing of old age.

Professor Wiseman's paper works on a broader canvas. He, too, emphasises how important it is to be clear on the precise rationale for encouraging long-term savings. If the major purpose of such savings in an enterprise economy is to promote economic growth, in order to improve the quality of life for everyone, then a case is made for discriminating in favour of the encouragement of savings amongst the less well-off. If this is not done, we risk increasing the proportion of the population who are made casualties of the growth process, which is hardly a recipe for social harmony.

Professor Wiseman's highly original application of so-called public choice analysis to the savings problem is matched by some telling criticisms of government policy, as instanced in the consultative document of the Inland Revenue on the taxation of life assurance. That document highlights the contradiction between the government's wish to broaden the base of ownership to assets and the Inland Revenue's clear intention to protect the revenue from tax concessions for savings media. Yet, in the narrow range of savings media effectively available to poorer people, life assurance plays a major role.

Professor Wiseman is a member of the Advisory Council of this Institute, but his views are his own. The Institute has no collective view on any of the questions that he has raised and the answers that he has given to them. The Institute nevertheless welcomes the opportunity of publishing his Paper which fully accords the Institute's policy of promoting discourse on important policy questions addressed by experts, such as Professor Wiseman, in political economy.

Alan Peacock

Executive Director.
November 1988

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LONG-TERM SAVINGS IN AN ENTERPRISE ECONOMY:A CASE STUDY OF THE PRINCIPLES AND PRACTICE OF UK ECONOMIC POLICY*

by Professor Jack Wiseman

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I
INTRODUCTION

As the UK enters the second decade of change from a culture of dependence to a culture of freedom and responsibility, there is a growing awareness of the emergent conflicts associated with the process of change. This is not surprising. The initial need was to change men's hearts and minds, and the major thrust of policy could be towards areas in which the overriding objective could be accepted as the need to show that free markets worked. With the passage of time, that goal has been achieved. Everyone loves the market now, though some embrace it more hesitantly than others. At the same time, the centre of policy interest has moved increasingly towards areas thought to be of "social concern", about which citizens appear to be a good deal less clear as to how far and in what ways the free market writ should be allowed to run.

This has not of course escaped notice: it is piquant that at the time of writing the Labour Party conference should concern itself with the role of markets, the Conservative one with such issues as citizenship and social cohesion. But so far, the Conservative reaction has been stronger in moral response than in the articulation of a general policy framework capable of

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* I am grateful for advice and assistance of Professor E Victor Morgan, Professor Sir Alan Peacock, and the Association of British Insurers (Mr A G C Parish). They of course bear no responsibility for my conclusions.

generating workable policies, demonstrably consistent across areas and responsive to the caring feelings of citizens as well as to the continued effective pursuit of present goals. Conservatives assert with reason that belief in the virtue of free markets and individual responsibility is in no way incompatible with a concern for others: the striving citizen can also be a caring citizen. But it does not follow that Government policy need do no more than facilitate the private charitable activities of the caring citizen. There is more to the problem than that, as for example the citizens themselves have made clear (and, implicitly, the Government has accepted) in the course of the ongoing debate about the future of the National Health Service. But beyond legitimate insistence upon the need for "managerial efficiency", no coherent philosophy of policy has yet emerged.

In what follows, I shall outline what I believe to be an appropriate intellectual framework for the elucidation of appropriate policies, and shall illustrate this briefly by reference to current issues in the debate about public policies towards saving. This area of policy provides a useful illustration: the issues are practically important; there are proposals "on the table" in respect of the important savings medium of life assurance; and (perhaps partly because this is not a policy area commonly thought to raise broader "social" or other concerns) the relevance of some issues I believe to be practically significant are being ignored in the policy-making process.

II
A POLICY MODEL

Neo-classical economics, while undoubtedly helpful in explaining the behaviour of markets, is intellectually too constrained to be of much help in evaluating dynamic public policies concerned also with broader (including non-market) objectives. In Hume Occasional Paper No 8, [Simpson, 1988] Professor David Simpson argues cogently for the superiority of the dynamic political economy of Joseph Schumpeter [Schumpeter, 1976] for the evaluation of the policies of the last decade. Using such a model, he concludes that the policies of the Thatcher period have been conducive to faster economic growth, positive in the enhancement of individual freedom, and capable of attracting further support by accelerating the already established movement towards a wider distribution of ownership of property. But, he argues, the Schumpeterian paradigm also suggests that the policies must risk potential unpopularity if their benefits are perceived to be gained at unduly high cost in terms of instability or inequality. The continued expansion of personal freedom and evolution of a purer form of capitalism requires that "the potential unpopularity of these two side-effects be contained". It is an illuminating thesis.

Schumpeter is less helpful, however, in providing practical guidance as to the policies that this evaluation implies. He was concerned less with the nuts and bolts of policy than with the wider vision: what he saw as the inherent tendencies of capitalist and socialist development. His capitalism and socialism are painted with a broad brush (indeed, nothing like Schumpeter's "socialist blueprint" has, or arguably could, exist). Consequently, while "instability" and "inequality" are no doubt important concepts to many people, in Schumpeterian usage they are also portmanteau terms. Citizens are "against" instability and inequality in the same way that they are "against" sin: the breadth of agreement is inversely correlated with the degree of precision with which the terms are defined. For practical purposes, we need something more. What we need is to be found in the concept of libertarian public choice: a set of more recent ideas which I suspect Schumpeter would have found exciting.

The major virtue of a public choice paradigm for our present purpose is that it extends the logic of choice beyond the choice-through-markets which is the dominant concern of neo-classical economics, to combine all the choice-behaviour of men-in-society[1]. It recognises the need for a logic which treats a vote in an election and the purchase of an apple as part of an integrated choice-process. This trite observation generates more fruitful insights concerning the nature of the "good society" than are derivable from neo-classical economics. The insights of the libertarian public choice model are of particular interest. Summarily, the libertarian society treats the values of all citizens as carrying equal policy weight. This translates into a fundamental policy "rule": that no policy should be implemented to which any citizen objects. This stark requirement is less destructive of emergent public policy than might at first appear. It is quite compatible with the acceptance by individual citizens of policies against their direct interest, since they may regard the potential consequences of veto for the reciprocal behaviour of other citizens as more damaging than acceptance of the adverse proposal. In an ongoing dynamic society, that is, the notional right of veto can be translated into the proposition that the good (libertarian) society will be one in which citizens do not believe themselves to be **improperly coerced**. Coercion will not be absent, in that the individual members of the group we call "society" (or less arguably, the nation state) do agree to use procedures from which institutions and social rules emerge. They are coerced by these processes and rules: but with their agreement. An efficient situation is thus not one from which coercion is absent, but rather one in which its form is not believed by citizens to be unacceptable. The rules and procedures of the libertarian society will themselves be designed to minimise the potential for improper coercion, essentially by ensuring that citizens enjoy adequate power, either by the use of **voice** (eg by voting in ways that change their representatives and/or institutions believed to be unsatisfactory) or **exit** (eg by leaving the jurisdiction conceived to be improperly coercive).[2] Examples relevant to the UK would be the choice exercised by voters at local and national elections, and migration between local jurisdictions or countries. A useful current illustration is provided by labour market legislation, which has been concerned to a major extent with changing the voice and exit options open to individual trade union members.

It must be emphasised that this formulation cannot be expected to provide us with some "scientific" procedure for identifying the uniquely "right"policies for any particular purpose. It is a dangerous fallacy, too much encouraged by economists, to believe that such procedure exists. But it is still something more than an unnecessarily complex re-casting of the proposition that citizens with the rights and institutional arrangements to do so will reject governments whose policies they dislike. The libertarian public choice model directs attention to the fact that in a free society, it is the values of the citizens themselves, as transmitted through responsive social institutions, that should determine what is regarded as improperly coercive, and hence what is and is not acceptable public policy. The implications of this can be elucidated at the level of principle. Citizens may be expected to reject the coercion implied by the need to buy from a single supplier, for example, so that policies concerned with the control of private or public monopolies would seem to be implied. In another context, the unrestricted freedom to indulge in particular types of behaviour may be regarded as improperly coercive of others, so that some restriction of choice, eg about the consumption of alcohol or tobacco, may be regarded as fully compatible with the libertarian position. But these examples serve also to illustrate the practical complexity of the issues. Monopoly has diverse other implications: for example, property rights in invention (a driving force of economic change) are themselves a form of monopoly. Practically, monopoly legislation is complex, because its characteristics and the nature of the coercion they imply are also complex. In the case of choice-restriction, the libertarian would reject policies grounded in the proposition that some citizens "know better" what other citizens "should" consume. But some delegation of decisions to "experts" is not completely incompatible **in principle** with the libertarian position. All that is needed is that consent for such delegation must be obtained by the use of appropriate procedures: and consent must always be conditional, in the sense that there exist adequate mechanisms through which it can be withdrawn.

Further, there is no reason to assume that the values of citizens will be constant over time within a country, or identical at any point in time between countries committed to the libertarian principle. For example, supply of health care in the UK is primarily conducted by public sector agencies, while in West Germany the delivery system is quasi-private with heavy public sector involvement in funding. Citizens of both countries are dissatisfied with aspects of their system. The UK arrangements give suppliers a positive incentive to denigrate the quality of the care they themselves provide, and generate labour market problems not explicable by staffing ratios. The German arrangements generate ready access to health care, but at very high and intractable costs of supply. Attempts at expenditure control produce dissidence in specific areas (such as striking taxi drivers). Citizens of both countries are dissatisfied with the detail of their health care supply arrangements. But a substantial majority in each country would embrace the present general arrangements in preference to those of the other country.

The translation of libertarian principles into operating policies is thus no simple matter: the "right" policies need to be determined by reference to the circumstances and values prevailing at the time. But this reinforces the need for the issues to be clearly articulated. For the current policy situation in the UK, the approach directs attention to policy considerations that seem likely to be thought relevant to citizens, but which are not at present given the explicit attention in the policy-making process that their importance merits.

III
FREEDOM, RESPONSIBILITY AND CARING

In a libertarian society of the kind I have described, the role of government is to direct policy to the implementation of the values of individual citizens. This is easier to state than to achieve. Values must be expected to conflict: the practical goal is the achievement of a condition of acceptable coercion for most citizens. (Even this may be an unattainable goal: the Irish problem, and the many others like it around the world, provide evidence of situations in which there appear to be no practical means of satisfying the needs of a dissident group without creating a situation regarded as improperly coercive by other citizens. But it is noteworthy that there are few such situations in which at least one relevant group cannot plausibly be described as libertarian in its attitudes). Also, values may change, and a libertarian government may see good reason to try to encourage this. There is a time-dimension on the process of change: policies too far ahead of the values of the electorate carry the risk of rejection at the polls. It is the willingness to take this kind of risk that has distinguished the Thatcher period. The magnitude and character of the risks concerned are changing for two reasons. The focus of policy is shifting inevitably towards areas in which conflicts about values are to be expected; and, paradoxically, citizens must be expected to be increasingly concerned about "side-effects", the more they come to accept the desirability of the shift away from a culture of dependence which has been the prime objective of policy so far.

It seems to me to be possible, without succumbing to the economist's common temptation to assert what values **ought** to be relevant, to identify some problems that are likely to become important to voter-citizens.

An obvious problem concerns the risk which the shift towards an "enterprise society" must imply for individual citizens. This is most easily illustrated by a naive growth-model. Economic growth depends upon technological change. Change thus implies obsolescence, of both human and physical capital. A higher growth rate consequently carries the potential for better standards for everyone, but will inevitably worsen the situation of some. Since change is unpredictable, so are its casualties. If the growth-oriented enterprise economy is to be acceptable to citizens, it must find means to deal with these casualties which are not themselves destructive of continued growth.

This problem is well-recognised: it directs attention eg the need for re-training and aided mobility programmes, aimed at "fitting people back into the system", while avoiding continued welfare-dependence. The issue becomes more complex, however, when we add to it the problems associated with social structure. In a recent book, Professor Dahrendorf provides a useful taxonomy for our present purpose [Dahrendorf, 1988]. He distinguishes the 80% of the population able in principle to look after their own affairs, and the bottom 20% within which he distinguishes the "working poor" and the "underclass". The two groups appear to occur, in fairly standard proportion, in many developed countries. The working poor are identified essentially by low earnings, associated with low levels of intelligence, education and training. The underclass are the group with low attachment to the labour force and multiple social problems. These two groups have a policy importance beyond their numbers in two general ways. They generate caring feelings among other citizens (in that the value-systems of the latter include concern for the welfare of the "bottom fifth), and the first group may have special problems in undertaking greater personal responsibility: they have less capacity for "learning" and adaptation to change than others. While citizens generally will not expect the policies evolved to meet the special needs of these groups to inhibit the development of a libertarian society, they will wish to be reassured that there is a dimension to policy that reflects both caring generally, and the special needs of this group for time and facilities for "learning" and for adjustment to change.

(A practical example may help. "Workfare" policies, directed to the reduction of welfare dependence, have great potential for improving the socio-economic situation of some of the submerged group. But it is probably optimistic to think that this will much reduce public spending, since it is also to be expected that the casualty rate will be high: not everyone can escape dependence. Success needs to be seen less in the reduction of government spending than in the rehabilitative consequences of its redirection).

As observed, Schumpeter identifies instability as a threat to the evolving capitalist economy. The libertarian position would be that in principle, the growth rate of an economy should reflect the (saving and investing) wishes of its citizens. But in a world of nation states and national currencies, governments are not in a position to eschew a policy-making role. A plausible description of the expectation of citizens might be that government policy should be as neutral and general as possible, and that the general goal should be to "make the capital market work" (in that it provides the flow of funds needed to finance the rate of growth that citizens desire), while maintaining stable prices and a high level of employment.

There are areas (such as health care) in which risk-and-caring type problems are now recognised to be important (though their policy implications await satisfactory articulation). In other contexts, stability has been more significant (the curbing of inflation has been an ongoing and important goal). It is the thrust of my argument that both questions have relevance over a much wider range of policy issues than is currently being recognised: there is a growing need to "test" policy proposals for consistency with an underlying philosophy of the kind I have described. In what follows, I shall illustrate the argument by examining current proposals for new policies bearing on the taxation of life assurance. As I explained in I. above, the proposals are practically important, currently under discussion, and valuable for my purpose because they have important implications which are in danger of being ignored.

IV
A CASE STUDY: THE TAXATION OF LIFE ASSURANCE

Policy towards the taxation of life assurance is currently under discussion, the debate being focussed by a **Consultative Document** [Board of Inland Revenue, 1988], issued by the Board of Inland Revenue and inviting responses by end-October 1988. The document is valuable for my present purpose not only because of its topicality, but also it can be seen as part of a broader set of policies concerned with the treatment of savings. We can thus identify the arguments and proposals that the government considers necessary to improve policy in this area, and compare these with the policies that would seem to be indicated by the discussion in earlier sections. The comparison will exemplify the kind of policy approach I believe to be called for across the board.

The document is the most recent step in a process of reform of UK tax policy and financial institutions. The story may be taken to begin with the 1984 Budget, whose central theme was the tax treatment of savings. At that time the Chancellor stated a policy position on the taxation of saving. He rejected the possibility of a shift to an expenditure tax base (with the implied exemption of all savings from tax). But he also rejected the status quo. The goal was to be fundamental reform within the existent general tax structure. There was ample scope for such reform: the savings market was characterised by a welter of special provisions affecting the relative yields and security of every kind of saving instrument. In the circumstances, the need was for drastic measures rather than concern for the niceties of policy. In respect of life assurance, the manifest anomaly was the "tax shield" resulting from premium tax relief [Beenstock, 1983]. The 1984 Budget abolished this. There is a striking difference of view as to the implications of this reform which should be noticed. Informed comment at the time saw the measure as ameliorating the most serious problems. Summarily, it was considered that with removal of the "shield" it would no longer be the case that the greatest fiscal benefit accrued to life assurance contracts held for the shortest time. For the basic rate taxpayer, the tax treatment of life assurance would become essentially similar to the treatment of direct share ownership or the holding of unit or investment trusts. A non-taxpayer would be worse off saving through medium of life assurance than in these alternative ways, while the position of those paying high rates of tax would continue to depend upon detailed considerations such as the rate of inflation and the length of the contract [Hills, 1984]. The Consultative Document pays little attention to this evaluation, claiming rather that the yield of taxes on life assurance is still "too low", and inferring that one reason for this is the underpayment of capital gains tax. On the former view, the most significant anomaly would seem to have been dealt with, leaving need for a "tidying-up" operation, but one which might have been seen as part of the need for general review of the ninety tax allowances and reliefs listed in **Inland Revenue** Statistics. The official view suggests that, at the least, the tidying-up should be characterised by an increased tax obligation. While this difference of perspective is clearly important, I shall not evaluate it here: the issues will surely be examined, in the debate generated by the Document. But it becomes a matter of greater importance, the more the **Consultative Document** would have implications which have not been considered. It is this possibility that I shall address.

The character of the Consultative Document suggests that it is not implausible to treat it as a tidying-up operation. It was prepared by the Inland Revenue. The document specifies the policy objectives conceived to be relevant, identifies problems, and offers a menu of policy solutions about which opinion is solicited. This is done within what can plausibly be seen as a "departmental policy" context. The form of the Document, that is, encourages the belief that, while the broader issues of policy towards saving are seen as a matter for the Chancellor and the Treasury (and perhaps the Cabinet), the "tidying-up' operation is essentially a matter for the Inland Revenue. In the absence of any clear guidance, the Revenue has acknowledged the existence of broader considerations but interpreted its own policy problem by reference to the narrow criteria appropriate to its (taxation) function. This is in no way improper: the point is, rather, that in the absence of guidance from a more clearly-articulated philosophy of policy, the compartmentalisation of policy-making in this way carries unusual dangers in a period of fundamental change.

The Consultative Document is concerned specifically with the taxation of life assurance, and the policy objectives it identifies are essentially the objectives of the relevant tax system. The guiding criteria, "applicable to any tax system", are listed as:

- effectiveness and enforceability.

- equity and neutrality.

- certainty and simplicity.

- adaptability and flexibility.

- consistency and compatibility with the wider tax regime.

- the Government's broader policy aims.

These are used to identify the "significant specific objectives of a tax regime for life assurance", from which emerge the policy options about which consultation is invited.

In short, the standard orthodoxy: the criteria are a latter-day version of Adam Smith's celebrated principles of just taxation. But as is usual with such formulations, the acceptability of the specification depends upon the interpretation given to the criteria. Two are of particular interest: "equity and neutrality", and "broader policy aims".

"Equity and Neutrality" are interpreted as being concerned with the traditional specification of fiscal equity as the "equal treatment of equals", which in turn is taken to imply equality of tax liability across different forms of saving.

"The Government's broader policy aims" is simply lip-service. There is reference to the need for the chosen policy option to be compatible with the planned promotion of freedom of services across a common EEC market. No other aims are identified, nor do the suggested policy options make reference to them.

The policy issues look markedly different if we treat these notions seriously, by using the public choice model developed earlier. It is convenient to develop the argument in two stages, concerned respectively with the characteristics of life assurance as a channel for small savings, and with the role of life assurance in the provision of long-term capital. This has the convenience that, in a general way at least, the discussion can follow both the Schumpeterian categories (equality and stability) used by Simpson, and the identification of an equity goal in the Consultative Document. But the parallel is no more than structural. It is apparent from my earlier argument that I shall give a different interpretation to these somewhat nebulous concepts; and the arguments of the two stages are in any case closely integrated from a policy point of view.

V
LIFE ASSURANCE IN HOUSEHOLD SAVING

The Financial Secretary to the Treasury has stated that the case for reform is taken as established: "consultation" can affect only which of the suggested policy options will be chosen. Each of the options would have complex consequences for the tax treatment of life assurance. But for my purpose, which is to examine whether such a position is plausible when evaluated against a broader policy background, it is enough to treat all three suggested options as implying a rise in the cost (fall in the yield) of this form of long-term saving. The question to be addressed in this Section is whether such a change would be likely to have policy consequences that escape the Inland Revenue's narrow interpretation of policy objectives.

To answer this question requires us to identify the role and characteristics of life assurance in the overall pattern of savings in the UK. Empirical information concerning savings is not very reliable, but a scrutiny of the evidence provides some clear pointers as to the importance and character of the life assurance medium.

Total Savings and Savings through life assurance

Tables 1 and 2 show the place of the life assurance in total savings. It is clearly an important savings medium. It is also unusual, in that life

TABLE 1:

TOTAL AND HOUSEHOLD SAVINGS, SELECTED COUNTRIES, 1971-86

	1971-3(av.)		1977		1981		1986	
	Savings as % of GDP							
	Total	Household	Total	Household	Total	Household	Total	Household
UK	9.2	4.0	8.26	6.96	4.86	9.13	6.04	4.88
W GERMANY	15.8	8.6	10.73	7.91	7.97	8.95	11.06	7.69
FRANCE	14.9	8.7	11.46	13.54	7.78	13.4	7.69	9.26
USA	7.7	5.9	6.84	4.75	5.76	5.43	2.47	2.91
JAPAN	26.7	15.2	19.62	15.87	17.88	12.82	18.46	11.41

Source: OECD National Accounts

TABLE 2:

SHARE OF LIFE ASSURANCE PREMIUMS IN GROSS DOMESTIC PRODUCT, 1977-1986

	Life Premiums as % of GDP		
	1977	1981	1986
UK	2.80	3.24	4.95
W GERMANY	1.95	2.29	2.53
FRANCE	0.93	1.06	1.83
USA	2.58	2.59	3.57
JAPAN	3.0	6.68	5.75

Source: Sigma

assurance is a specially important form of saving for particular social groups. This Section provides evidence concerning this, and comments upon its implications for the proposed policy changes. The following Section turns to the special position of this form of saving in the UK savings market, and the broader implication of this for the long-term performance of the economy.

Sources of evidence as to who buys life assurance are scattered, but their cumulative weight is persuasive: it is *par excellence* the savings medium favoured by the lower income group with the poorest set of alternative long-term saving options.

The Ownership of Financial Assets

Table 3 uses Inland Revenue data to show the estimated wealth of individuals, distributed by type of asset and total wealth. The estimates are compiled for capital transfer tax purposes, and need to be treated with caution. It is very probable that the numbers seriously under-estimate the importance of assurance. Specifically, large numbers of industrial policies are never assessed for capital transfer tax. (These are "home service" policies, premiums on which are collected at the policyholders' homes at intervals of less than two months.) There were over 25 million such policies existent in 1987 (Association of British Insurers, **Insurance Statistics 1983-87**). Table 3 shows that, apart from equity in occupational schemes (not included here), the total value of life assurance policies (over £109 Bn) is greater than that of any other financial asset. Of the 9 million policies, 21% were held by people having net assets of less than £10,000, 44% less than £25,000 and 76% less than £50,000. By value, nearly half the policies were held by people with net assets of less than £50,000. In contrast, the ownerships of the other assets is concentrated in the higher wealth categories: 30% of government securities (including National Savings securities), and only 8% of listed and 3% of unlisted securities were held by persons with less than £50,000 of net assets.

TABLE 3:

ESTIMATED WEALTH OF INDIVIDUALS IN 1985

(Selected Assets by Range of Wealth)

		RANGE		
	TOTAL	Per Cent of Total		
TYPE OF ASSET		UNDER £10,000	UNDER £25,000	UNDER £50,000
Policies of Insurance				
Number (000S)	9,089	20.9	44.3	76.2
Value(£Million)	109,045	4.1	16.6	46.0
UK Government Securities				
Number	5,617	20.6	40.7	70.8
Value	20,639	4.2	11.0	29.7
Listed UK Companies				
Number	2,328	11.4	28.4	59.0
Value	36,563	0.6	2.9	8.1
Unlisted UK Companies				
Number	570	0.5	10.7	28.8
Value	15,199	-	0.6	3.1
Cash and Deposits				
Number	12,602	22.8	46.6	76.0
Value	90,610	7.2	21.8	46.5
Total Net Wealth				
Number	16,628	28.6	52.7	80.1
Value	603,358	3.6	15.2	42.0

Source: Inland Revenue Statistics, 1987, Table 7.3

Whatever the data difficulties, it seems safe to conclude that life assurance is a savings medium of special and major importance to those with little wealth, which in turn (insofar as there is any correlation between earnings and the accumulation of wealth) would suggest that it is likely to be a medium of great importance to lower income-groups. The Family Expenditure Survey suggests that this is indeed the case.

Expenditure on life assurance by occupational grouping

Table 4 brings out the wide penetration of life assurance across occupational groups. The proportion of households with some cover ranges only from 71.6% for unskilled manual workers to 84.9% for the administrative and managerial group. Insofar as the occupational groupings can be roughly correlated with size of income, life assurance saving is shown to rise with income, but to be significant even for the lowest income-categories (unskilled manual workers and shop assistants). Given the amounts shown as spent on life assurance by occupational groups, the fact that the figures exclude policies converted to a paid-up basis (around 20 million in 1987), and the much larger numbers in the lower-income occupations, Table 4 provides convincing reinforcement for the view that life assurance is the dominant long-term saving instrument of the less well-off.

Survey evidence

A survey undertaken for the Life Offices' Association in 1970 is the only evidence of the kind I have uncovered. Although dated, it is instructive. 78% of the households surveyed had private life assurance policies. About three-quarters of these had an agent calling at their houses. 36% made weekly premium payments, 27% every four weeks and 17% calendar monthly payments, which suggests that something between two and three-fifths of all premium transactions were in cash. The proportion will be smaller now, as this type of business has grown less quickly than life assurance generally. But new industrial life assurance premiums still accounted for 14% of all new yearly individual life assurance premiums in 1987 (**Insurance Statistics, 1983-7**).

TABLE 4:

EXPENDITURE ON LIFE ASSURANCE BY OCCUPATION OF HEAD OF HOUSEHOLD (1986)

	Professional and technical	Administrative and managerial	Teacher	Clerical	Shop assistant	Skilled manual	Semi-skilled manual	Unskilled namual	self employed	retired	Unoccupied
ANNUAL EXPENDITURE	609.5	551.2	494.9	378.0	241.7	366.2	315.6	266.2	828.7	127.2	211.3
%[1]	77.3	84.9	81.2	70.8	71.4	84.5	77.8	71.6	83.9	57.6	53.6

(1)Proportion of households with some expenditure

source: Family Expenditure Survey

It should be noted that those who carried out the original collection and analysis of the family expenditure survey data bear no responsibility for the further analysis shown in Table 4, nor for the interpretive comment given in the text.

Life assurance was seen by those surveyed as providing long-term protection by way of a guaranteed future sum, and as a "favoured" method of saving, though it was seen to provide inadequate protection against inflation. "Investment", in contrast, was thought to be long-term, risky, but carrying a potentially high return. But the level of understanding of savings media was not high. The role of the agent was central, not simply as salesman but as adviser and influence on savings behaviour. The two most important influences on the assurance decision were parental experience and the advice of the assurance agent, who acted as "catalyst" and even as adviser as to "what the household could afford".

The emerging picture is of a form of saving popular across a wide spectrum of income and occupational categories, but one whose relative importance is greatest for the lower income groups. This importance is the greater in that, while life assurance is essentially a long-term savings medium, the evidence suggests that the perceived alternatives are government securities and cash and deposits. Although some part of National Savings may be for long-term (life-cycle) purposes, it seems unlikely that the proportion is very large. The other options considered practical for the low-income saver would thus appear to be more liquid and potentially more transient than life assurance.

For this group, the likely consequence of a reduced yield to life assurance saving would be a shift into more liquid markets such as National Savings and building society deposits, with a clear risk of overspill into current consumption.

The value of a broader policy framework will now be apparent . The group we are concerned with ranges upward from Dahrendorf's working poor through the lower range of skill and income-brackets, and arguably comprises a significant proportion of the employed population. More important, it is precisely the group likely to encounter problems in adapting to an enterprise culture (and hence most in need of reassurance and encouragement), and the one whose problems are likely to be of concern to other citizens. Specifically:

(1) At the bottom of the scale are Dahrendorf's working poor. The savings of this group must be negligible, since they are the group which finds it difficult to subsist on earnings. (When it is recognised that they are part of the "unskilled" occupational groups, the 70+% participation of those groups in life assurance (Table 4) becomes an even more striking demonstration of the importance of this medium for the less affluent). In the eyes of the citizens generally, the success of policy in facilitating the escape from dependence of this group is likely to be important to their continued commitment to an enterprise culture. It is not an easy problem, and one that is unlikely to have a complete solution. But it seems clear that the encouragement of thrift must have a role to play in reducing the number or ameliorating the condition of the working poor. The long-term saving medium to which they seem most likely to turn is the one most familiar to their peer group: the life assurance policy.

(2) For the lower income groups as a whole, the effective choice of savings medium is a narrow one. The ones I have identified: national savings and building society and bank deposits, do not have the same long-term characteristics as life assurance and are more likely to result in shorter-term deferred consumption. For the more sophisticated, unit trusts and shareholding become possible options. But the Tables do not support the view that they are realistic options for many, and while this may be seen as a situation that an enterprise culture will change, it would be unrealistic to expect the change to be particularly large or particularly rapid. The attitude of the Government is curious. In a recent speech to a Wider Share Ownership Council conference, the Financial Secretary asked:

> "Why is it that low cost share dealing and advisory services are so difficult to obtain, when in contrast, life assurance salesmen seem to appear on the doorstep all too often?"

The speech offer for consideration a set of possible measures, including tax concessions, that would encourage wider share ownership. But it recognises that the process will take time, and the evidence adduced (eg from USA) suggests that the share ownership option is most realistic for those with larger savings and more financial sophistication. The negative attitude to life assurance is nowhere explained directly, but appears to originate in a critical view of what is seen as the short-term attitude to investment policy of institutional investors. The ongoing importance of life assurance as a savings medium for lower income groups is nowhere recognised. In a libertarian society that cares about the escape from poverty, there is an inconsistency between the simultaneous support of policies proposing tax incentives to encourage higher-income groups to diversify their savings behaviour, and policies which would worsen the position of lower-income groups whose savings options are already narrower. It would surely be closer to the perceptions of a libertarian community to see the problems and policies as complementary, with the benefit of fiscal advantage, if any, going to those currently most disadvantaged in the savings markets?

(3) These arguments are reinforces by the need for public policy to facilitate **learning**. The reaction of citizens to the need to take personal responsibility for important economic decisions is going to be influenced by their perception of their actual or potential competence. Libertarian policies will be the more acceptable, the more citizens perceive them to be designed to provide time and facilities for learning how to make decisions. In the speech referred to above, the Financial Secretary expressed concern over the time it was taking financial environment embracing small potential investors. If the market specialists need time and find difficulty in adapting to a more open and competitive environment, how much more severe must be the problems of savers, and lower income-savers in particular, in coping with unfamiliar financial decisions of major importance to them? Yet there seems to be little concern to facilitate learning by the group who most stand in need of help. The life assurance "man on the doorstep" clearly has an important role to play, in helping the groups concerned to adjust to the serious complexities associated with the "privatisation" of retirement pension arrangements, and in encouraging voluntary long-term savings. For a considerable proportion of the working population, this would appear to be a necessary first step toward such more ambitious goals as wider share ownership. From this point of view, a worsening of the yield to their most significant form of potential saving (and learning medium) would seem to be contrary to the Government's broader goals.

VI
LIFE ASSURANCE, STABILITY AND GROWTH

I have pointed earlier to the need to define "stability", and offered an interpretation relevant to a libertarian society: that, consonant with the maintenance of a satisfactory growth-rate, citizens will expect that the inevitable casualties of technological advance will be helped, but by policies focused on rehabilitation rather than simple income-maintenance or compensation. But there is another question, concerned specifically with savings: what savings are going to be needed to sustain the desired growth-rate, and what role is life assurance expected to play in providing them?

It seems a straightforward question. But it is not easy to interpret, much less to answer, for two reasons.

First, in an ideal libertarian world, the "desired growth-rate" of a community would be the outcome of the choices of individuals using competitive markets to channel their preferences about current consumption, investment and saving. This is an unrealisable vision for a world of nation states exercising monopoly power over national currencies and taking nationalistic attitudes to matters such as international trade. It is not an option for a government in such a world to be "neutral" in respect of growth and stability, save in the general sense that its policies are intended in principle to interfere as little as possible with the decisions of citizens pertinent to long-term growth, but are concerned essentially to ameliorate the inevitable and unpredictable short-term instabilities. But there will always be room for disagreement as to the practical policies implied by this philosophy at any point in time: and the short-term policies adopted may well affect long-term growth. Nevertheless, I propose to leave this important question aside. Short-term policy problems notwithstanding, it is still of interest to investigate the probable implications of the evolution of the UK economy for the volume and structure of long-term savings.

The second difficulty concerns our understanding of the growth process. The relationship between savings behaviour and economic growth is poorly understood. An inspection of the ratios of savings to gross domestic product in different countries shows no consistent relationship, and the differences are not explicable simply by statistical observation [Hitiris and Wiseman, 1972]. Table 1 provides some comparative information. Of the countries surveyed, Japan has historically by far the highest savings ratio, USA the lowest one. (A wider sample would only compound the confusion. The savings ratio of USA and Ecuador, for example, were similar at the beginning of the period). UK has had the second lowest savings ratio in the group, around one-third of that of Japan and at the lower end of the EEC countries.

At the beginning of the period surveyed, household savings accounted for a rather smaller share of total saving in UK than in the other countries, and a markedly smaller share than in USA. Over the period, household saving fell everywhere as a share of GDP in 1981, but had returned to earlier levels by 1986 in European countries. In contrast, household savings remained significantly below beginning-period shares in both the lowest-savings-ratio (USA) and the highest-savings-ratio (Japan) countries. Total savings were everywhere below historic levels in 1986, and household savings were generally a significant part of the total.

The evolving role of life premiums in this pattern is in interesting contrast. Life assurance premium income corresponds more closely in character to gross than to net saving, so that Tables 1 and 2 are not strictly comparable. I do not believe however, that the picture they present is seriously misleading, particularly in respect of the comparative changes in the countries concerned through time. Table 2 shows that UK, a low-savings ratio country, has the highest ratio of life premium saving in the group save for Japan, in which country this form of saving is a much smaller component of the unusually high total savings ratio. (Even so, the Japanese premium ratio was below that of UK in 1974 and 1975).

The annual savings ratios are affected by a variety of local influences, and I would not suggest that undue weight should be attached to them. For example, one reason for the fact that life premiums were higher than total household savings in UK in 1986 was clearly the behaviour of the housing market and the financial consequences thereof. But some broad conclusions about the trend of the UK situation appear to be supportable.

UK's growth-performance has traditionally been associated with a comparatively low savings ratio. This ratio declined throughout the 1970's and is currently around two-thirds of historic levels. Until around 1983, household saving was accounting for an increasing proportion of the total.

Since then, the growth in consumer borrowing (particularly for house purchase), rising corporate savings helped by the improvement in company finances, and the emergence of a public sector surplus, have checked this trend. The life assurance savings medium has been, and continues to be, of unusual importance within this low savings performance and as a major contributor to household saving. It has grown both in absolute share of gross domestic product and its contribution to household savings. By any criterion, its behaviour must be of crucial significance for the behaviour of the capital market and the UK economy.

This provides a background against which the proposals of the Consultative Document can be interpreted. I have already pointed to the absence of any trustworthy general theory of the relation between savings and growth, and from here on shall use the comparative evidence simply as background, save for two propositions.

(1) The importance of changes in the "transmission mechanism" (of savings into productive investment and growth) will be the greater, the higher the growth-rate that is being sustained by a given volume of savings. The kind of policy proposals here being considered are thus of peculiar importance for a country with the savings market characteristics and recent policy history of UK.

(2) Household savings occupy a special place in the growth-process:

> "In general, corporate savings are applied directly to finance capital outlays of the saver .... The same is true to a large extent of saving in the public sector .... The main business of financial intermediaries and of the markets in which they operate is to mobilise household savings and transform them into loans for the private corporate sector, for the public sector, and, in some cases, for overseas borrowers. The more important the saving and lending of the household sector becomes, the greater will be the opportunities for growth and

> development in capital markets, and the more important will be the efficient operation of these markets for the general health of the economy." [Morgan and Harrington, 1977, p309].

This suggests a scenario. For the financial markets, the changes associated with what I have described as the escape from dependency implies a reduction in the role of the public sector and a growing role for private funding, with household savings coming to account for a growing share of total savings. This shift of itself should enable the achievement of a higher sustainable long-term growth-rate for any given savings ratio. But, given the relatively low total savings ratio, it also seems likely that any marked improvement in the long-term rate of growth, once the initial "slack" in the economy has been taken up, is going to require a long-term rate of growth of the capital stock achievable only through a higher savings ratio.

It is illuminating to confront this scenario with the evidence. It is an interpretation which is consistent with a whole set of Government initiatives, such as state and occupational and personal pension arrangements, reductions in tax rates, and a range of specific incentives to private savers (Personal Equity Plans are a particular example). In this regard, the proposals of the Consultative Document, which would reduce the yield to a form of savings important to a group with least satisfactory recourse to alternative savings media, stand in contrast to the general thrust of policy towards saving.

The predicted shift in the growth-rate has also occurred. Currently, the UK economy is enjoying a higher rate of growth than most developed countries. The change in the performance of the economy over the period under review has been quite dramatic, and marked by a significant rise in worker-productivity since the 1980-81 downturn. The change has not been characteristic of developed countries generally, and few would question its association with the shift from a dependency to an enterprise culture. There is consequently a growing belief that the change could signal the beginning of a new trend, with the economy achieving a sustainable growth-rate of some 3-4% per annum.

However, when we look at the behaviour of savings, the evidence becomes less straightforward. There is no clear rising trend in the household savings ratio, which was only a little higher in 1986 than in 1971/3. (Only the ratios of USA and Japan changed (fell) significantly over the period). Household saving has become more important in total savings, but this appears to be because the total savings ratio has fallen significantly (again, in common with other countries in the sample). Life premiums again provide a contrast: the trend is consistently upward, and the ratio and rate of growth higher than in any country save Japan.

It could be argued, of course, that there has not yet been enough time for the long-run consequences of recent changes to become clear. But the same might be said about confidence in the sustainable growth-rate. To put it no higher, the evidence (which continues to be confirmed by more recent information) does not support the view that savings are yet behaving in the fashion that is needed to support the kind of growth-rate that the community is coming to expect. If this is so, then, other policy considerations apart, the discouragement of life assurance saving would seem to be contrary to purpose. To discriminate against the form of savings which most nearly fits the growth scenario. the government must believe, first, that the future rate of growth of other forms of household saving, together with the government saving implied by a higher yield from life assurance taxation, will be enough to sustain the desired growth-rate despite the discouragement of saving through life assurance; and, second, that this reversal of recent experience will occur quickly enough for the growth rate not to become unsustainable.

At the time of writing, the evidence to support such beliefs is less than overwhelming.

VII
CONCLUSIONS AND SUGGESTIONS

It has been the theme of this paper that, as the benefits of the shift from a culture of dependency to a culture of enterprise have come to be more widely recognised in the UK, the importance of the inescapable side-effects of the change has begun to grow in policy-significance, and this is now being further reinforced by the shift in the focus of public policy towards areas in which citizens are commonly concerned for the welfare of others. While these developments are generally recognised in principle, it is no longer enough for policy-making to proceed on the assumption that all the problems can be dealt with simply by encouragement of the "caring citizen". There is a growing need for a better-articulated general philosophy of policy across policy areas, to produce an overall package that reflects the caring feelings of citizens consistent with the continued pursuit of libertarian goals. The policy model I consider appropriate for such a purpose is that of libertarian public choice, and I have illustrated its potential utility in relation to the topical policy issue of the tax treatment of life assurance. This provides a useful "test bed", since the policy arguments presented in the Consultative Document can fruitfully be contrasted with those that would be supported by the proposed broader policy framework.

The three policy options offered for discussion in the Consultative Document would all in different ways have the consequence of raising the price (reducing the yield) of life assurance to policy-holders. My concern has been to evaluate this intent in the broader policy context which I propose. This directs attention to important issues neglected by the Document. Summarily:

(1) Life assurance is the dominant form of long-term saving for a significant sector of the community, ranging from the "working poor" (who have negligible voluntary savings but are in particular need of encouragement if they are to escape dependence) up to those in higher earned-income brackets whose members can plausibly be believed to have access to alternative long-term savings instruments such as unit trusts or share ownership. For most members of this group, the savings market offers an unavoidably narrow range of choice, and the discouragement of participation in life assurance is specially likely to result in reduced long-term saving rather than a switch to other saving media.

(2) The argument at (1) is reinforced by the fact that the group concerned stands most in need of help in coping with the transition towards self-reliance in respect of savings. In the context of the libertarian public choice

policy model, it is also the group whose savings habits are most likely to be of concern to citizens generally. The apparent prejudice against the life assurance "man on the doorstep" would appear to be out of sympathy with this. It also accords uneasily with the Government's failure to make any provision for "learning" by this significant group, while showing much more active interest in such ideas as the fiscal encouragement of wider share ownership, designed to broaden the savings behaviour of the already more sophisticated.

(3) If the higher growth-rate which the UK economy has now achieved is to become established as a long-term norm, this is likely to imply the need for a larger proportion of gross domestic product to be channelled into savings, and for a larger share of this to be accounted for by the savings of households. The evidence so far provides no convincing support for the view that household savings have begun to respond in the fashion that is likely to be needed, nor does the Government policy suggest any consistent awareness of the existence of a problem. True, the Government has demonstrated interest in the encouragement of particular kinds of saving. But it has also pursued policies that actively encourage dissaving elsewhere. This is most strikingly evident in respect of housing. Whatever the other merits of the policies, mortgage interest relief, sale of council houses to tenants at favourable prices, and constraints on the building of new council houses, have together generated an enormous expansion of borrowing for house purchase, some of which appears to be leaking into the finance of other goods and services. If to this is to be added the proposed discouragement of household savings implied by the life assurance proposals, it must be questioned whether the savings needed for sustained growth are going to be generated.

Use of the broader policy framework suggest, then, that the Consultative Document proposals are misguided in principle, in that the rationalisations which are undoubtedly needed should be aiming at a reduction rather than an increase in the level of taxation of savings. It would also seem that the problems which the Document addresses are probably much less important than other anomalies in the savings and related markets that the Government has so far been unwilling to tackle. The most obvious target for attention would seem to be that of continued fiscal dependency at higher levels of income, the most striking example of which concerns mortgage tax relief. Reluctance to deal with middle income fiscal dependency seems to be fairly clearly attributable to a belief that the "caring citizens" in this group would reject any government that simply abolished such privileges as mortgage tax relief. The belief may be well-founded. But the Government has succeeded in converting the sceptics about other aspects of the escape from dependency. The time and effort expended upon such relatively minor activities as the tidying-up of policy towards life assurance might be better directed to this larger and potentially more significant issue. It should not be beyond possibility to devise a phased package of policies, combining benefit from general tax reduction and loss from removal of specific allowances, that would promote libertarian ideals without unduly alienating short-term political support. It would certainly be worth the effort, since it is through such policies, rather than the one I have been examining, that the Government is likely to retain the support of those most likely to begin to doubt.

NOTES

(1) The development of the theory of public choice begins from the publication of **The Calculus of Consent** [Buchanan and Tullock, 1962]. Useful background reading relevant to the policy model being developed here is to be found in the writings of James M. Buchanan [see e.g. Buchanan, 1987].

Since the term "libertarian" has a specific meaning in this context, elucidation may prevent misunderstanding. The essential characteristic of the libertarian society is that the values of all citizens should carry equal weight in the determination of policy. This in no way implies that the motives of citizens are entirely selfish. It is completely consistent with the libertarian position that citizens should care about (attach value to) the welfare of others, and that they should believe that some of these values can best be given expression through the agency of government.

(2) The exit option is affected by the citizen's perception of the available alternatives, as well as by conditions in his present jurisdiction. The costs and benefits attaching to movements between sub-jurisdictions within one country, for example, are likely to be very different from those involved in emigration to a new country. The notions originate with Hirschman [Hirschman, 1970].

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