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Saving and Asset-Building in Low-Income Households

Tony Dolphin

December 2009

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This paper was first published in December 2009. © ippr 2009

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Acknowledgements

ippr would like to thank the Consumer Spending and Debt project's funders, Friends Provident Foundation, and the advisory group: Jim Fearnley, Money Advice Trust; Andrea Finney, Personal Finance Research Centre; Milla Gregor, Toynbee Hall; Suzanne Hall, Ipsos MORI; Martyn Saville, Which?; Danielle Walker Palmour, Friends Provident Foundation; and Judith Wardle, Wardle McLean. Thanks are also due to Dalia Ben-Galim and Kate Stanley at ippr for their comments on this briefing.

Finally, a big thank you to all the families who took part in the research for their time and input.

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Executive summary

Having a store of 'rainy day money' can increase a low-income family's resilience and enable it to cope better with an unexpected shock, such as the breakdown of a washing machine or even the loss of a job. Storing up assets can increase opportunities, by, for example, providing the funds to support children when they go to university or to pay for training. But most low-income families find it very difficult to save, other than for specific events already on the horizon.

ippr's new study of the income, spending, saving and borrowing of 58 low-income families reveals that most have a positive attitude to the idea of saving, but find it very difficult to translate that attitude into actual saving for any length of time. Most families cope well with the task of saving for Christmas, birthdays and the school holidays, often by using informal methods, which range from keeping money in a jar to Christmas clubs organised by family or friends. But most do not manage to build up any precautionary savings. As a result, when the washing machine or boiler breaks down, they are forced to take on debt to pay for repairs or a replacement. And very few low-income families are doing any saving for the medium term, even though many would like to do so for their children.

The recession has had an effect on the ability of some low-income families to save – where a wage-earner has lost their job or had their working hours reduced. But perhaps more significant in the last two years were the double-digit percentage increases in food and energy prices in 2008. Families reported that spending more on these items meant it was even less likely there would be money left over to save.

This highlights how low-income families, quite reasonably, regard precautionary saving and long-term asset-building as optional, residual activities and helps to explain why their saving activity is so low. Survey data suggest that 44 per cent of families with a weekly income of less than £200 have no savings (Department for Work and Pensions 2009).

However, behavioural economists believe that saving can be increased through a combination of incentives. The most effective savings products for low-income families combine making saving as easy as possible (or even automatic), while providing an incentive for savings to be retained, for example through a savings match. Such products can now be found around the world. They are not for all families – some will still not have the capacity to save. But they can help those that might be able to put a little aside from time to time. In the UK, the Child Trust Fund and the soon-to-be-introduced personal accounts for retirement savings make saving easy through auto-enrolment, while Saving Gateway accounts will match savings after a two-year period.

ippr is now proposing a savings account, backed by the Government, that will encourage low-income families to save throughout their lives. Our research shows it needs to be simple, easy to monitor and access and might pay 'bonuses' rather than interest. The Government should provide incentives for retaining savings, but the account must allow some flexibility for withdrawals. If such a product were made available, and the right financial information provided alongside it, our research suggests that low-income families would take the opportunity to build some precautionary savings, and perhaps even accumulate a modest store of assets. This would help low-income families by making them more resilient to shocks and better able to take advantage of opportunities.

The costs of extra incentives to encourage low-income families to save could easily be covered by limiting tax relief on pension contributions to the basic rate for everyone. This would be a progressive move, replacing tax relief that now benefits those on high incomes to improve the financial wellbeing of those on low incomes.

Introduction

There are numerous studies that show having a store of readily-accessible assets increases the wellbeing of households (see, for example, Paxton 2003). For the most part, these studies emphasise the financial benefits of assets. For example, it is suggested that:

- Assets built up during childhood might be used to finance further education or training after leaving school.
- For those of working age, assets can be used to cover an emergency, such as the loss of one's job or a period of serious illness; to pay for retraining or adult education; or as a deposit on a house.
- For older people, having a store of assets can boost living standards in retirement.

However, there is also evidence that, for many people, a store of assets provides a psychological benefit, too. Knowing that they have some funds to fall back on, if necessary, improves people's current wellbeing, even if the likelihood of having to access the funds is low. Assets increase a person's resilience to shocks and thereby improve their quality of life (see, for example, Lister 2006).

It is also well documented that low-income households struggle to save and that most have few, or no, assets. As one of the families in our study put it:

> *I suppose because I am really not in a position to save or think of any long-term plans, because I basically live from day to day on the money that I get, so I just get on with it … I don't even think about it [saving]. It is awful, I suppose you should really.*
> (Female, 45, Nottingham, single-parent household, one child)

When asked, the majority of low earners say they do not save because they cannot afford to. People on low incomes have disposable incomes that are barely sufficient for their day-to-day needs and there is nothing left for saving. However, researchers debate whether this explanation is adequate. While in some cases it may be true that households literally have nothing left over after providing for the basics of shelter, food, clothing and heating, in some cases a failure to save appears to be the result of a conscious decision to spend all available income. Saving seems simply not to be a priority.

ippr's research

This paper reports the results of research designed, in part, to examine how low-income families manage their budgets. It presents some of the findings from a study of the income, expenditure, saving and borrowing of a sample of 58 low-income households, and from interviews with those families to discover what drives their behaviour. It examines what low-income households understand by 'saving'; how low-income households save; and how the economic events of the last two years might have affected their saving behaviour.

The analysis suggests that low-income households are, in fact, good at managing their budgets. While a few do adopt a 'live for today' attitude and are happy to spend all their income (something that is true of all income brackets), most say they would like to save more in order to build a store of assets for their children and to make their family more resilient. These households might be responsive to products and incentives that would encourage them to save and, importantly, to retain their savings until they are really needed. If they can be encouraged to build a store of assets, it could make them more resilient to shocks and so improve their wellbeing.

Research methodology

The findings in this paper are based on research that employed an innovative methodology. We interviewed 58 low-income families (see box) with children below working age, located in Glasgow, London, Newcastle upon Tyne and Nottingham. The families then completed a detailed diary of income, spending, saving and borrowing for a month before participating in further rounds of interviews. Overall, each family's experiences were monitored over a four-month period, making it possible to understand the decisions the families were making around spending and saving in some depth[1].

The sample of families was selected to cover a range of household sizes and types, with some variation in ethnicity and employment status:

- There were 34 two-parent households, 22 with a single parent and two living in extended households (with family or friends).
- The families had between one and five dependent children.
- 45 of the heads of households (self-selected to answer questions on family finances) were female[2].
- The age of the participants ranged from 21 to 50 years old. 14 respondents were aged between 21 and 30, 19 between 31 and 40, and 25 between 41 and 50.
- 50 households were white British, four were British-Asian, two were mixed race (white British and West Indian) and two were not UK nationals (Sri Lankan).
- 16 of the households included someone with a disability, reflecting the prevalence of carers and the disabled among low-income households.
- 22 households (16 of them two-parent households) had mortgages. Two single mothers and one couple owned their house outright. 33 rented, of which 15 had their rent paid by housing benefits (11 of them single mothers).

How do we define low income?

A broad definition of low income was used to allow the selection of a range of households. The selection criteria were based on a measure of equivalent income (equal to below £226 a week, or £11,752 a year, for a couple with one child). Other criteria such as household size, ethnicity and employment status were also considered.

The sample was also selected to encompass the diversity of income among low-income families, to allow for comparisons across different social and economic circumstances. Figures 1 and 2 (next page) show household equivalent incomes for the families, measured before and after housing costs, and compare them to the median and poverty line incomes. On both measures, about one quarter of the families were below the poverty line and over three quarters below the median income.

During the course of the research, the employment situation in several households changed, creating fluctuations in levels of income and expenditure, which enabled the research to capture the fluid nature of employment for many low-income families, particularly in a

1. Primary research was conducted between December 2008 and May 2009. Face-to-face interviews were conducted in December 2008 and January 2009. Families were then asked to complete a diary for a month. Between February and May 2009, researchers contacted participants at regular intervals to see if there had been any significant changes to income or expenditure. Final interviews were conducted in April and May 2009 with 52 families. Six families dropped out in the later stages of the study but have still provided data from the earlier stages.
2. This might have some effect on the findings because previous research has found the way people save is often gendered. Westaway and McKay (2007), for example, found only men low to moderate income families are dismissive of the whole notion of saving.

Figure 1. Household weekly income before housing costs (2008)
Source: ippr

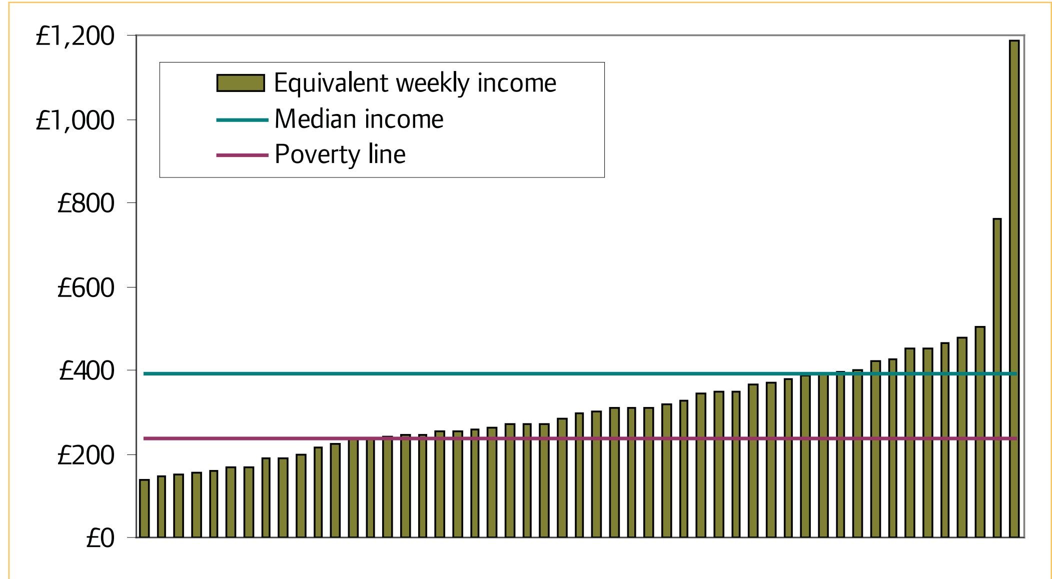
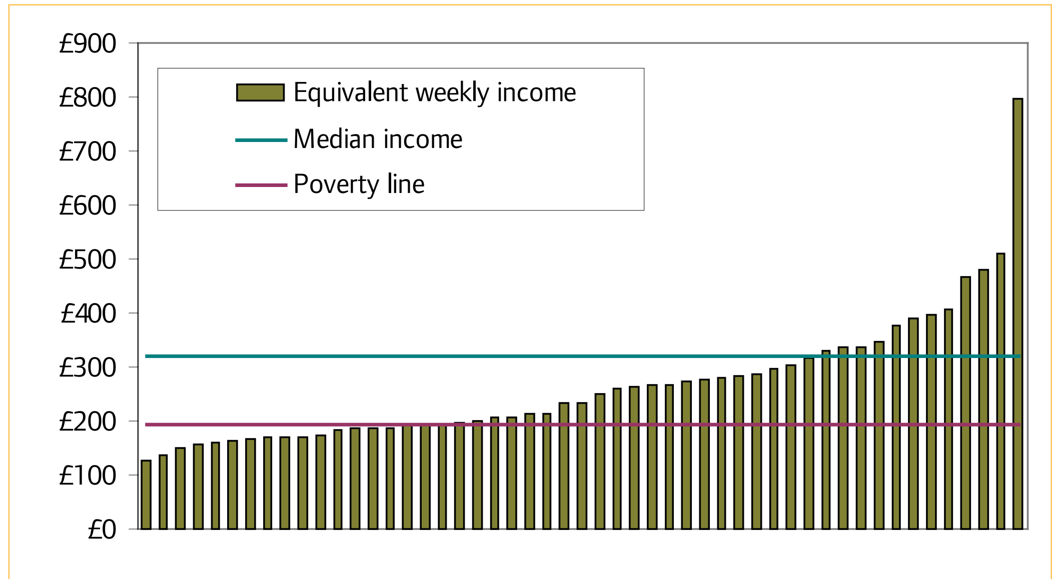


Figure 2. Household weekly income after housing costs (2008)
Source: ippr



recession. At the start of the project there were 10 households with two adults in employment (this included the two participants living in extended households), 29 households with one adult in employment and 17 households with no employed adult. By the end of the research period – four months later – a number of changes had occurred, both in employment status and hours worked. One participant – a single mother – became unemployed, two participants lost their businesses and also became unemployed and several reported that their working hours had been reduced by their employers.

Benefits of saving and asset ownership

There are obvious financial benefits to having some readily-accessible assets and these are even more apparent now that the economy is in recession. School-leavers faced with the most difficult labour market for young people since the mid-1980s will be better placed to pursue further education and training opportunities or to afford the driving lessons that might open up extra job opportunities if they have assets to help fund them. Now that the mortgage market has contracted, adults will find it easier to buy a house if they have assets that can be used as a deposit. With unemployment widely expected to reach 3 million in

2010, people who lose their jobs will be better able to look after themselves and their families if they have access to additional funds. And retirees, who are living longer than ever, will be able to enjoy a better retirement if they have assets that can help them maintain a reasonable lifestyle.

However, the benefits of asset ownership extend beyond the purely monetary. Michael Sherradan has argued that the security provided by ownership of assets leads to individuals making better long-term decisions and also to greater civic engagement through having a stake in society (Sherraden 1991). This conclusion has been supported by evidence from the UK. Previous ippr analysis suggests that ownership of a financial asset worth between £300 and £500 at age 23 is positively correlated with mental health and employment prospects 10 years later (Bynner 2001). It also underpins the interest of 'progressive Conservatism' in 're-capitalising the poor' (see, for example, David Cameron's speech to Davos in January 2009).

There is, therefore, a case for the Government to encourage all households, but particularly low-income households, to build a store of readily-accessible assets, and to retain them until they are really needed.

This is already happening, or scheduled to happen, to a limited extent through policies of various types:

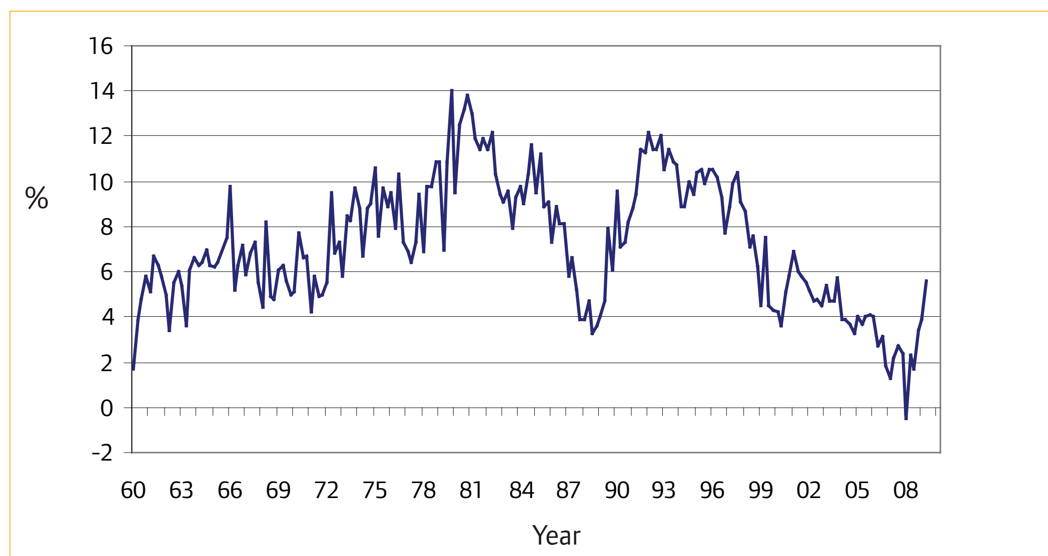
- Providing assets as a form of a benefit (the Child Trust Fund)
- Matching contributions to savings schemes (the Saving Gateway)
- Offering tax relief for pension savings
- Setting up accounts that people have to opt out of, rather than into (personal accounts for retirement savings)
- Improving financial understanding.

Trends in saving in the UK

Households in the UK have been saving less and less of their disposable incomes (after tax and National Insurance contributions) for the last 15 years. The household saving rate[3]

Figure 3. UK household saving rate (%), 1960–2009

Source: Office for National Statistics 2009 (see www.statistics.gov.uk/instantfigures.asp)



3. The saving rate is calculated as disposable income less consumption as a percentage of disposable income. It can fall either because households are saving less out of their incomes or because they are borrowing more to finance spending.

averaged 8 per cent between 1960 and 1998 but subsequently fell to a low of -0.5 per cent in the first quarter of 2008. The onset of the recession has seen the saving rate reverse some of its decline and in the second quarter of 2009 it was back up to 5.6 per cent.

This is quite typical. Saving normally falls in a boom, when people have fewer fears about the future, and increases in a recession, when they worry that they might lose their job and find it difficult to get another one.

Several explanations have been put forward for the decline in the saving rate. The greater stability of the economy over the period from 1993 to 2007, and the transfer of responsibility for setting interest rates to the Bank of England, might have encouraged some people to believe that they needed fewer precautionary savings; lower nominal interest rates might have led some to believe that saving was less worthwhile; a desire to participate in the housing market boom encouraged mortgage borrowing; and there was a more general sense that rampant consumption, even if financed by debt, was a 'good thing'.

Of course, these factors were largely irrelevant for low-income households, who were doing very little saving in the early 1990s and have limited access to borrowing and so had no real scope to reduce their saving rate. Changes in the national saving rate are largely the result of the behaviour of middle and higher-income households. However, low-income households are not completely isolated from developments in the rest of the economy and their children are not immune from the desire to keep up with their peers.

As consumer spending in the economy boomed and as we chose as a society to define ourselves increasingly by what we owned, low-income families will have felt extra pressure to spend more, making it even harder for them to save.

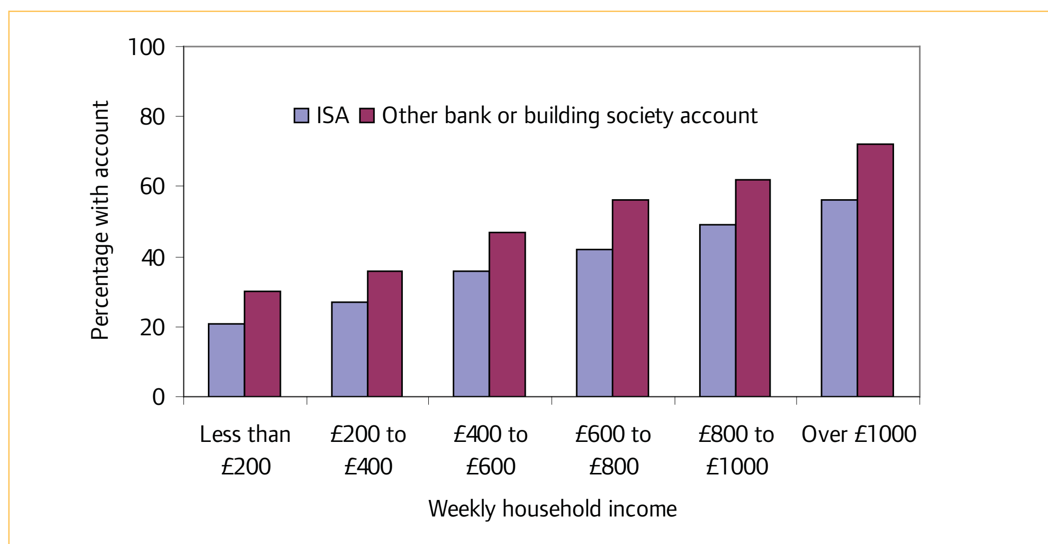
> *I worry about the future financially. As and when the boys get bigger, they will want bigger things and more expensive things, designer things, because they are going to grow into it eventually, because they can't help who they are at school with.* (Female, 32, Newcastle, two-parent household, three children)

Saving by low-income families

There is plenty of evidence that demonstrates those on low incomes do less saving than those on higher incomes. In the UK, the Family Resources Survey shows that, in 2007–08, there was a clear positive correlation between weekly household income and the probability of a household having a bank or building society account, or an ISA (Individual Savings Account) – see Figure 4.

Figure 4. Savings account holding, by income, 2007–08

Source: Department for Work and Pensions (2009)



Unsurprisingly, it is also the case that the value of savings increases with income. Figures from the Family Resources Survey show that 27 per cent of all households had no savings in 2007–08 and a further 20 per cent had savings of less than £1,500 (Table 1). Fewer than half of all households have put aside the three to six months' net pay that most advisers recommend to be the minimum level of saving that is desirable.

Among low-income households saving is even lower. Almost half of families with weekly incomes of £200 or less have no savings at all and a further 17 per cent of families have savings of less than £1,500.

Table 1: UK households by amount of savings and assets and total weekly income (2007–08, %)

	Total weekly household income						
Amount of savings and assets	< £200	£200–400	£400–600	£600–800	£800–1,000	£1,000 or more	All
No savings	44	38	27	20	15	9	27
Less than £1,500	17	20	22	24	22	14	20
£1,500 to £3,000	7	5	7	9	8	8	7
£3,000 to £8,000	14	13	13	17	18	16	15
£8,000 to £10,000	3	4	3	4	4	5	4
£10,000 to £16,000	6	6	6	6	9	10	7
£16,000 to £20,000	3	2	2	3	4	5	3
£20,000 or more	8	11	17	18	19	33	17

Source: Department for Work and Pensions (2009)

Policies to encourage saving in the UK

The UK government has taken active steps to encourage saving over the last decade. It currently supports saving and asset-building in a number of ways, discussed below.

Tax relief

This is the most important method of encouragement. Income tax relief for registered pension schemes costs the Exchequer about £20 billion a year in foregone revenues (net of tax paid on pension payments), while relief for ISAs costs a further £2.5 billion (HM Treasury 2008). There are also a number of smaller schemes that attract tax relief, at much lower aggregate costs to government revenues. Low-income households receive extremely little of this relief. The progressive nature of the British income-tax system means tax relief benefits mostly higher earners and few low-income households have ISA accounts.[4]

The Saving Gateway

This scheme, on the other hand, is designed specifically to benefit low-income households when it is introduced in 2010. People will be eligible to open a Saving Gateway account only if they receive certain benefits or tax credits and have an income low enough. Account holders will be able to save up to £25 a month for two years and at the end of two years they will receive 50 pence for every £1 saved, so they could accumulate as much as £900. Pilot schemes suggest that matching savings in this way encourages participation.[5] It is

4. The latest data from the Family Resources Survey, for 2007–08, shows that fewer than one in four households with a total weekly income of £300 or less have an ISA (DWP 2009).
5. An evaluation of the pilot study found that three in ten participants were not regular savers prior to the scheme but were regular savers two years after their accounts matured. In aggregate, 60 per cent agreed that the scheme had helped them to save regularly each month (Ipsos MORI 2009).

estimated that the cost of this scheme will be around £130 million in 2012/13 (when the first matching payments are made), falling to £70 million a year after an initial peak in demand passes.

The Child Trust Fund (CTF)

This programme provides every child born after 1 September 2002 with a voucher from the Government worth £250, together with a further voucher worth £250 when they reach the age of 7. Children in low-income households (earning less than £15,575 in 2008–09) receive double these amounts. Funds can be invested in a stakeholder account (equities) or in a cash account. Interest received is tax-free and up to £1,200 a year can be added to the fund. Only the child can access the funds in the account and then not until their 18th birthday. The scheme cost the Government £0.25 billion in 2008–09, but this will double from 2010–11, the first financial year in which every child reaching 7 years of age will be eligible for the second payment. Note that the Conservatives would want to reduce the programme.[6]

Workplace pension schemes

From 2012, employers will be required to automatically enrol all eligible employees into a workplace pension scheme and make a minimum contribution, to be matched by a contribution from the employee.[7] If the employer does not have a scheme, enrolment will be in the new Personal Accounts occupational pension scheme, which is targeted at low to middle-income workers. The benefit to employees is, therefore, twofold: they receive their employers' contributions and they get tax relief on their own contributions. Employees can choose to opt out of the scheme, should they so wish.

Although children in poorer families receive larger payments into their Child Trust Funds, the Saving Gateway scheme is designed specifically to increase saving among those with low incomes, and Personal Accounts will be largely held by employees on low to middle-incomes, the bulk of the support for saving in the UK benefits those on higher incomes through tax relief.

Explaining saving behaviour

At this point, it is a good idea to define exactly what is understood by the term 'saving'. It is useful to distinguish three types of behaviour[8]:

1. Coping with uneven spending patterns throughout the year: Most households spend more at certain times of the year, especially Christmas and birthdays, and will try to budget for this occurrence. Saving schemes, such as Christmas clubs, have been set up to facilitate this type of saving. The evidence is that people, particularly those on low incomes, regard this type of behaviour as saving, even though there is no intention to retain for any length of time the assets that are accumulated.

2. Saving for short-term precautionary reasons: The primary aim of this type of saving is similar to saving for Christmas: to ensure that some funds are available when extra spending is required. The difference is that it is undertaken with no specific event in mind, but in the knowledge that washing machines and cars break down, children need new shoes, and so

6. George Osborne, the Shadow Chancellor of the Exchequer has said that under any future Conservative Government only disabled children and the poorest one-third of families would receive new Child Trust Funds (Osborne 2009).
7. Employees will contribute a minimum of 4 per cent of income, employers 3 per cent and there will be an extra 1 per cent in tax relief. All employees aged 22 and over and earning at least £5,225 (in 2007/08 terms) will be covered by the new scheme.
8. Others have come up with similar groupings. Kempson and Finney (2009) refer to 'rainy day savers', 'instrumental savers', 'non-savers' and 'passive savers'.

on. It is, therefore, different from long-term asset-building because there is a clear intention to spend the money.

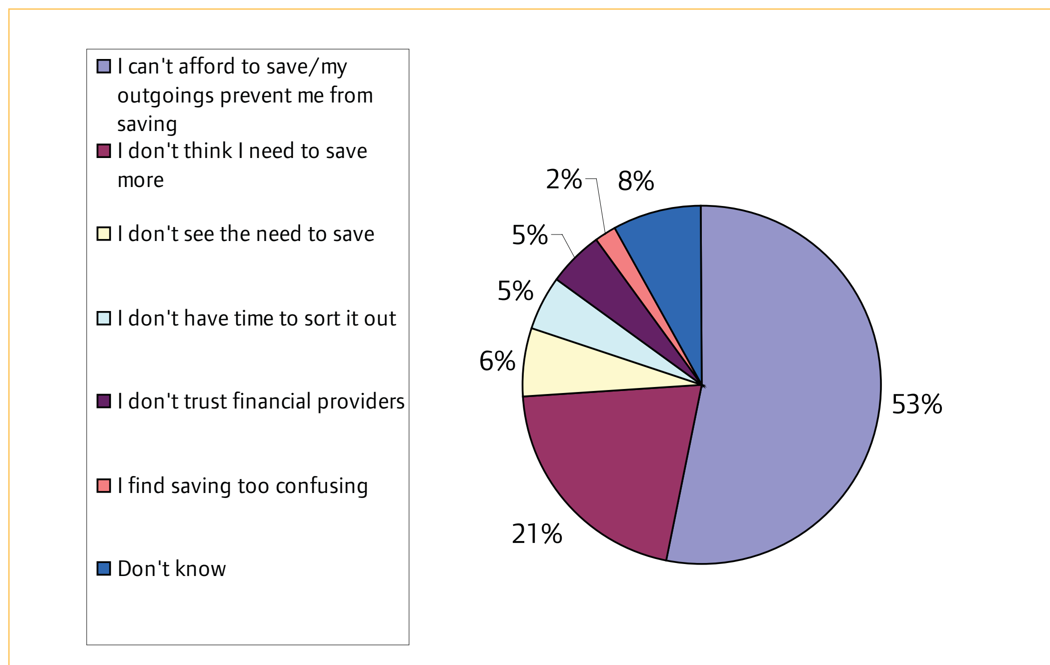
3. Longer-term asset building: The most common long-term saving people undertake is to build a pension for retirement. The Child Trust Fund scheme is another example, as are those life insurance policies that incorporate a payout when the policy matures. More generally, any savings that are retained for a long period and are only accessed infrequently or in extreme circumstances fit into this category.

Previous research suggests low-income households do very little asset building but do save through the year for specific events like birthdays and holidays. What is less clear from the literature is how much saving for short-term precautionary reasons takes place in low-income families and whether households who are not saving in this manner are unable to do so, or are simply choosing not to.

This is an important distinction. The most common reason given for not saving, or for not saving more, is an inability to afford it (see Figure 5).

Figure 5. What stops people saving more? (Spring 2009)

Source: National Savings & Investments (2009)



Of course, there are low-income families that are not saving because they truly cannot afford it. Typically, such families will have other financial problems – paying off debts, difficulties in paying utility bills – and will be struggling to find the money they need for such basics as food, clothing and shelter.

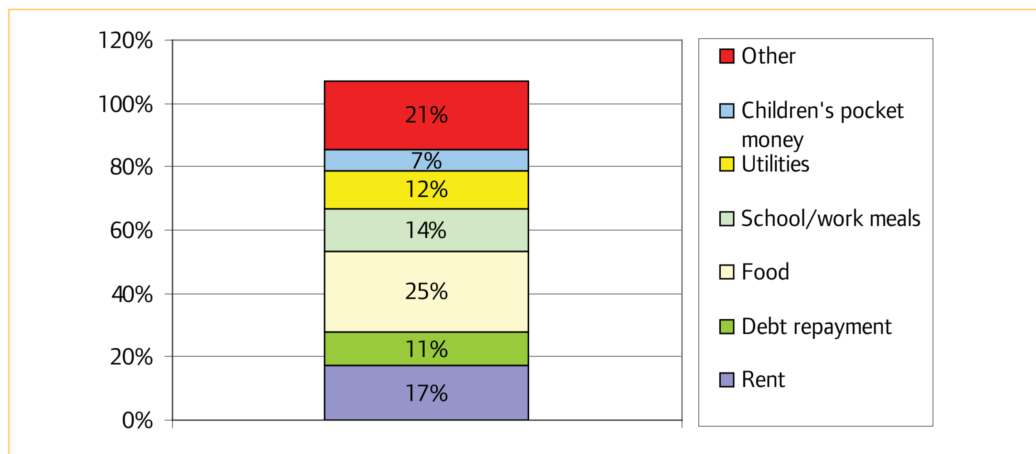
> *I have never really had any savings; I've not really earned enough to have any savings.* (Female, 30, Glasgow, two-parent family, three children)

Many of the low-income families in our survey had little money left over after spending on basic items. Figure 6 shows the expenditure breakdown of one of the families. Over the four-week period for which they completed an income and expenditure diary, their spending was 7 per cent greater than their income. Four-fifths of their income was spent on housing costs, including utility bills, debt repayment and food.

But can this be true of over a quarter of the population, as implied by Table 1 above? Some people who say they cannot afford to save really mean saving is not a high priority for them. For this group, saving is typically seen as an optional, residual activity – something that might be done with any money left over at the end of the week or month.

Figure 6. Expenditure as a percentage of income of a couple from the ippr sample, one in work, with three children, Newcastle, 2009

Source: ippr



Economists in the neo-classical tradition would say that these people have a 'revealed preference' for spending over saving. Neo-classical economic models assume individuals always act rationally and suggest that the prime determinants of saving are age and income (the so-called 'life-cycle' hypothesis). In a neo-classical world, what people say about their desire to save is irrelevant if their behaviour reveals that spending is the greater priority. This does not mean that people will not react to incentives to save – such as tax breaks – but most neo-classical economists argue that such incentives distort the market and so should not be provided.

However, the assumptions of neo-classical economics – in particular the idea that people always behave in a rational manner – are increasingly questioned. Supporters of behavioural economic theory argue that financial decisions are influenced by a number of common human characteristics, such as 'lack of self-control, limited cognitive abilities, inertia, the tendency to interpret default options as "advice," and the tendency to use mental accounting techniques' (Beverly *et al* 2008, p.ES-1). Once these influences are accepted, it follows that there can be a role for incentives to save and to accumulate assets.[9]

Kempson and Finney identify three 'meta-barriers' to formal saving by low-income households, relating to 'access', 'knowledge and understanding' and the 'attractiveness of formal products' (Kempson and Finney 2009, p.viii). They argue that low-income households would be more likely to save formally with providers they trusted, such as the Post Office and credit unions, if products were simpler to understand – for example, offering bonuses rather than interest payments – and if they offered incentives not to make withdrawals, while at the same time allowing access to money if it is really needed.

Attitudes to the Child Trust Fund also reveal behavioural barriers to saving. In a study by Prabhakar (2007), when parents were asked whether they would prefer to receive extra child benefit for one year (roughly £5 a week) instead of a £250 payment into a Child Trust Fund, they opted for the Trust Fund payment on the grounds that the child would benefit more from the savings in the future than from the immediate extra income. Low-income families also agreed that it was better to receive £500 of savings rather than £10 a week extra child benefit for a year. However, all the evidence suggests that low-income families, given an increase of £10 a week in child benefit payments, would not choose to save the money into their child's Trust Fund. Low-income households tend only to choose saving over spending when it is the default option.

Others have found evidence of a strong 'compartmental' approach to saving. An American study into the effect of individual development accounts (IDAs)[10] found they encouraged

9. See Appendix 2 for examples of savings products that have been constructed along lines suggested by behavioural economics.

10. Savings accounts for low-income persons that encourage saving for a specific purpose by providing matching funds when funds are withdrawn for an allowable reason (e.g. to pay for education or training).

saving and produced better life outcomes. In particular, after three years in the scheme, participants were more likely – after adjusting for other factors – to be homeowners, to own or have part-ownership of a business and to have pursued post-secondary education (Mills *et al* 2008).

In the UK, a significant proportion of parents (or relatives and friends) take advantage of the option to put extra money into Child Trust Funds. Almost one in three funds that were opened by parents have received some extra money, falling to one in five of accounts that were opened by parents and eligible for the extra £250 (that is, low-income households).

Table 2: Child Trust Fund: Accounts receiving contributions from parents and others in 2007/08 (% of all accounts)

	Opened by parent	Opened by HMRC*	All accounts
Receiving extra £250 payment	20%	1%	14%
Not receiving extra £250 payment	35%	3%	29%
All accounts	31%	2%	24%

*HMRC= Her Majesty's Revenue and Customs
Source: HMRC (2008a)

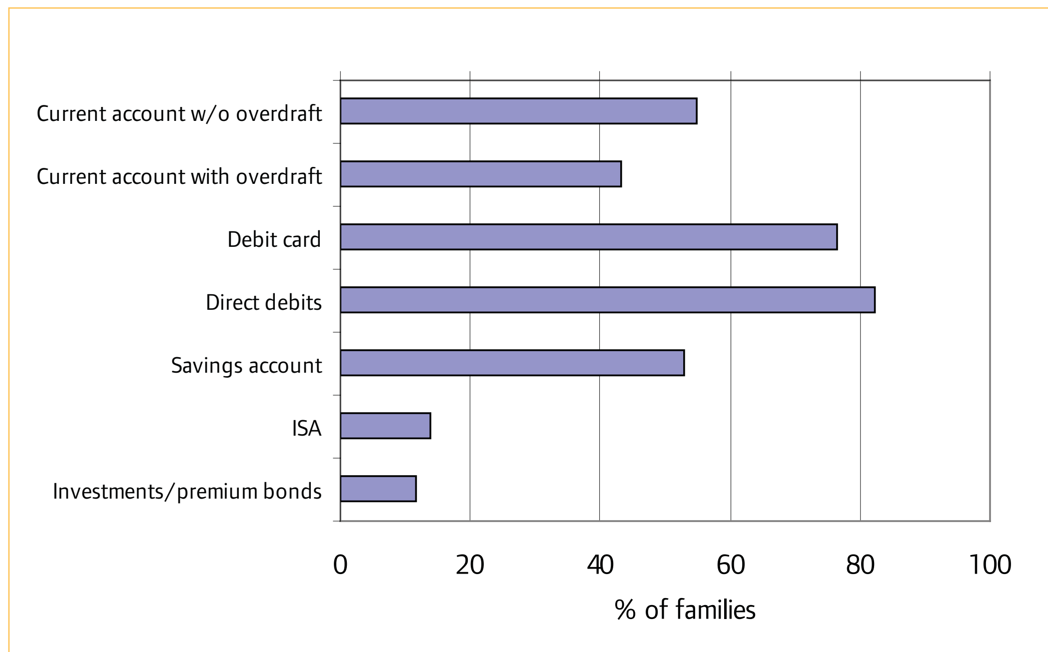
What is more, the evidence suggests that the existence of the Child Trust Fund is encouraging extra saving. The Children's Mutual – a leading provider of Child Trust Funds – claims that among its customers there has been 'a trebling in the rate of saving' from pre-Child Trust Fund levels and 'lower income families are amongst the most engaged, with 30% topping up monthly' (The Children's Mutual 2009).

Research findings

Almost all the low-income families in the ippr survey used one or more financial products, with the most common being a current account, either with or without an overdraft facility (only one family said they had neither). Just over half also had a savings account but only one in eight had an ISA, with the same proportion saying they had other investments or premium bonds.

Figure 7. Financial products used by families in the sample (2009)

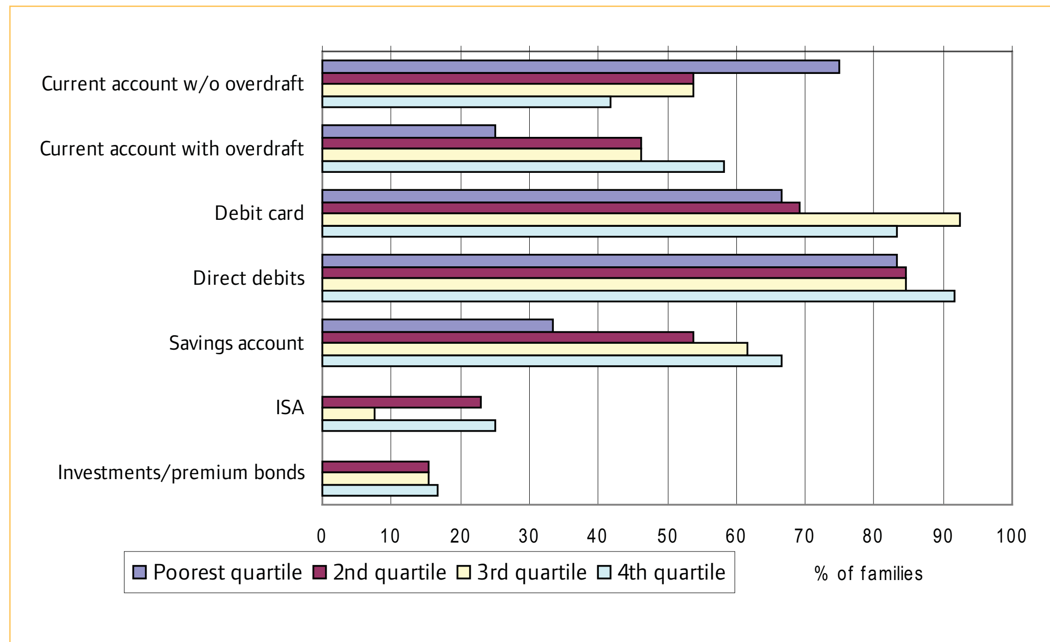
Source: ippr



Disaggregating by income yielded some interesting results. Families with the lowest incomes within our survey were more likely to have a current account without an overdraft facility; those on higher incomes one with such a facility. The proportion of families with a savings account also increased with income. No families in the lowest quartile, by income, had an ISA or other investments or premium bonds (nor did any of the families with no one in employment)[11].

Figure 8. Financial products used by families in the sample, by income (2009)

Source: ippr



Although around half of the low-income families had a savings account, in several cases there was very little money in these accounts. In some instances, the account had not been actively used for months.

> *That savings account would always have £50 in or something for emergencies. It hasn't had anything in for absolutely months, probably a year.* (Female, 28, Newcastle, two-parent family, two children)

When interviewed, the low-income families generally displayed a positive attitude to the idea of saving. These families interpreted 'saving' as any behaviour that did not involve spending all their income in a particular week or month. Putting some spare change in a jar in the kitchen was saving, just as much as making a deposit into a savings account. Only a very few said that they did not save and that they thought there was no point in doing so. Most expressed some desire to save, though many said that they were not doing any saving at the time of the study because they could not afford to. Unsurprisingly, these families tended to be among the ones in our sample with the lowest incomes.

The recession has had some effect. In two instances, families said that they used to save but had not been able to do so because the main wage-earner had been made unemployed. A small number of other families reported that their incomes had fallen due to working fewer hours and this had affected their saving behaviour.

> *My savings are nearly all gone away. We had nearly £3,000 between us in ISAs and we're now left with £600. Saving like that was, we kept saying, for a rainy day. We keep saying 'it's been raining forever this last few months'.* (Female, 34, Glasgow, two-parent family, three children)

11. Charts showing the use of financial products according to other characteristics of the families in our survey (employment status, location, family size etc.) can be found in Appendix 1.

But when asked about the effect of the recession, over two-thirds of families said that their biggest problem was the high prices of food and energy.[12] At the time of the research, food price inflation was above 10 per cent and energy price inflation close to 15 per cent.[13] For families on low incomes and tight budgets, increases of these magnitudes, which were not matched by higher incomes, created huge problems. Most regard saving as a residual activity, something that they do if they have any spare cash left at the end of the week or month. Some households that had previously been able to save found that they did not have money left to do so now because they were spending more money on food and energy. For example:

> *We've not been able to put any [money] in [to our savings]. We're spending so much in the shops and supermarkets and on bills…* (Female, 46, Nottingham, two-parent family, two children)

Most of the saving that was being done by families in the study was for specific reasons. The most commonly mentioned were Christmas, birthdays and holidays (sometimes saving to pay for a holiday; sometimes saving to have a little extra to keep the children amused during the school summer holidays). The following quotes were fairly typical:

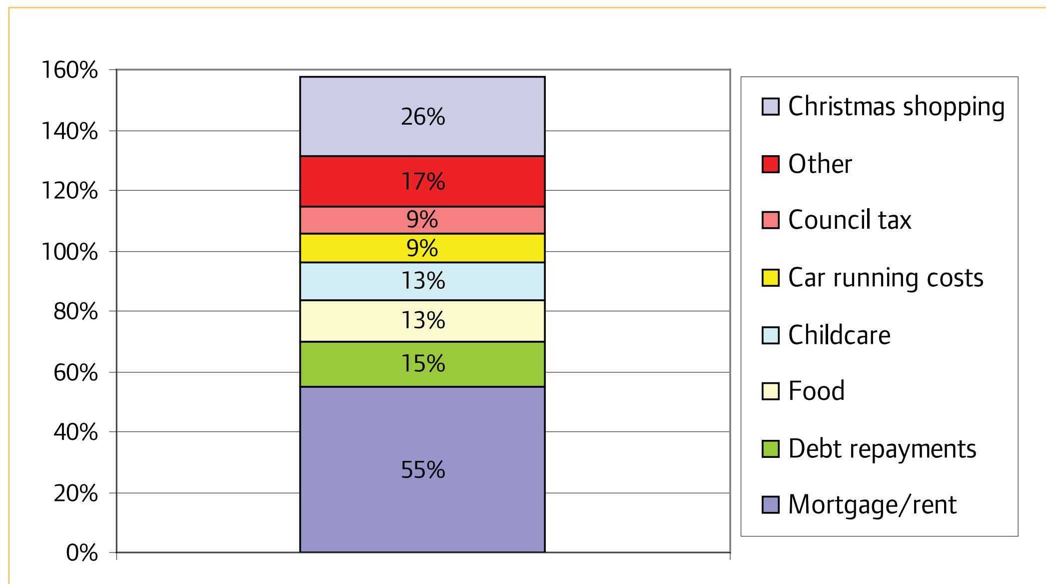
> *The money that I put away is for specific purposes, like one of them will pay off a debt in July.* (Female, 44, Nottingham, single-parent family, three children)

> *I've not been one for saving long-term. I can save for a purpose.* (Female, 33, Newcastle, single-parent family, two children)

Because the interviews were conducted close to Christmas-time, families were asked specifically about how they coped with the extra spending at that time of year. For one family, who were already spending well above their income and so were unlikely to save any time soon, Christmas shopping still took a quarter of their income – see Figures 9 and 10.

Figure 9. Expenditure as a percentage of income of a couple from the ippr sample, both in work, two children, Nottingham

Source: ippr



12. Higher food and energy prices were not actually a result of the recession: they were caused by the preceding boom, especially in large emerging economies. But they did play a part in tipping the economy into recession, so it is understandable that people refer to them when asked about the recession.
13. According to the Office for National Statistics, inflation for food and non-alcoholic beverages was 10.4 per cent in December 2008, while inflation for housing, water, electricity, gas and other fuels was 14.3 per cent.

Figure 10. Weekly income and expenditure for family as above

Source: ippr

About two thirds of the families said that they had saved specifically for Christmas. Most of the remaining households had taken on extra debt (a couple of households mentioned both saving and taking on extra debt). This suggests that the majority of low-income families are relatively good at coping with the uneven pattern of spending throughout the year. For the minority, though, the Christmas period causes increased levels of stress and anxiety, particularly among families who felt they were depriving their children:

> *Christmas will be very tight. It's my grandson's first Christmas and I'm feeling very guilty that I can't spend what I want to spend on him.* (Male, 42, Nottingham, two-parent household, two children)

Similar problems also occur around the time of children's birthdays and the school summer holidays.

The families in this study were using a range of savings devices, including Christmas clubs, giving the money to a friend or another family member and jars and tins in the kitchen:

> *The only time I save is when we are going on holiday. And all I do is – it is quite sad really – I put all my change, 20p, 10p, 5p, 2p, 1p, 50p all in a pot. And when we are going, I change it up and I split that between my kids.* (Female, 30, London, single-parent family, two children)

Having some regular commitment, and handing the money over to someone else to look after, are seen as important because they take away the temptation to dip into money before it is supposed to be spent. However, most of the saving being done was informal, rather than through financial institutions. In a few instances, this was a matter of trust, which seemed to centre on fears that banks might collapse. In many cases, however, it was just a matter of convenience. Several of the families in Glasgow mentioned credit unions as a convenient alternative to High Street banks:

> *I just put that money away with the credit union. If I need it for anything I can go and get it. It's good to have it there.* (Male, 44, Glasgow, single-parent family, one child)

Interestingly, despite the well-publicised collapse of Christmas saving club Farepak in 2006 (see, for example, Guardian 2006), low-income families still find similar saving schemes attractive. One of the interviewees had been an agent for Farepak when it collapsed (and so had lost money along with family members and friends that she had signed up), but she was happy to use a competitor scheme:

> *What I did last year was I saved with Park Hampers. They have got some sort of [government] guarantee.* (Female, 33, Newcastle, single-parent family, two children)

There was less evidence of short-term precautionary saving, with less than a quarter of families saying that they were able to put money aside for unexpected events. Even then, a few acknowledged that they were often tempted to dip into this 'rainy day' money because it was not being kept for any specific purpose. There was some evidence to suggest families understood they were making a choice between spending and saving and choosing not to prioritise saving:

> *I suppose we could cut out that sort of thing [having a 'Chinese or an Indian or a pizza' on a Saturday]. We could save, you know. I could save maybe 15 quid a week even if we didn't have that on a Saturday but then I think, well that's living, isn't it.* (Female, Newcastle, two-parent family, two children)

Others, though, simply thought that they could not afford to save:

> *To be able to save today people have got to be on more than £25,000 a year. In our situation – two adults and three children – you've got to be on a minimum of £25,000 a year. That's basically so you can live a normal life and save. I'm not saying astronomical amounts but the odd £50 now and again a week saved.* (Male, 47, Nottingham, two-parent family, three children)

The lack of precautionary saving leaves low-income families poorly positioned to cope with 'shocks'. In the course of the interviews for this study, 10 families reported shocks in the form of unexpected spending due to the breakdown of a household item (including a refrigerator, boiler, washing machine and oven). In only one instance did the family have savings that they could use to pay for repairs or a replacement. In one case, a replacement was bought from a catalogue. In the other eight instances, the families took on more debt, either by using their credit card, borrowing from family or friends or, in one case, applying for a crisis loan from the Government. Families that had to cope with the shock of someone losing their job were, of course, even worse placed.

Only a handful of the low-income families in this study were saving for the medium term. To most, it was inconceivable that anyone would think they were in a position to do so, though some did express a desire to save for their children:

> *If they want to do college, university, you know they have got the money behind them. That's what I would like to do, to set up.* (Male, 47, London, two-parent family, three children)

One family was managing to save their child benefit money in an account for their daughter and another was putting £10 a week into a child savings account. There was virtually no reference to long-term saving, such as for pensions.

Conclusions

This research has shown that low-income families would benefit from increasing their savings. While most of the families in the study are good at coping with additional spending on expected events, such as Christmas, birthdays and school holidays, few have built up a 'rainy day fund' and most have to cope with unexpected events by resorting to taking on – often expensive – debt. While many families would claim that they cannot afford to save, some were willing to admit that they did not choose to save because they attached a higher priority to spending. Precautionary saving and long-term asset-building are seen as optional, residual activities.

This suggests that there is scope to change behaviour and increase saving activity, perhaps through the use of some of the ideas of the behavioural economists, such as auto-enrolment and incentives. If people are prepared to save for Christmas through informal schemes like hamper clubs and for holidays by placing money in a jar, it might be possible to persuade them, with the right incentives, to save for other eventualities too.

> *I save for Christmas all year and I save for holidays.* (Female, 43, Nottingham, single-parent family, three children)

One of the families came up, unprompted, with their own policy suggestion along these lines:

> *The Government could set up an option to put tax credits into a savings scheme.* (Female, 38, Newcastle, single-parent family, three children)

Thus, there appears to be an appetite for a framework of support and advice about the benefits of saving and the products available to low-income families.

Recommendations

Our research supports the view that low-income families need to save more and to retain their savings for longer. However, it also confirms evidence from other studies that families (not just low-income families) often realise the importance of savings too late. This suggests there is a role for policymakers to put in place policies that will broaden saving and asset ownership opportunities for low-income households and for suppliers of financial services to design products that are more attractive to them. In this way, policymakers and providers can build on the individual saving behaviour of low-income families.

If government and providers of savings products want to broaden saving and asset ownership opportunities for low-income families, there are plenty of ideas, experiments and evidence from other countries to draw on (see Appendix 2 for a few examples). And the bulk of this evidence suggests that the best products combine making saving as easy as possible – often including a 'nudge' through auto-enrolment – with incentives to retain savings, for example through matching. Products with these features should be available in the UK throughout life for the various savings needs that families have.

As a start, the Government could provide an incentive to encourage low-income families to make extra savings into Child Trust Funds. For example, it could promise to match, at a rate of 50p for every £1, any savings made into a Child Trust Fund, up to a limit of £100 per child per year, for those children in the poorest one-third of families and for disabled children. Pilot studies for the Saving Gateway scheme show that this type of incentive can produce a significant change in saving behaviour. Even if the response is very high, the total cost of these changes would be only around £100 million now (eventually rising to £250 million). This will demonstrate the importance government attaches to savings and ensure that every child has a sizeable lump sum when they reach the age of 18, mitigating the risk of Child Trust Funds exacerbating, rather than reducing, asset inequalities at 18.

However, it is also important for the Government to encourage people to build a store of assets for when they are really needed. This will not necessarily be achieved if 18-year-olds simply spend their funds as soon as their Child Trust Funds mature. The Government should, therefore, establish a new category of approved account into which maturing Child Trust Fund money will be automatically transferred. As with Child Trust Funds, interest and capital gains in this account would be tax-free. It could also be linked with other schemes designed to encourage saving. For example, there could be incentives to

transfer funds from a Savings Gateway account into the approved account. Indeed, the new account could be a reformed version of the Saving Gateway. Following the suggestion of one of the families in the survey conducted for this research, tax credits could also be paid into these accounts.[14]

The purpose of this new account would be to encourage long-term asset-building for specific purposes – such as the deposit needed to buy a property – as distinct from short-term saving for Christmas. For low-income families this might be underlined by providing matching funds when money is withdrawn for an allowable reason (for example to pay for education or training, or to buy a first property), as is the case with individual development accounts in the United States.

The approved account should be simple and available from a range of trusted and easy-to-access providers, including through the Post Office and credit unions. Providers should play their part by ensuring that these new funds are particularly attractive to families on low incomes. Some low-income families prefer an account with a passbook, so it is easy to monitor their savings, others are happy to use the internet or have a telephone account. All these options should be made available to enhance choice.

The accounts should provide incentives for keeping money in the account, while allowing some flexibility to withdraw it and they might pay a 'bonus' rather than a rate of interest. If they were subject to a cap on their overall size, they could also be excluded from calculations of asset holdings when assessing benefit levels (one of the reasons some people do not save is through a fear that it might affect their future entitlement to benefits).

The total cost of the various incentives and other payments embedded in this proposal would depend on their scope and size. They would also only build up over a number of years. However, they could easily be funded by limiting tax relief on pension contributions to the basic rate for everyone, not just those with an annual income of £150,000 or higher (as planned from 2011–12). This measure would increase Government revenues by over £10 billion a year. It would be a progressive measure to use some – or all – of this money to provide saving incentives to those on lower incomes.

At this stage, however, the details are less important than identifying the broad direction of travel. Our study of low-income families has highlighted their vulnerability due to a lack of precautionary savings and their inability to build up a store of assets that would increase their opportunities in life. We argue that the Government – helped by providers of savings products – could do more for these families. Alongside better financial education, they should develop more products that make saving as easy as possible (or even automatic) for low-income families, while providing an incentive for savings to be retained through a savings match.

14. The current Save As You Earn (SAYE) scheme, which allows employees to save between £5 and £250 a month for a fixed period of time and gives them the option to buy shares in their company at a pre-arranged price, could also be expanded to make it attractive to low earners, perhaps by allowing some flexibility over contributions and withdrawals from the plan, and linked to this new account.

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Appendix 1: Savings products used by families in our sample

Figure A1. Financial products used by families in the sample – by location

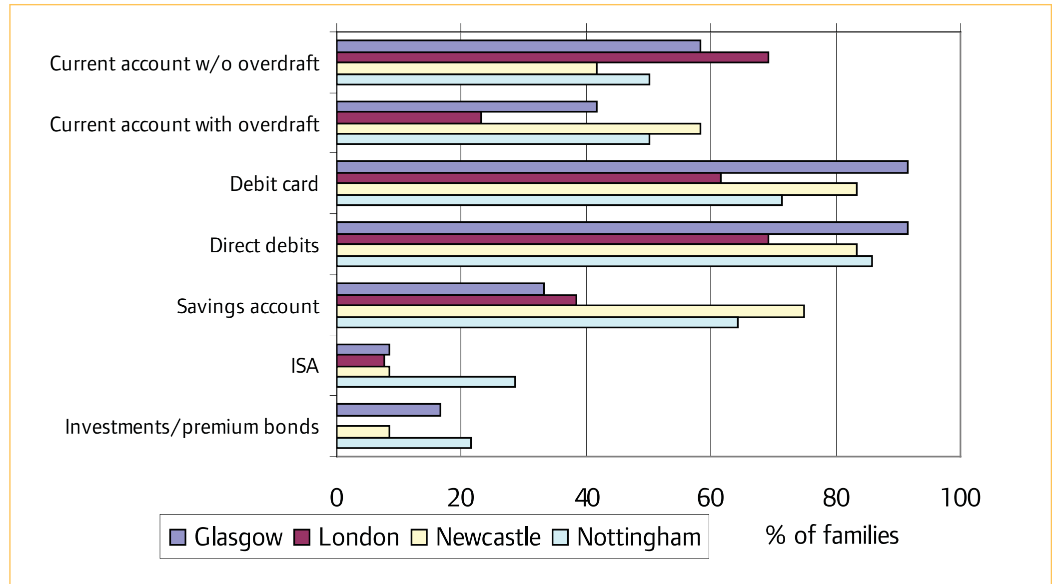


Figure A2. Financial products used by families in the sample – by age

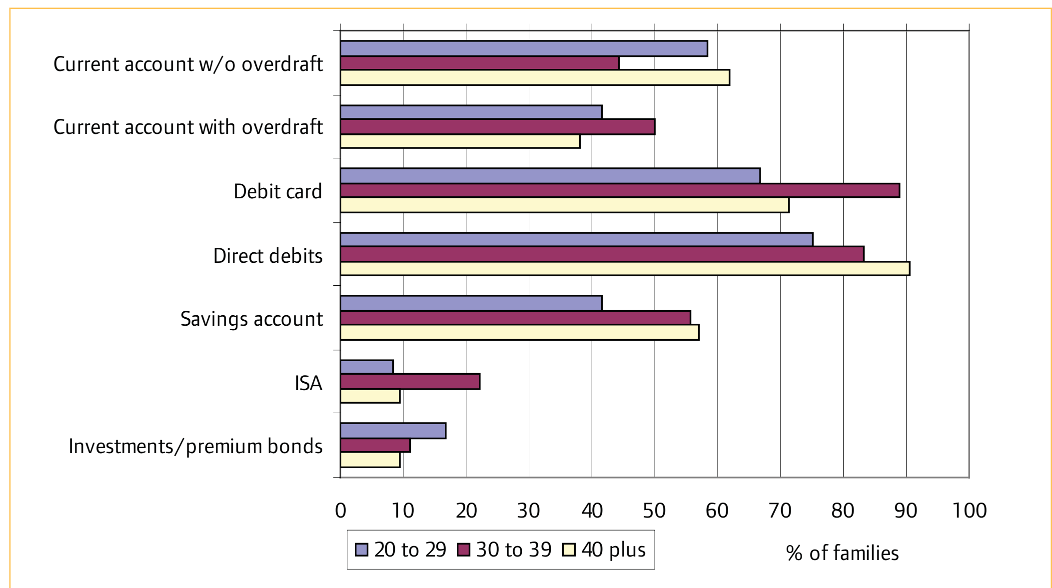


Figure A3. Financial products used by families in the sample – by number of children

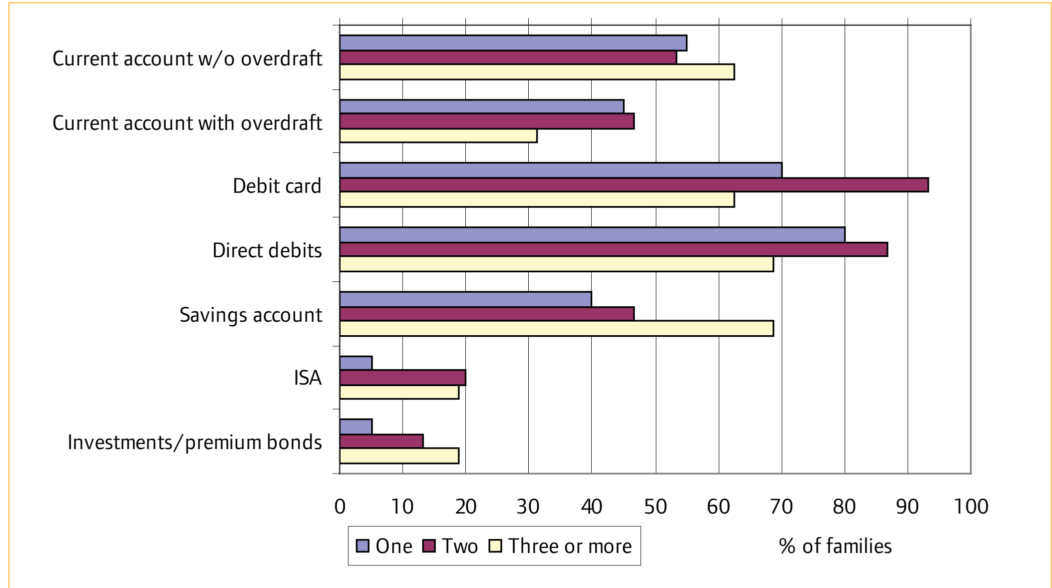


Figure A4. Financial products used by families in the sample – by household type

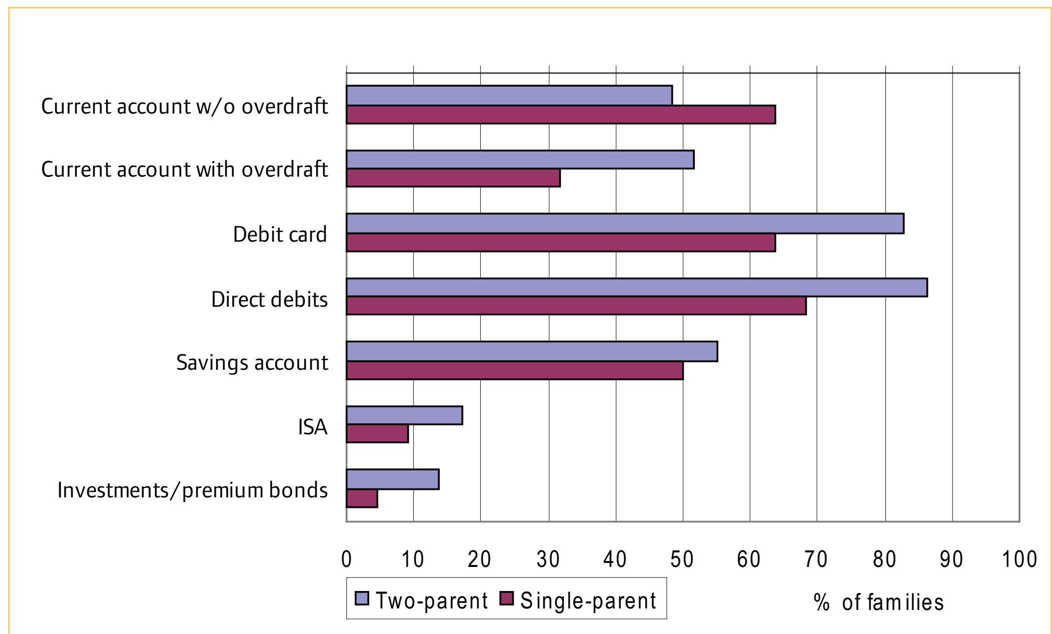


Figure A5. Financial products used by families in the sample – by renting or owning property

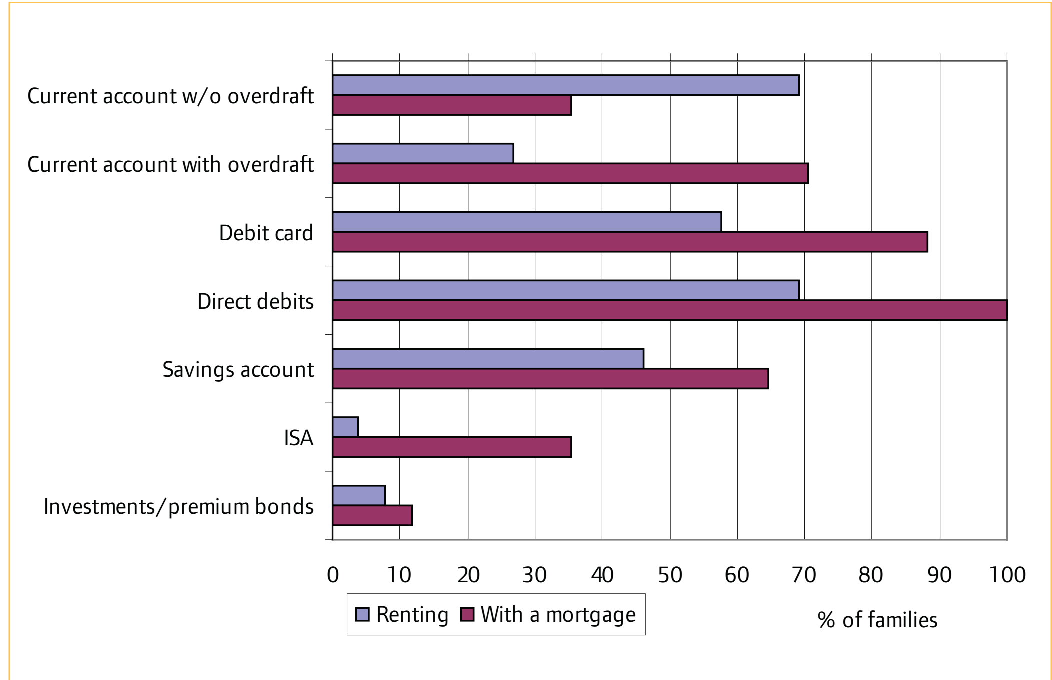
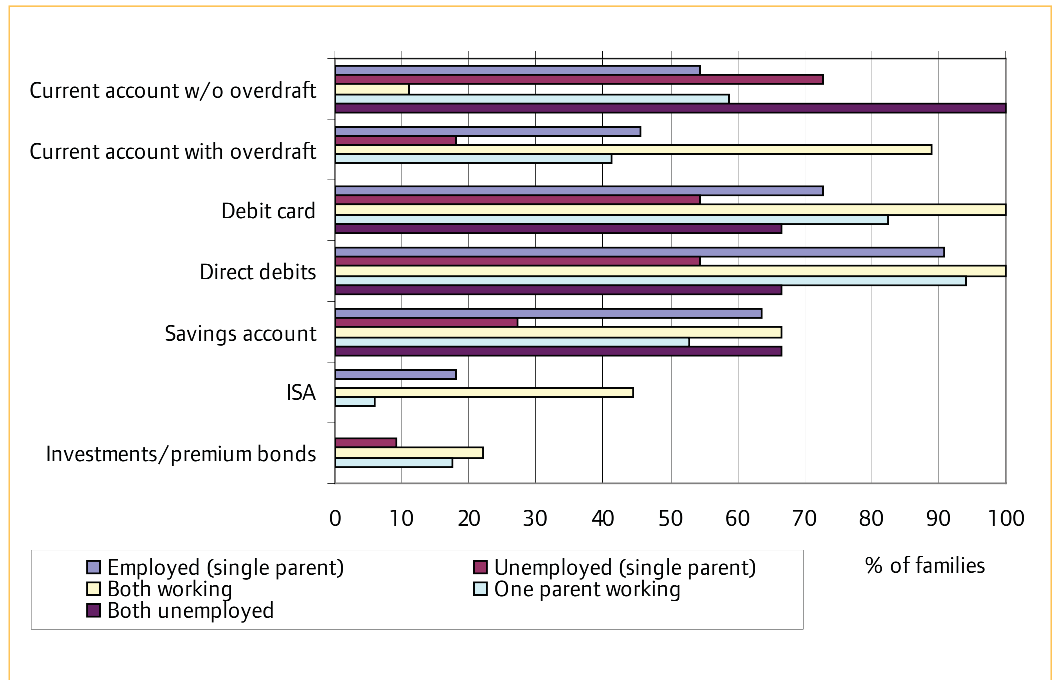


Figure A6. Financial products used by families in the sample – by employment status



Appendix 2: International examples of savings products designed to incentivise saving

Behavioural economists have tried to break down barriers to saving for low-income families by designing savings schemes that take advantage of human nature and so lead to higher participation. These schemes usually incorporate automatic enrolment – addressing people's inertia in matters financial – combined with incentives to 'nudge' people into saving. Three examples follow below of how their ideas can work in practice.

Save More Tomorrow (United States)

Under the Save More Tomorrow scheme designed by Richard Thaler and Shlomo Benartzi, employees commit to start or to increase their saving by agreeing that a proportion of future pay increases should be transferred into a saving account, rather than into take-home pay (with an opt-out at any time) (Thaler and Benartzi 2004). The scheme works with behavioural theory because it avoids a cut in current nominal take-home pay, so people do not have to sacrifice some current spending; it requires an advance commitment, so limiting the possibility of people finding something else to do with the money; it relies on inertia to keep people in the scheme; but gives them an opt-out so that they do not feel trapped. In one trial, 80 per cent of people stayed in the scheme through four pay increases.

This is not designed to be a universal solution to the problem of low saving among those on low incomes, because it is best suited for those in a stable job, but it could work in the public sector, for example, and shows how accepting the need for incentives can lead to innovative product design.

KiwiSaver (New Zealand)

The KiwiSaver account, recently introduced in New Zealand, combines elements of auto-enrolment and incentives. Anyone taking a new job in New Zealand now automatically has a KiwiSaver account opened for them (those already in jobs can choose to open one). The government kick-starts accounts with a deposit of NZ$1,000 (about £450). It also matches employee contributions up to a limit of NZ$1042.86 a year (NZ$20 a week). Employers have to match employee contributions up to at least 2 per cent of salary (unless they are contributing to an alternative pension scheme). If, despite all these incentives, someone wants to opt out of the scheme, they can chose to, but only if they do so within eight weeks of starting work. Although the accounts are primarily a vehicle for pension saving, one withdrawal is allowed to purchase a first home and a first home deposit subsidy of up to NZ$5,000 is also available.

Superannuation Guarantee (Australia)

The Australian Superannuation Guarantee has been in existence since 1992. Employers have to make compulsory contributions to a superannuation fund on behalf of their employees. Contributions were initially set at 3 per cent of income, but have since been increased to 9 per cent. Employees can add their own voluntary contributions, which attract tax relief, on top. The fund can only be accessed on retirement (except in certain extreme cases such as serious illness). Because almost all workers are covered by the scheme, it has led to increased pension provision for those on low incomes.