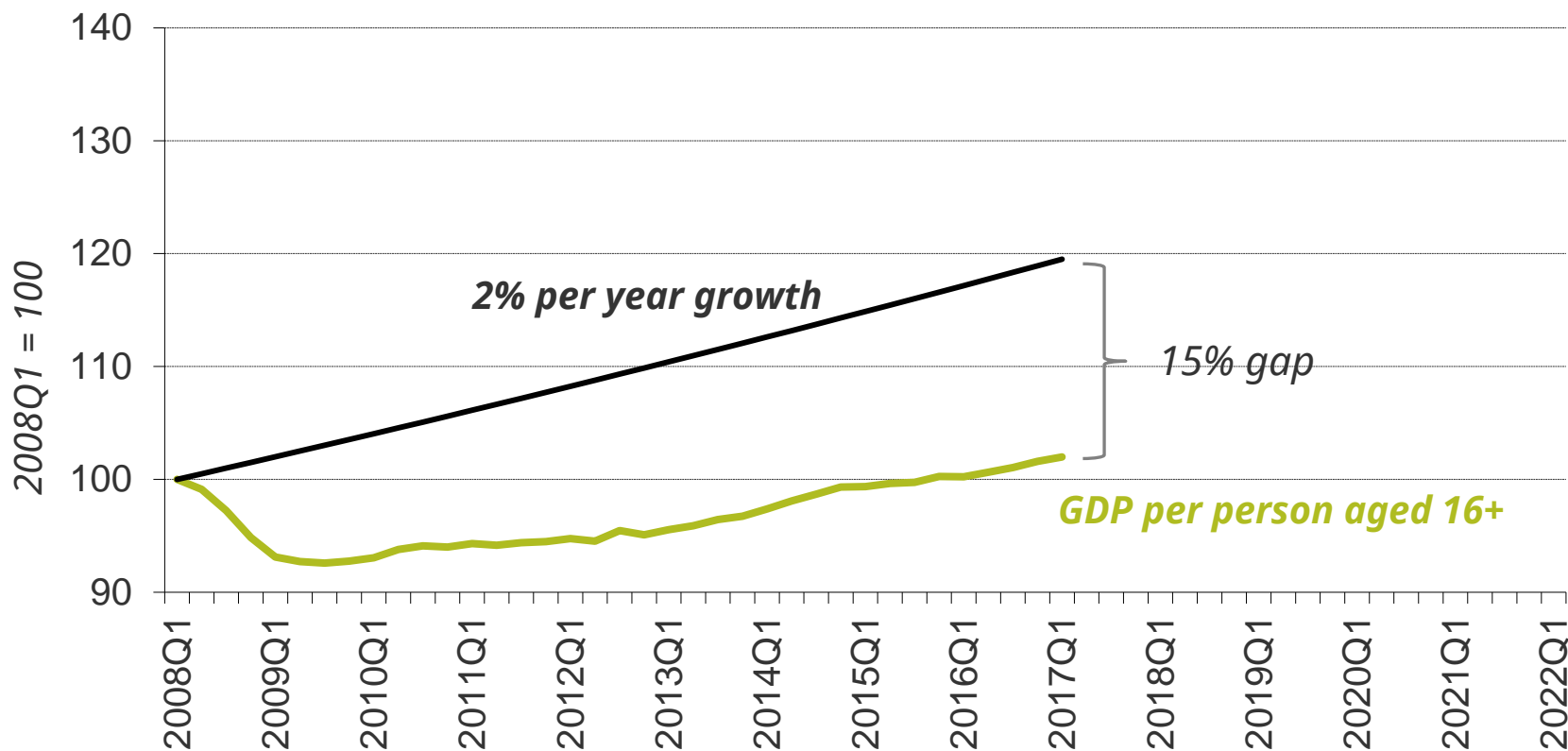


# *Fiscal Policy, Monetary Policy and Intergenerational Inequality in the UK*

*Paul Johnson*

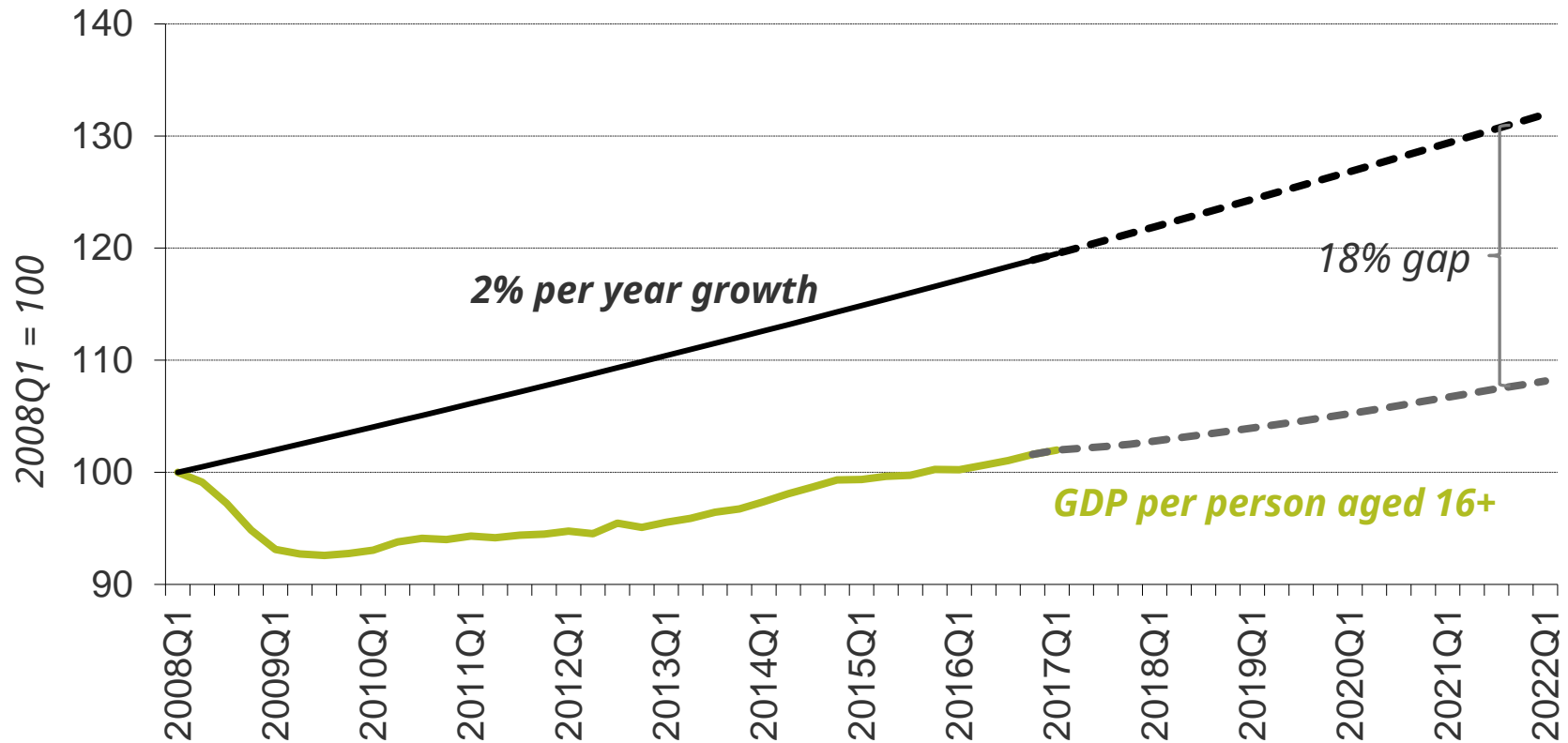
*19/05/2017*

# Output per head only just above 2008Q1 level



Source: Office for Budget Responsibility

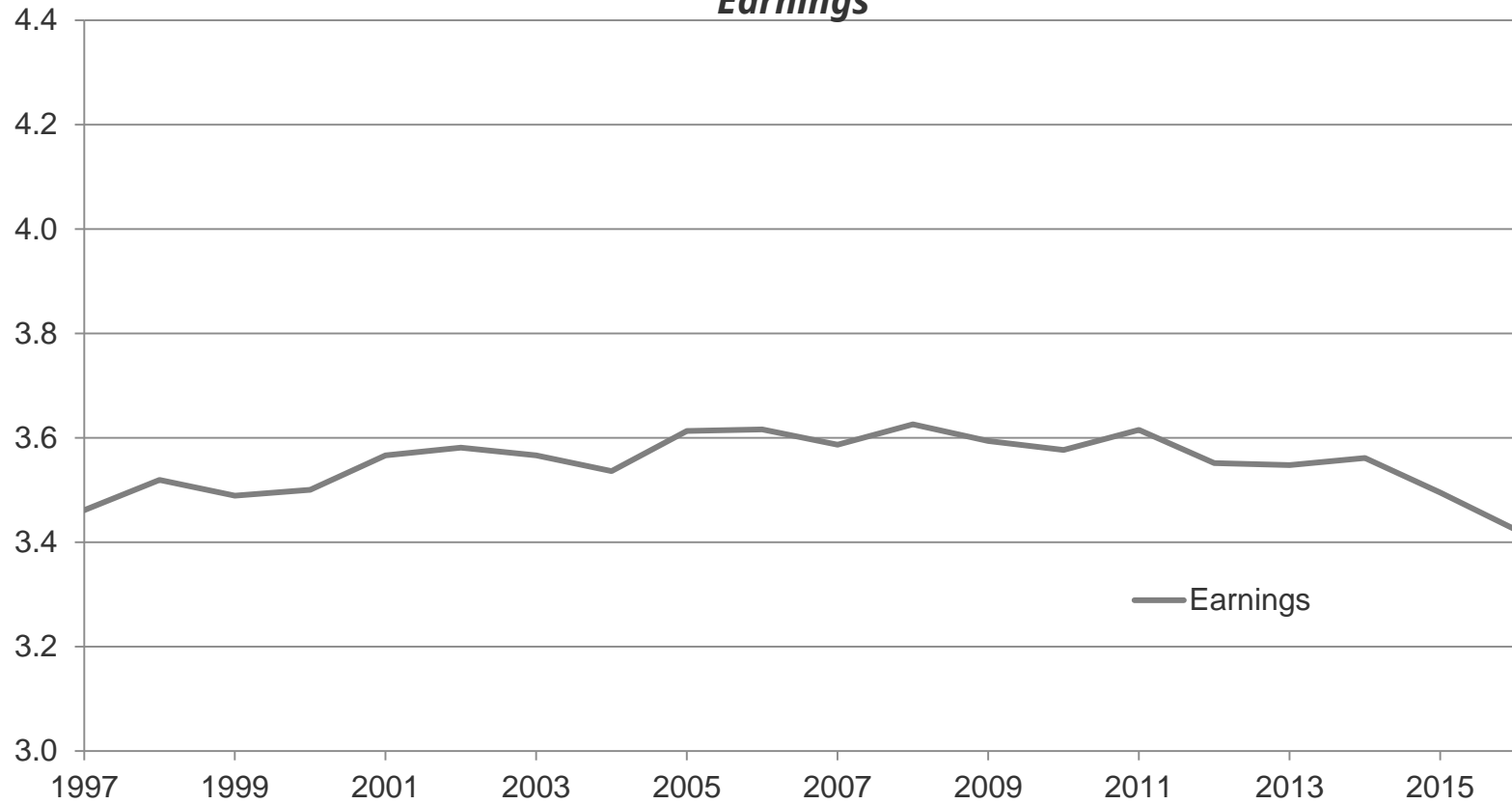
# And forecast growth also weak ...



Source: Office for Budget Responsibility

# Income and earnings inequality down recently

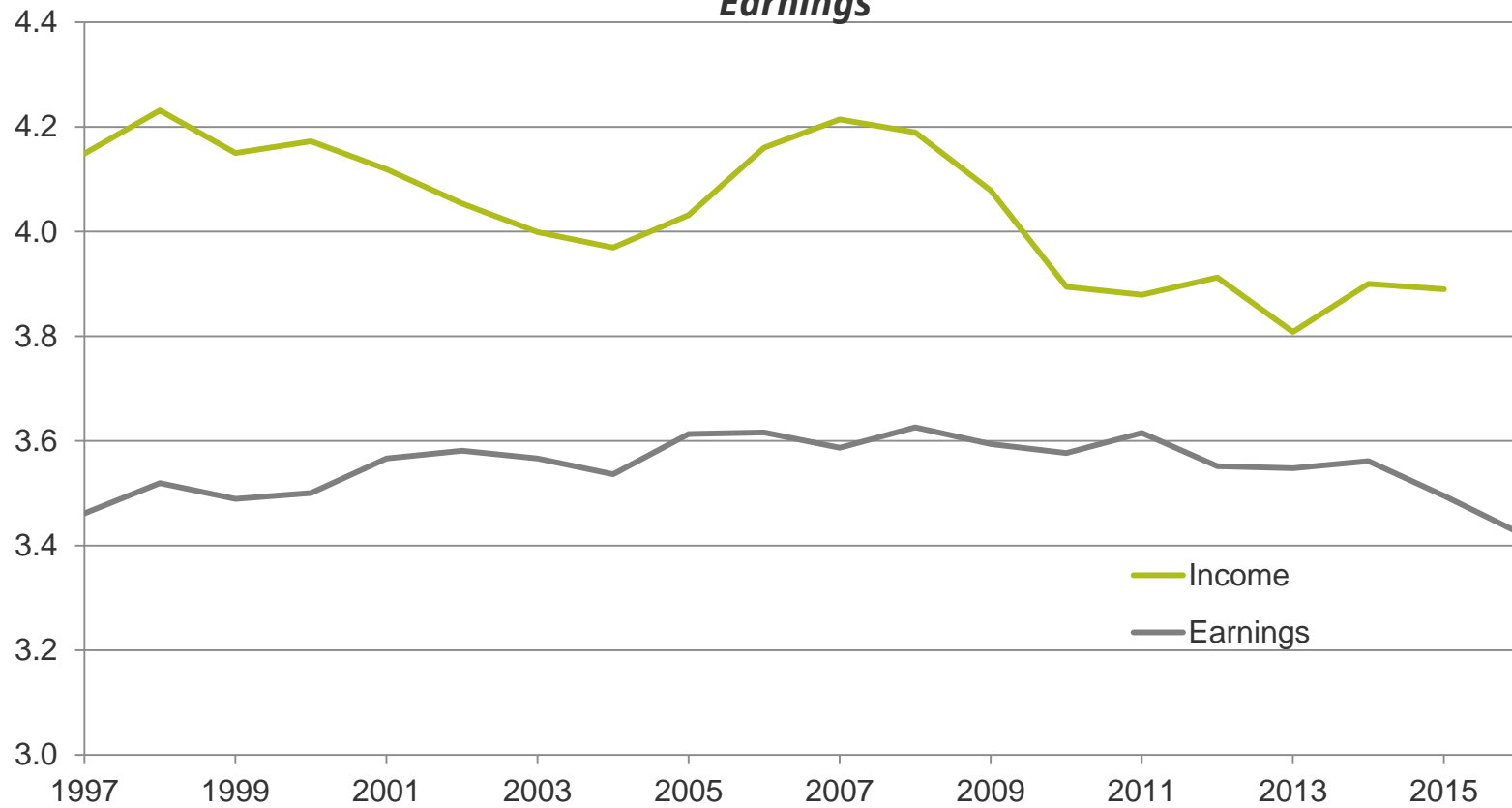
## 90:10 ratio for UK Net Equivalised Household income and Gross Weekly Earnings



Source: Family Expenditure Survey; Family Resources Survey; Annual Survey of Hours and Earnings

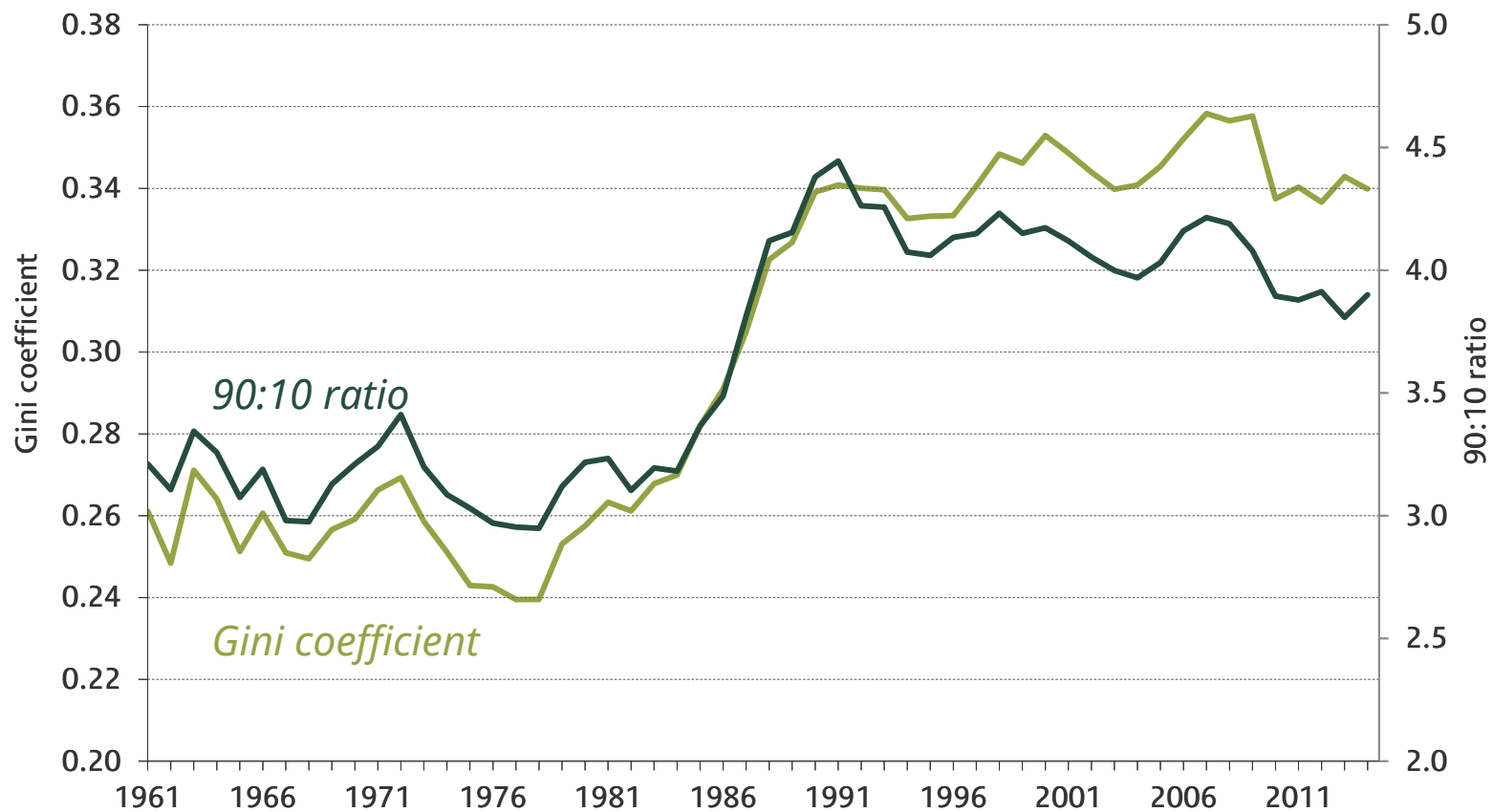
# Income and earnings inequality down recently

**90:10 ratio for UK Net Equivalised Household income and Gross Weekly Earnings**



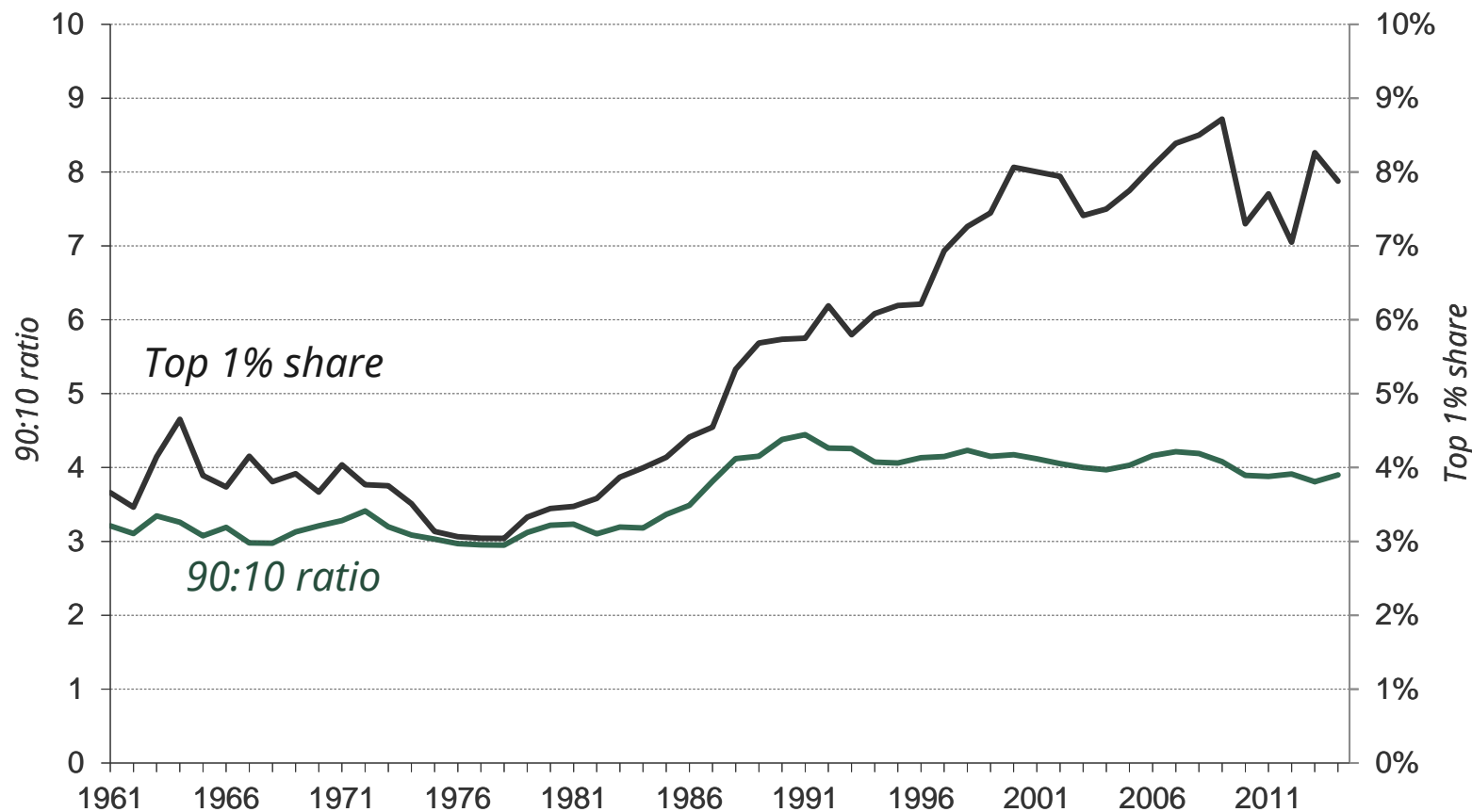
Source: Family Expenditure Survey; Family Resources Survey; Annual Survey of Hours and Earnings

## Having grown sharply over 1980s



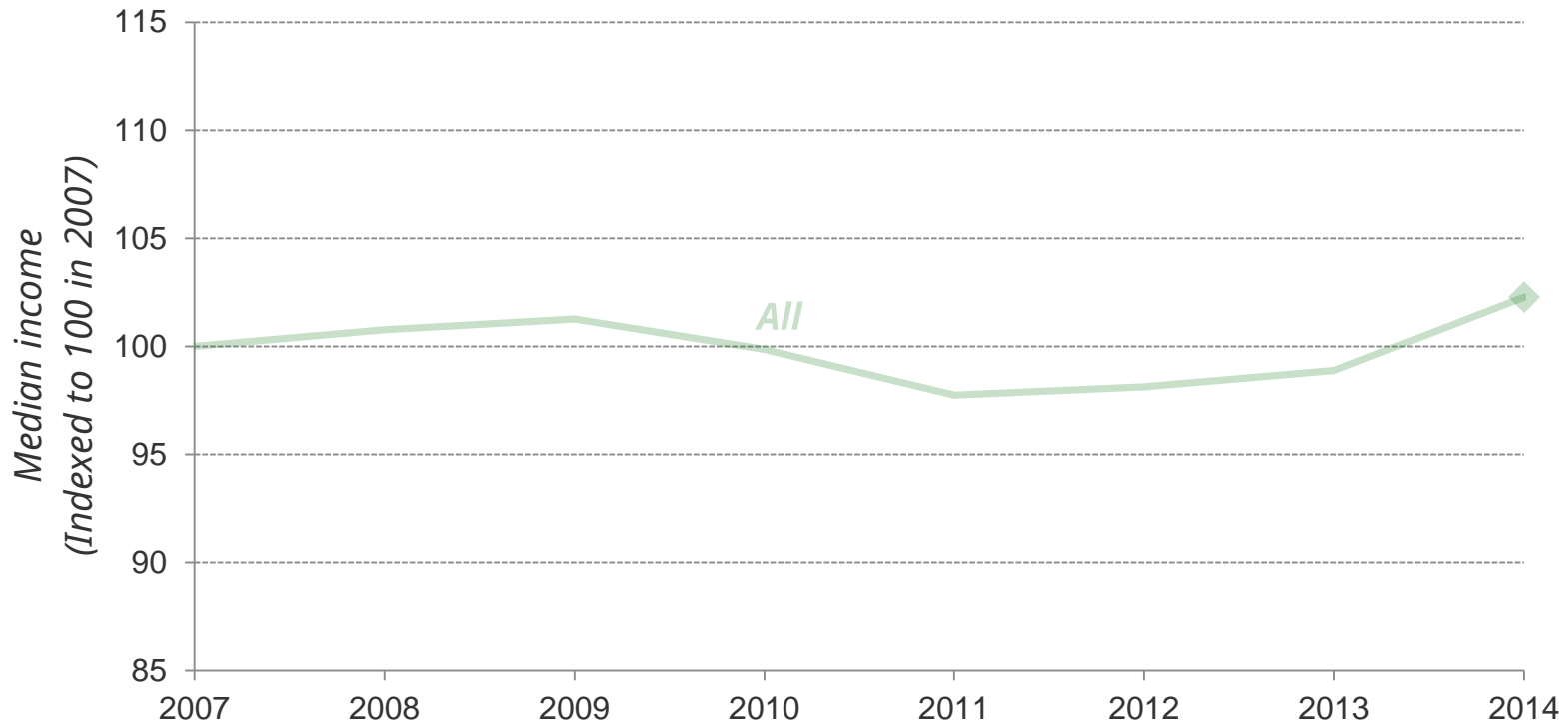
Source: Figures 3.6 and 3.7 of *Living Standards, Poverty and Inequality: 2016*

## Top 1% share continuing to rise until 2008



Source: Figure 3.7 of *Living Standards, Poverty and Inequality: 2016*

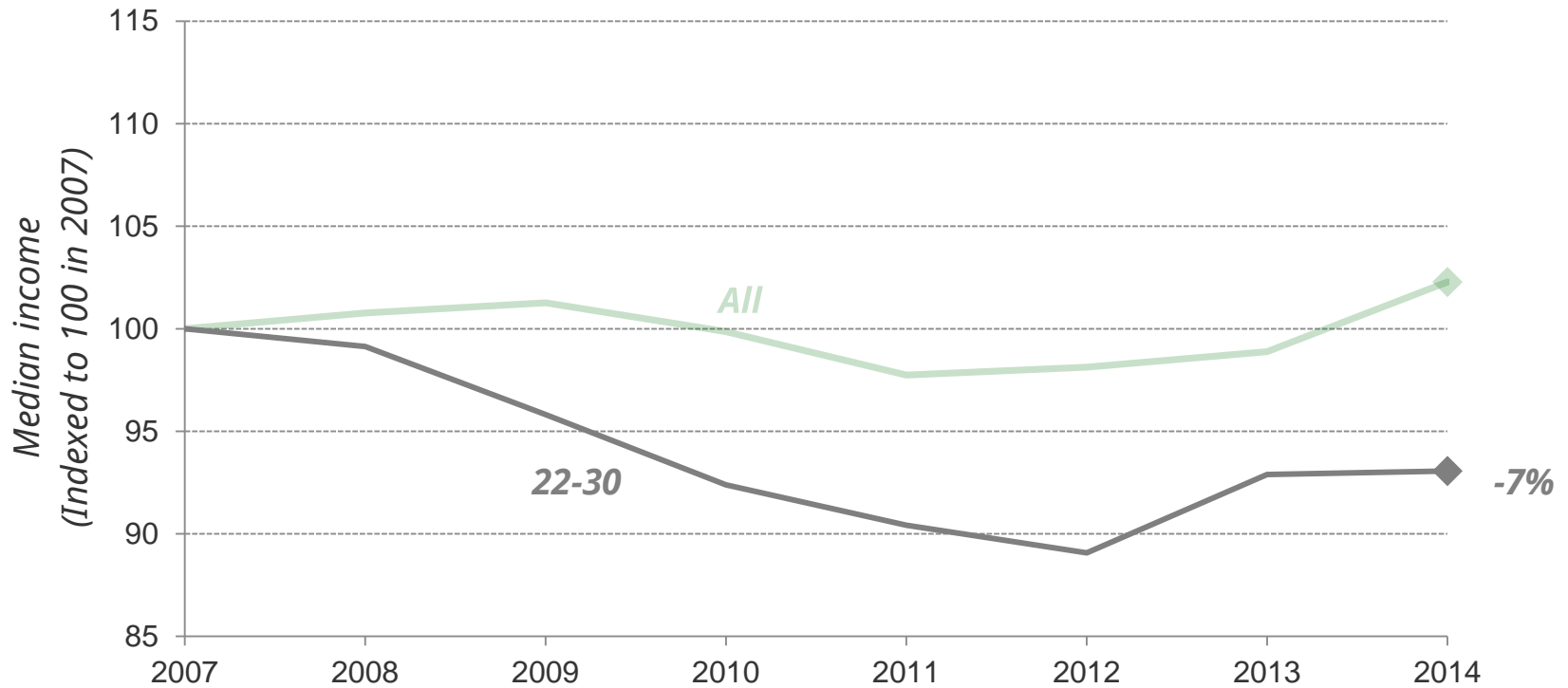
## Median incomes stagnant



Source: Figure 2.6 of *Living Standards, Poverty and Inequality: 2016*

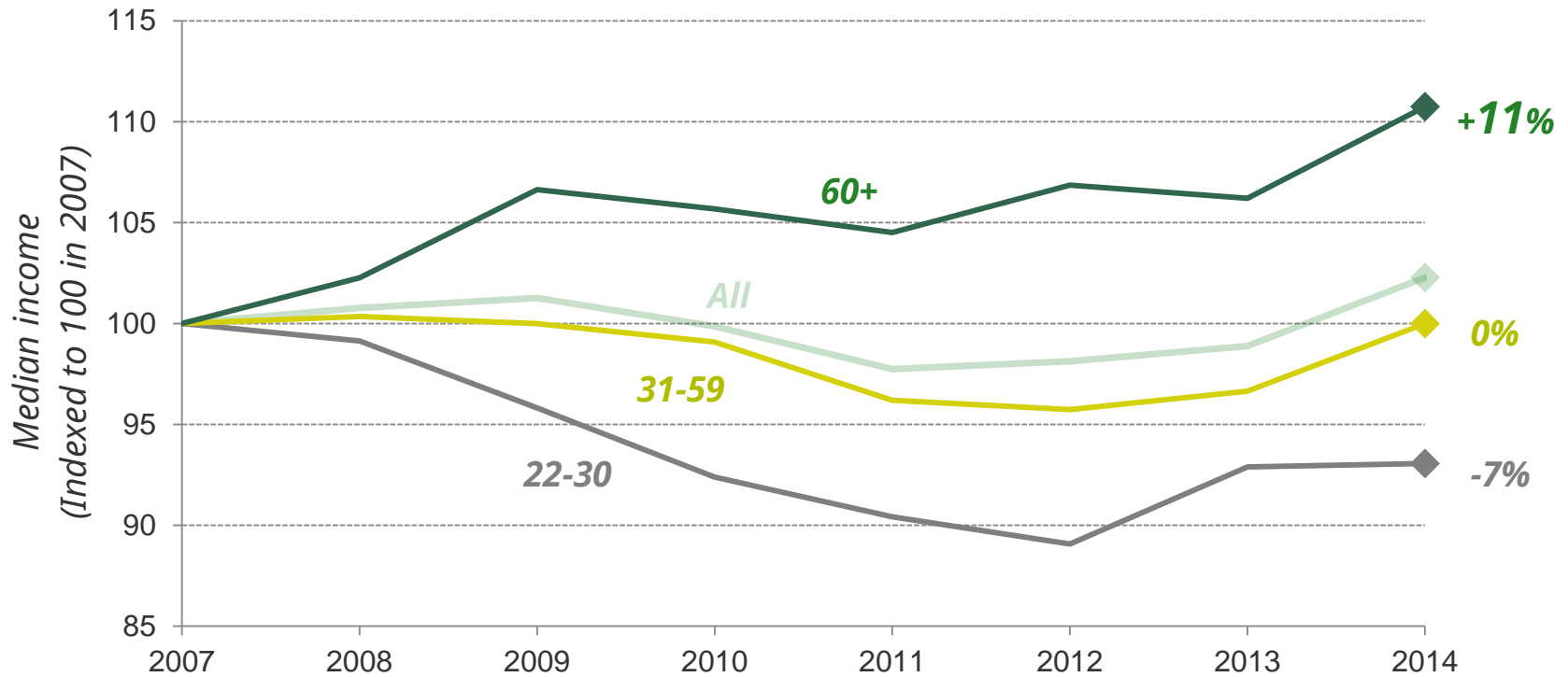


## *Much worse for the young*



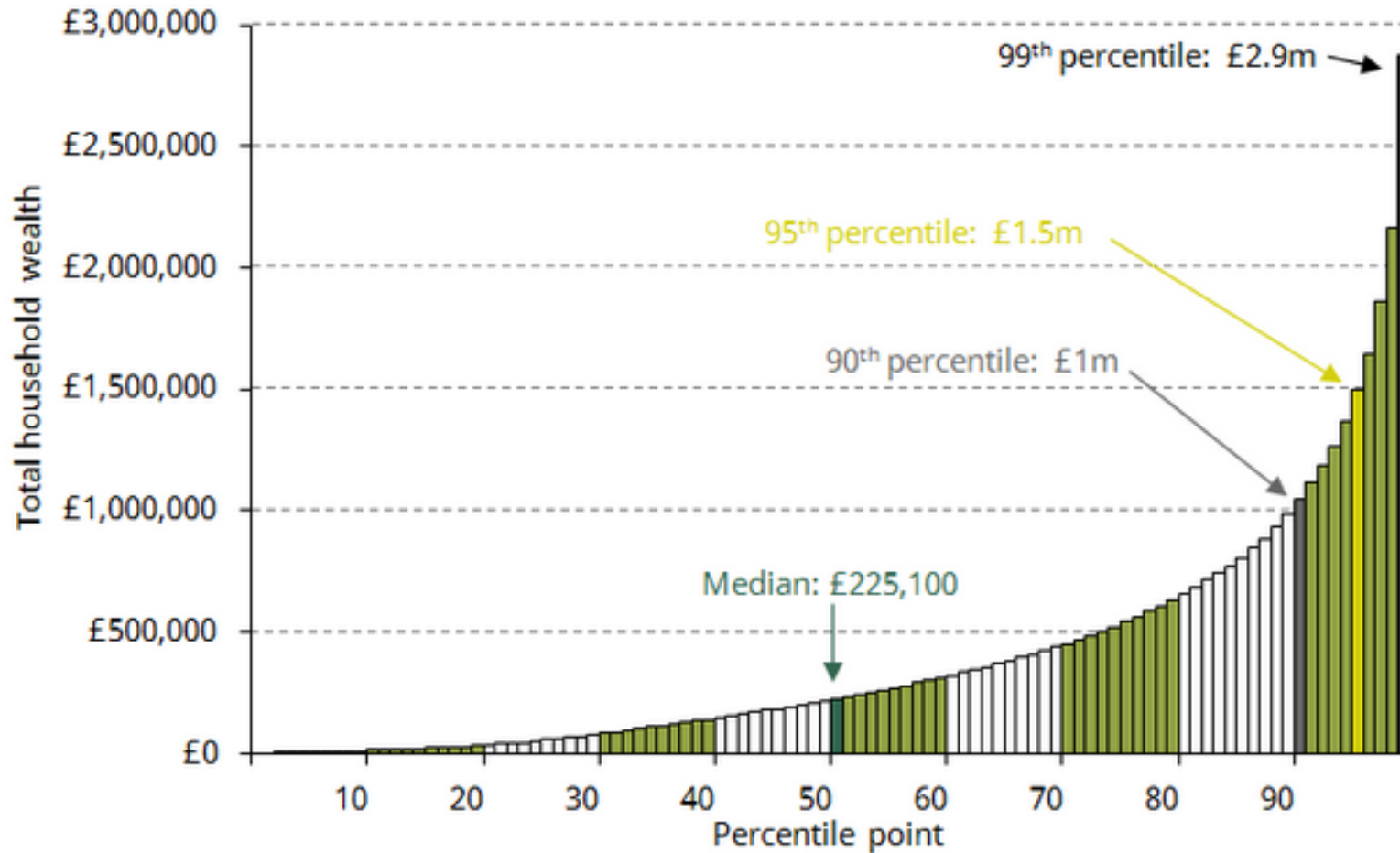
Source: Figure 2.6 of *Living Standards, Poverty and Inequality: 2016*

## Much better for the old

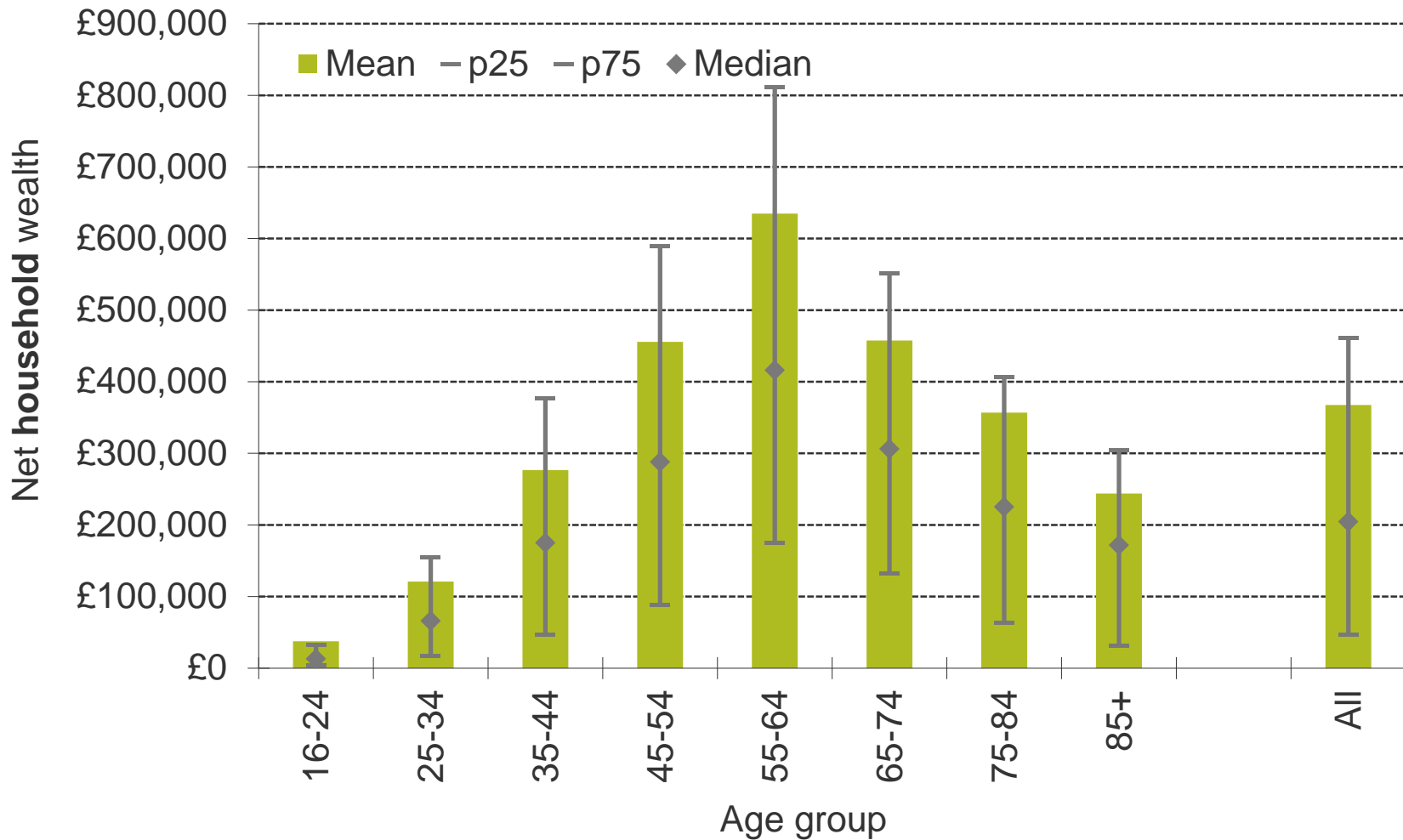


Source: Figure 2.6 of Living Standards, Poverty and Inequality: 2016

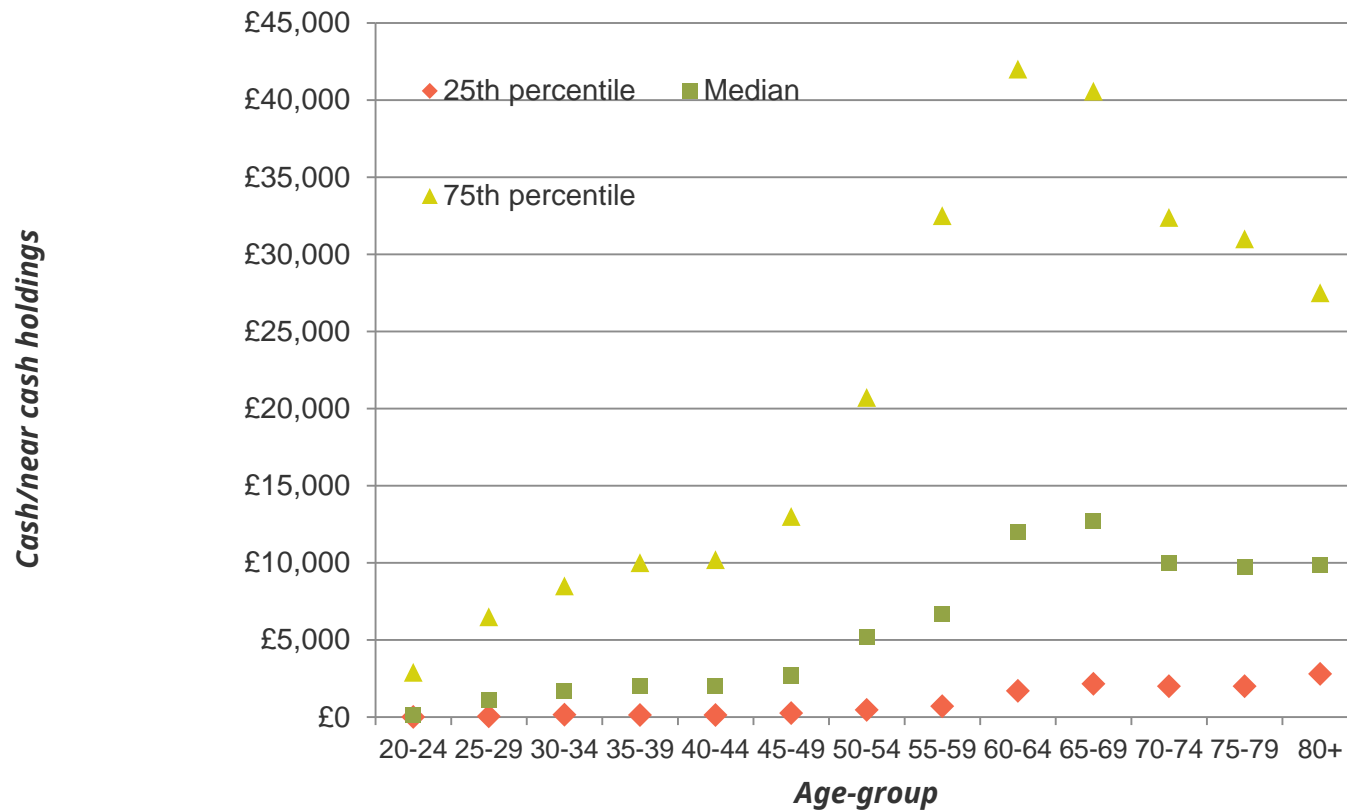
# The distribution of wealth



# And concentrated at older ages



# Of course the old hold the cash



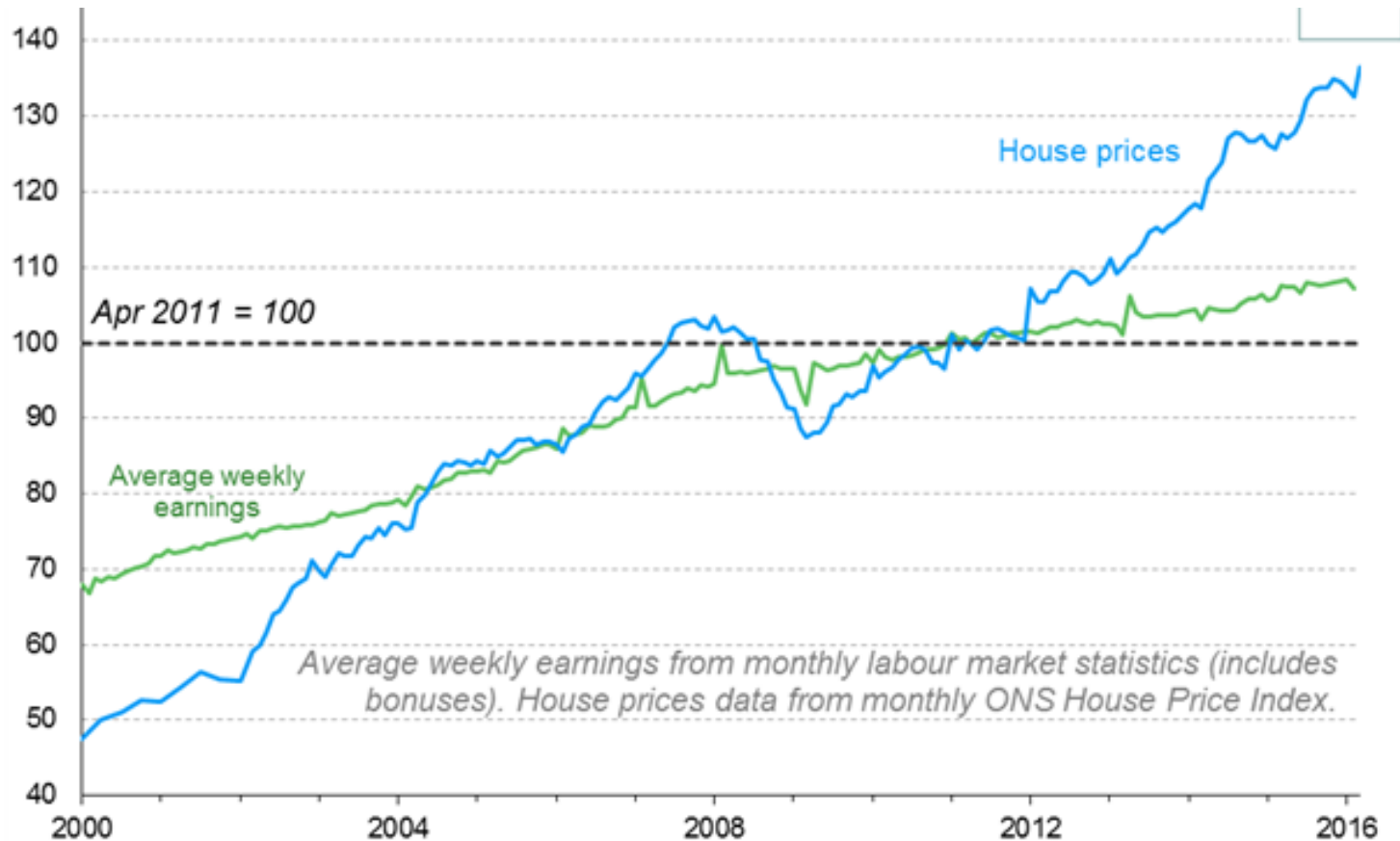
## ***But it's the young who can't build up savings***

***If you work until 67, die at 90, and have earnings that grow 2% p.a.***

***With 4% real interest rate you need to save 10% of income to replace 50% in retirement***

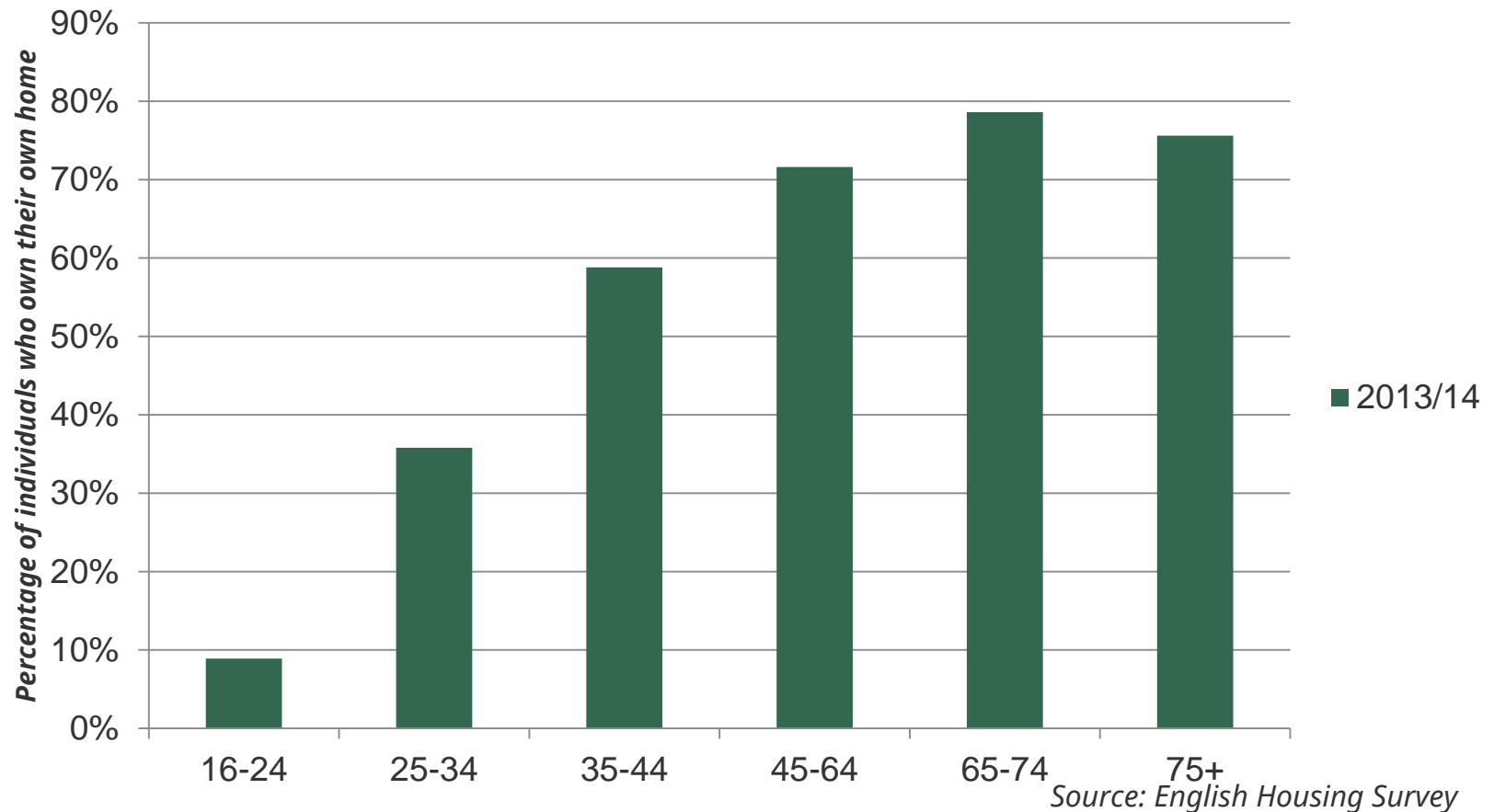
***With 0% real interest rate saving rate needs to be 30%***

# House prices have risen much faster than earnings



# The old also hold the housing wealth

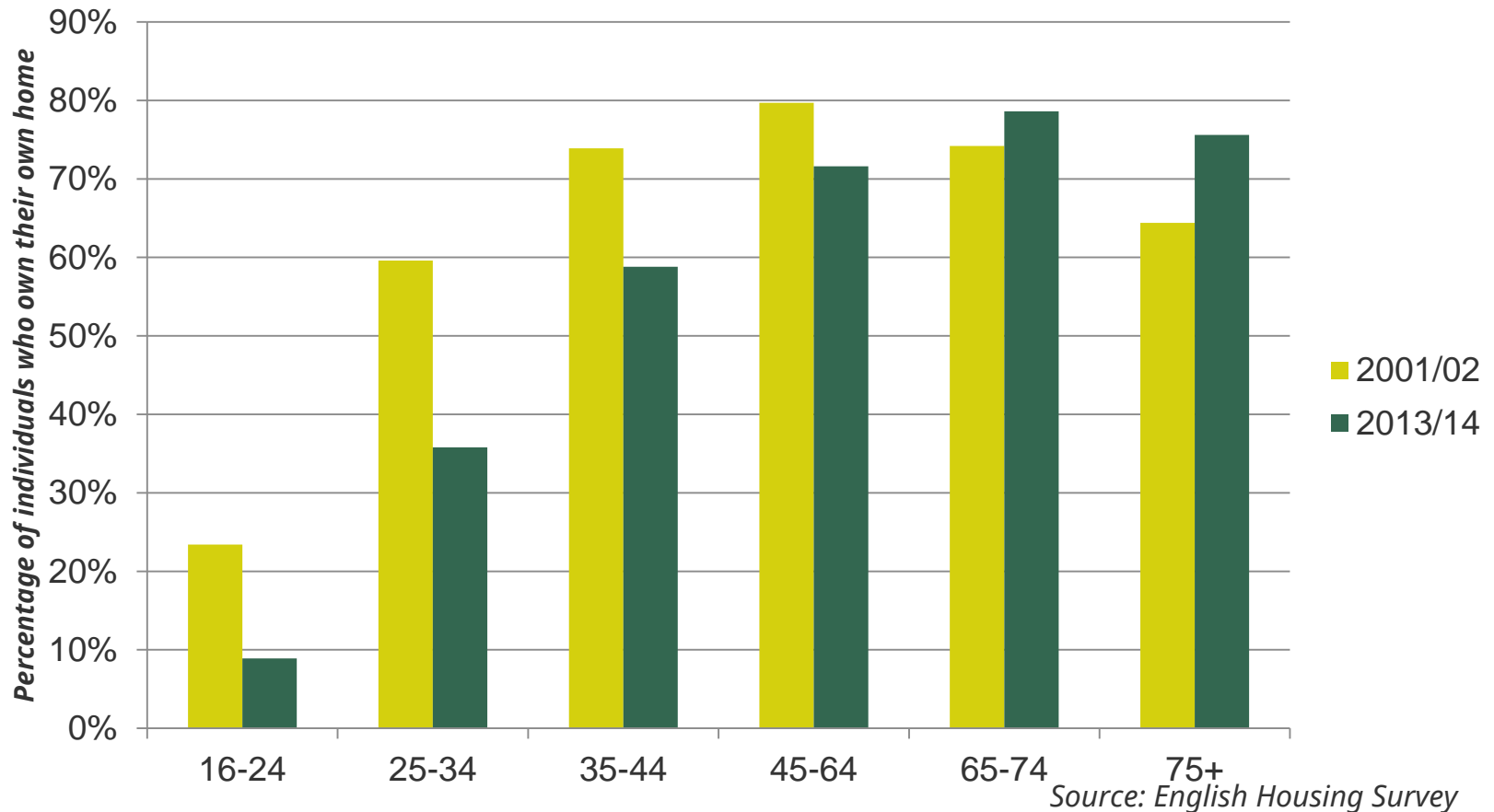
## Home-ownership rates by age-group



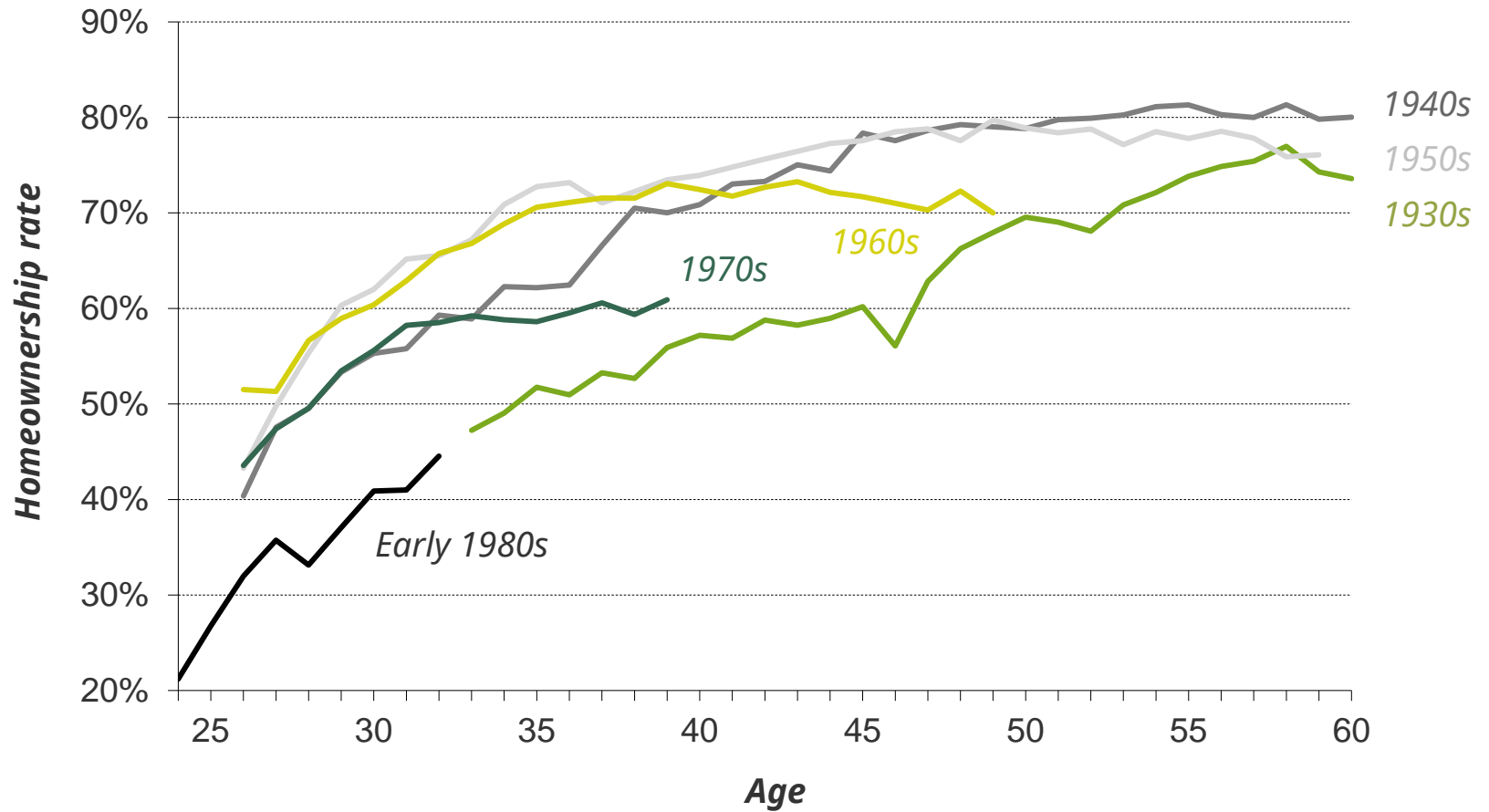


# Much more so than just 15 years ago

## Home-ownership rates by age-group

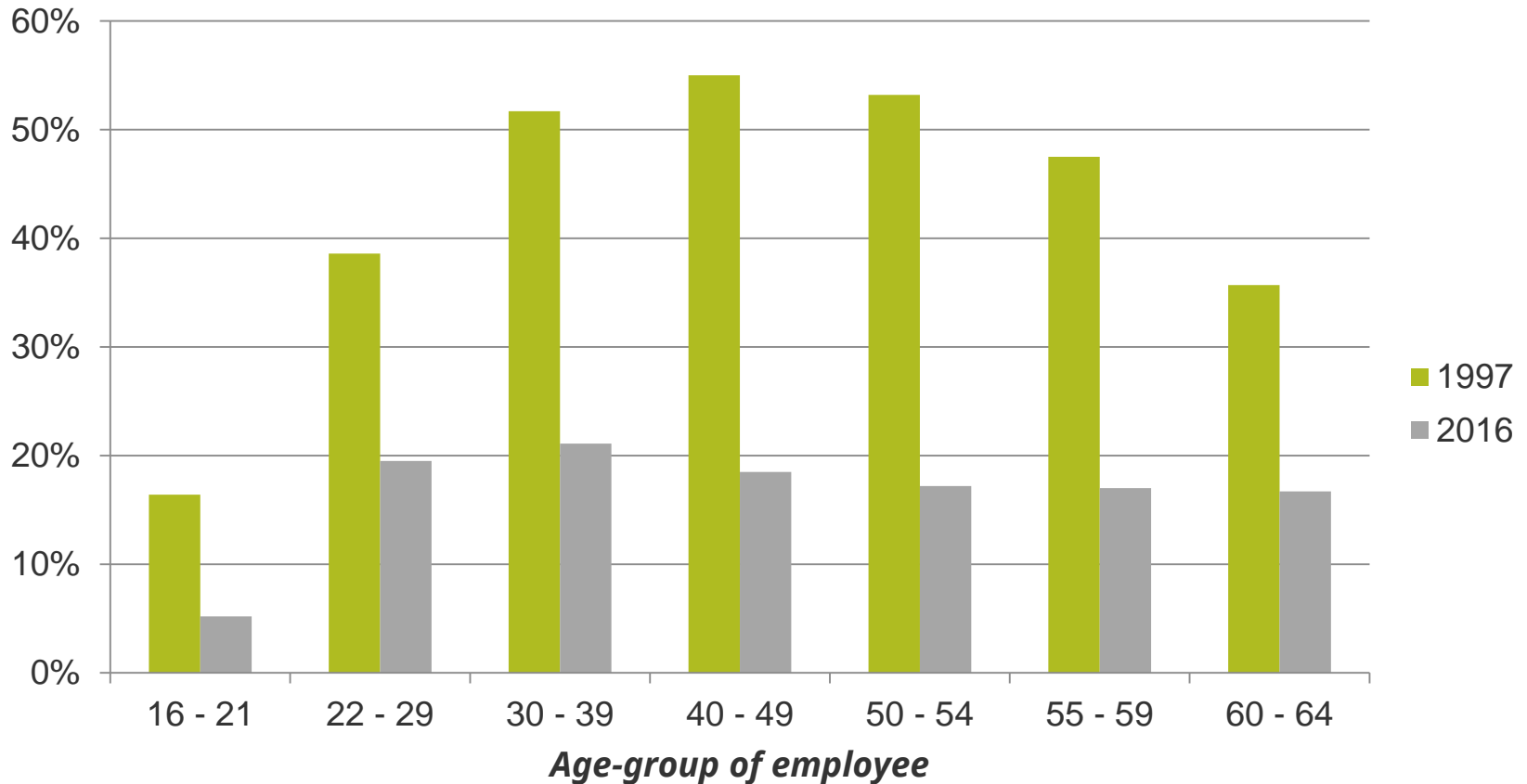


## Younger cohorts much less likely to be owner occupiers



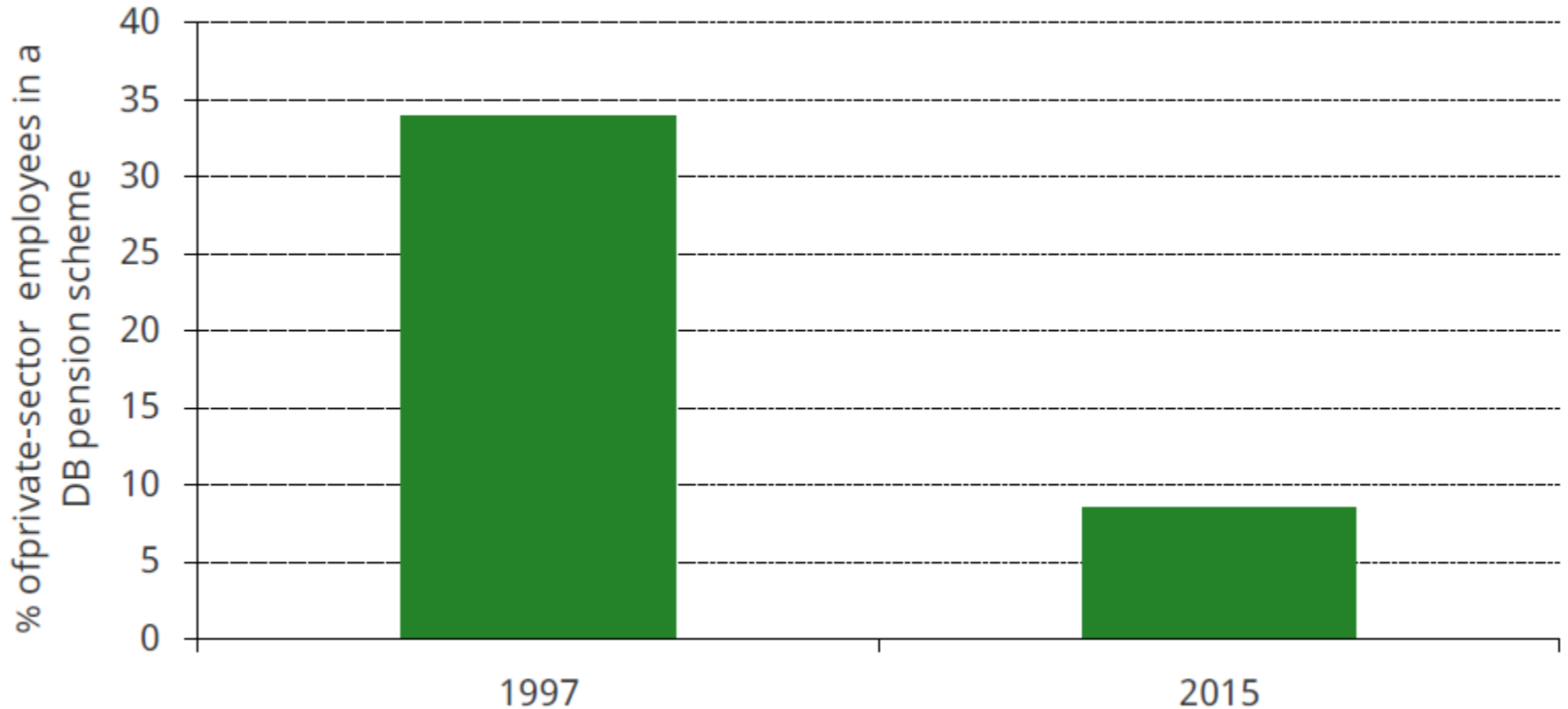
# And DB pensions have collapsed

**Percentage of employee jobs in a defined benefit pension scheme**



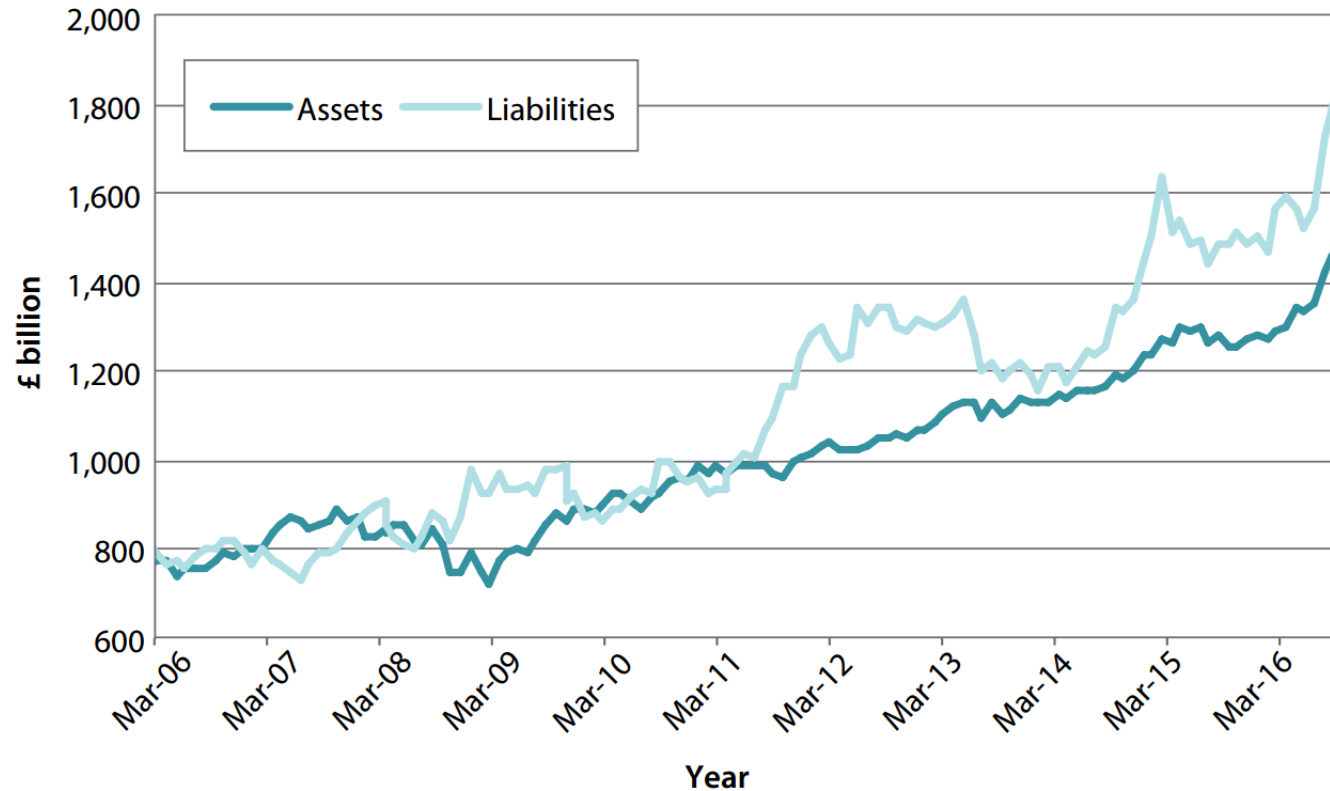
Source: ONS

## ***Proportion of private sector employees in DB scheme 1997 and 2015***



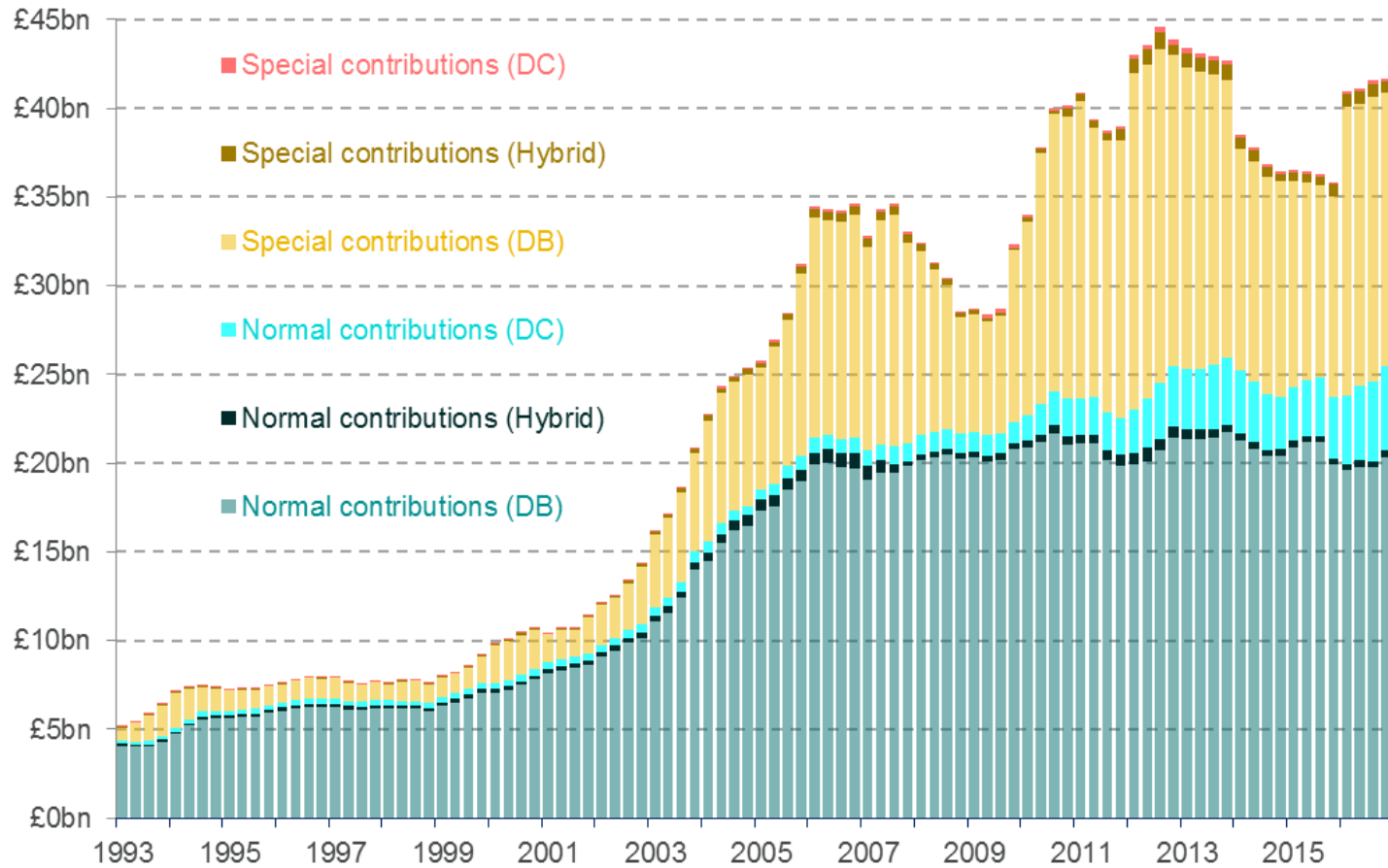
# But there is an increasing aggregate deficit of DB schemes

### Assets and liabilities of DB schemes in the Pensions Protection Fund

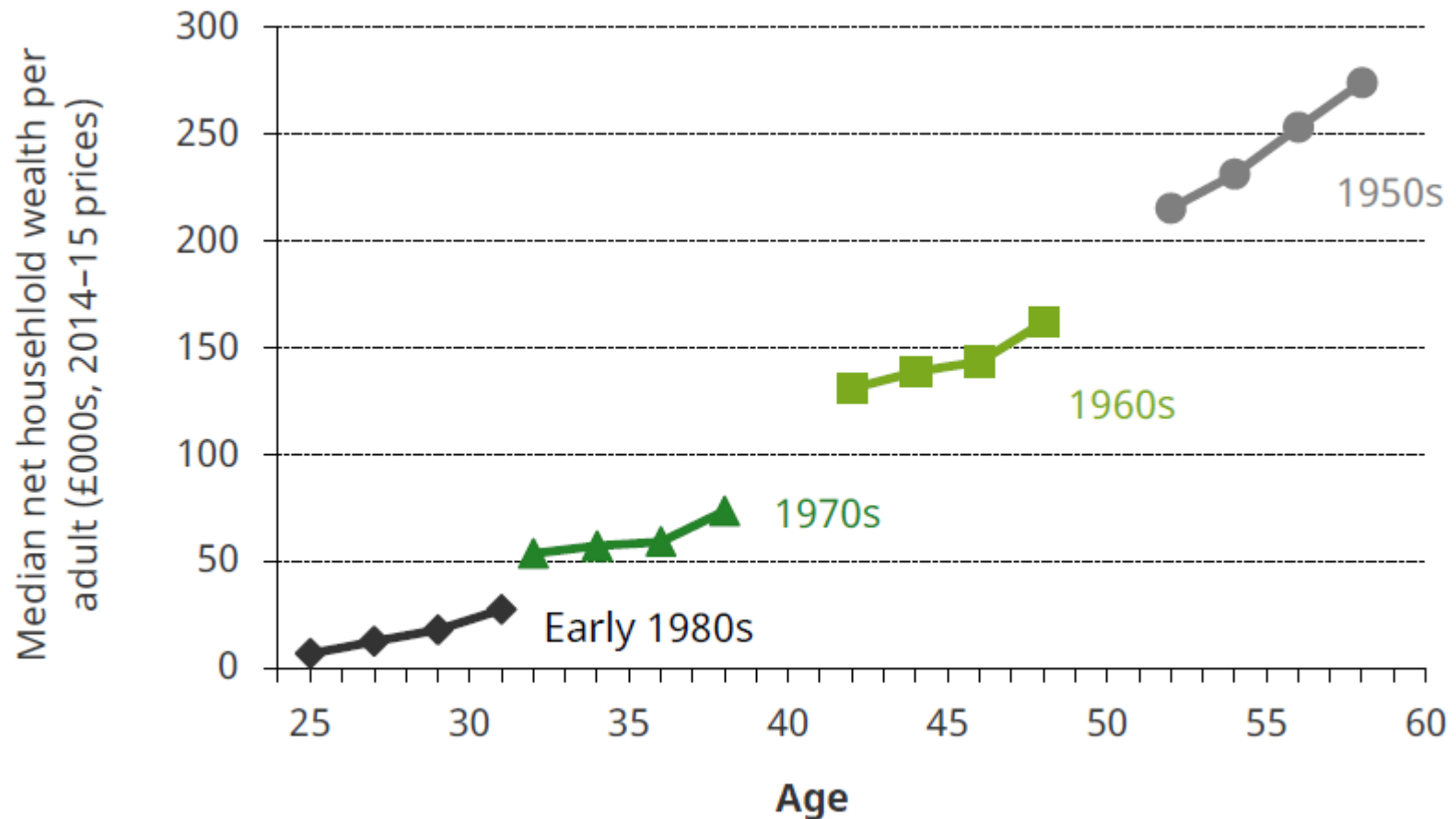


Source: PPF/ The Pensions Regulator

# Causing huge increase in contributions

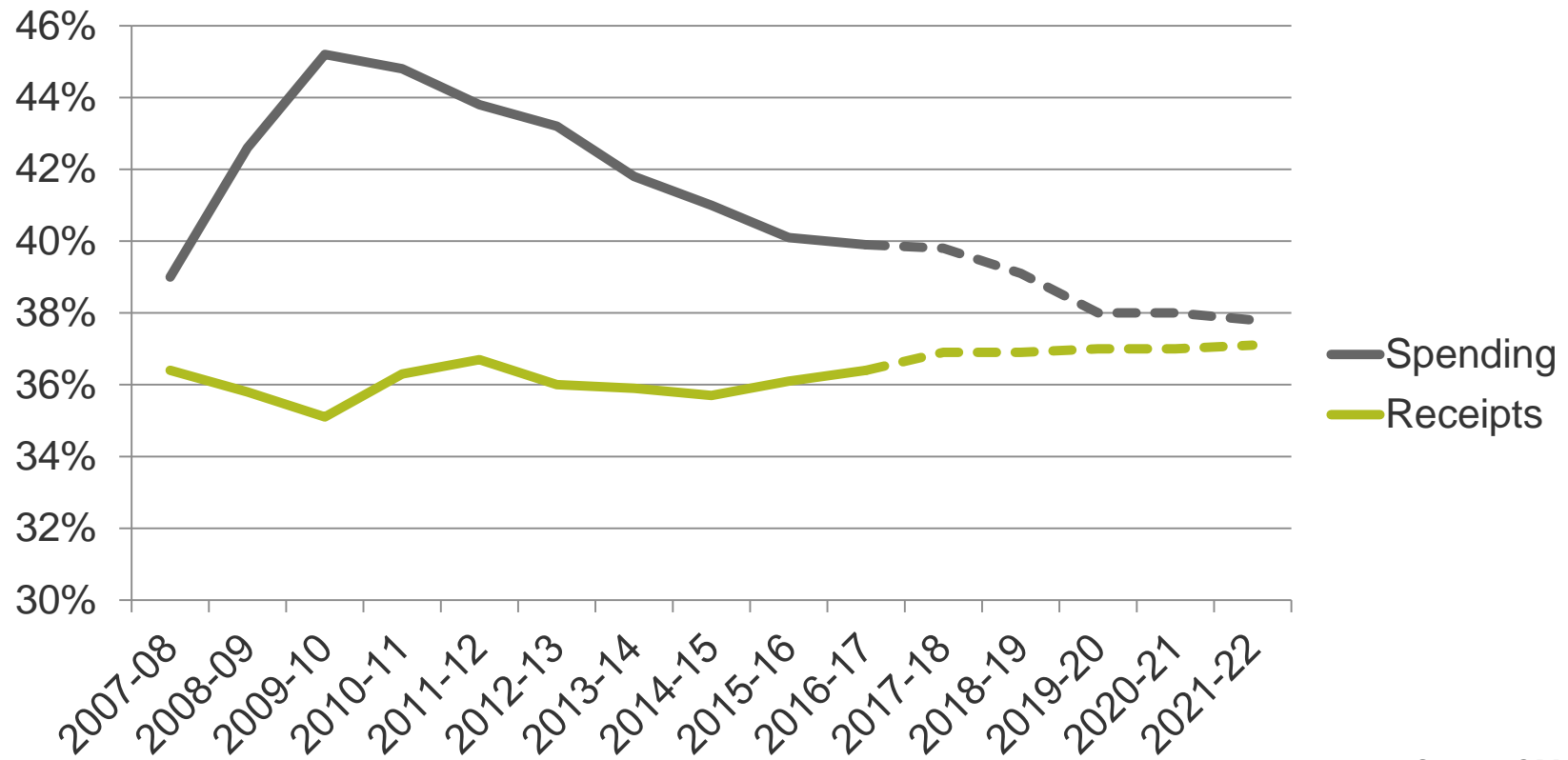


# Overall younger cohorts accumulating less wealth



# Loose monetary policy supporting tight fiscal policy

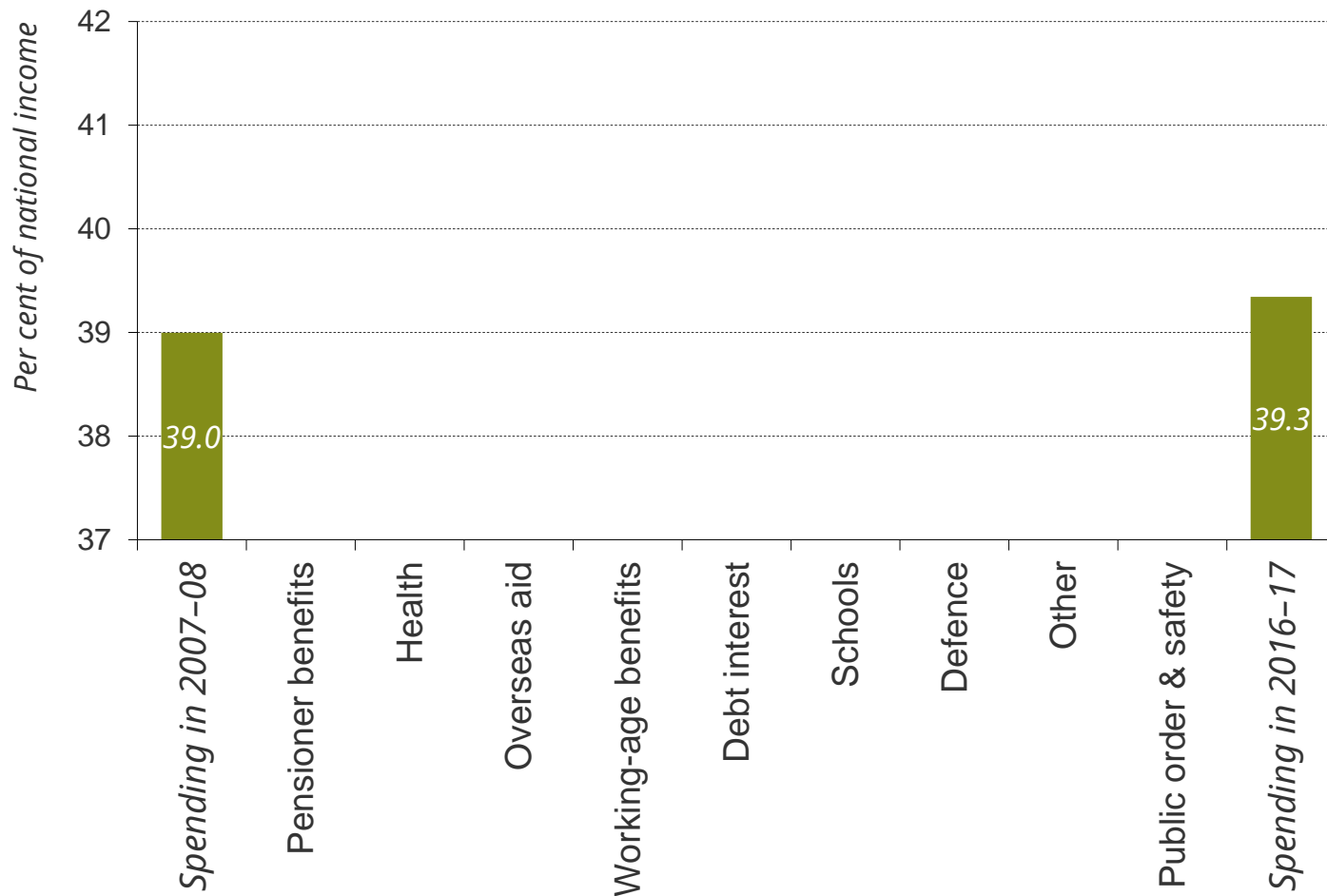
### Latest outturn and forecast for total Government spending and receipts



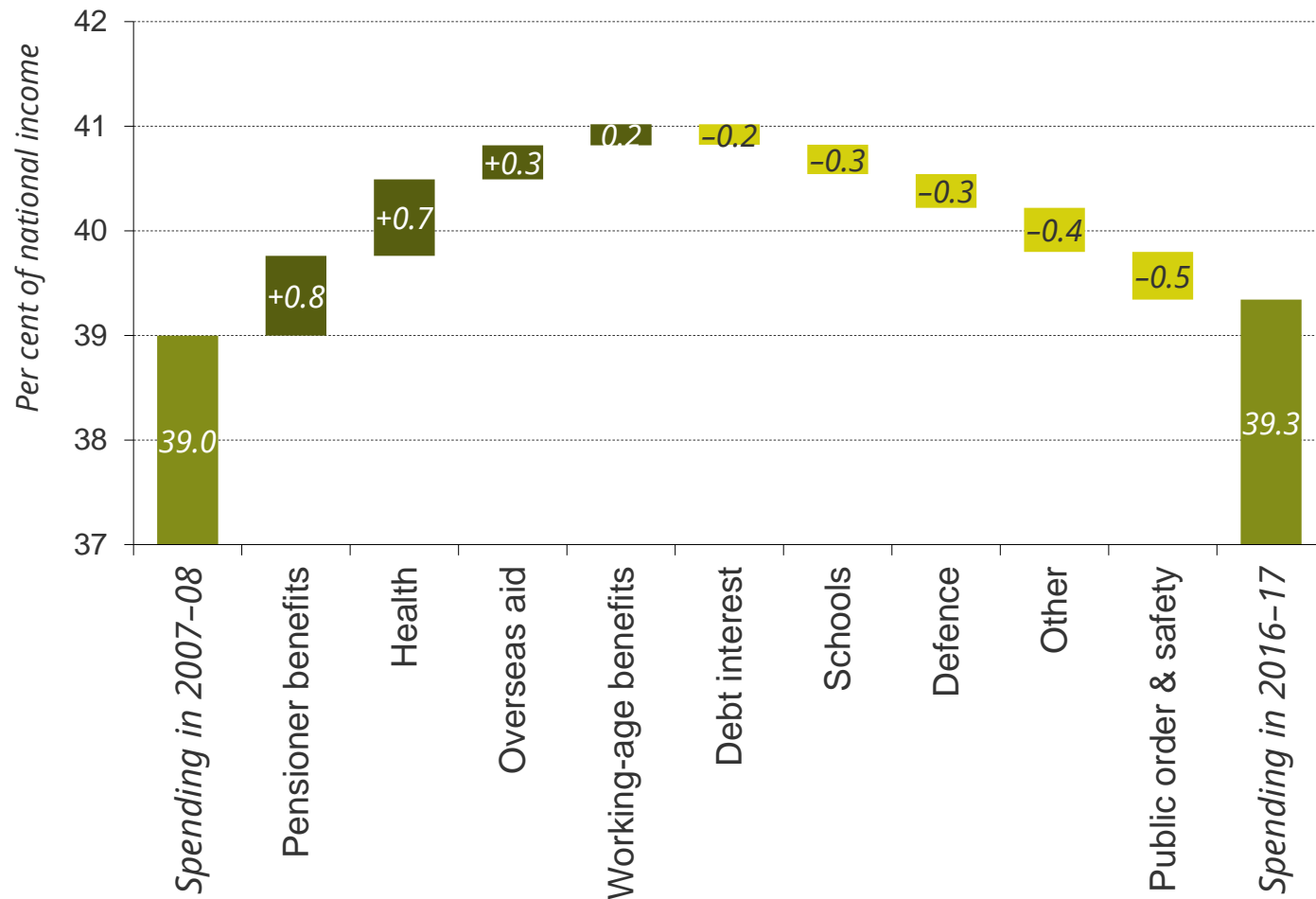
Source: OBR



# Crucial point: after 8 years of “austerity” the size of the state is just back at pre crisis levels

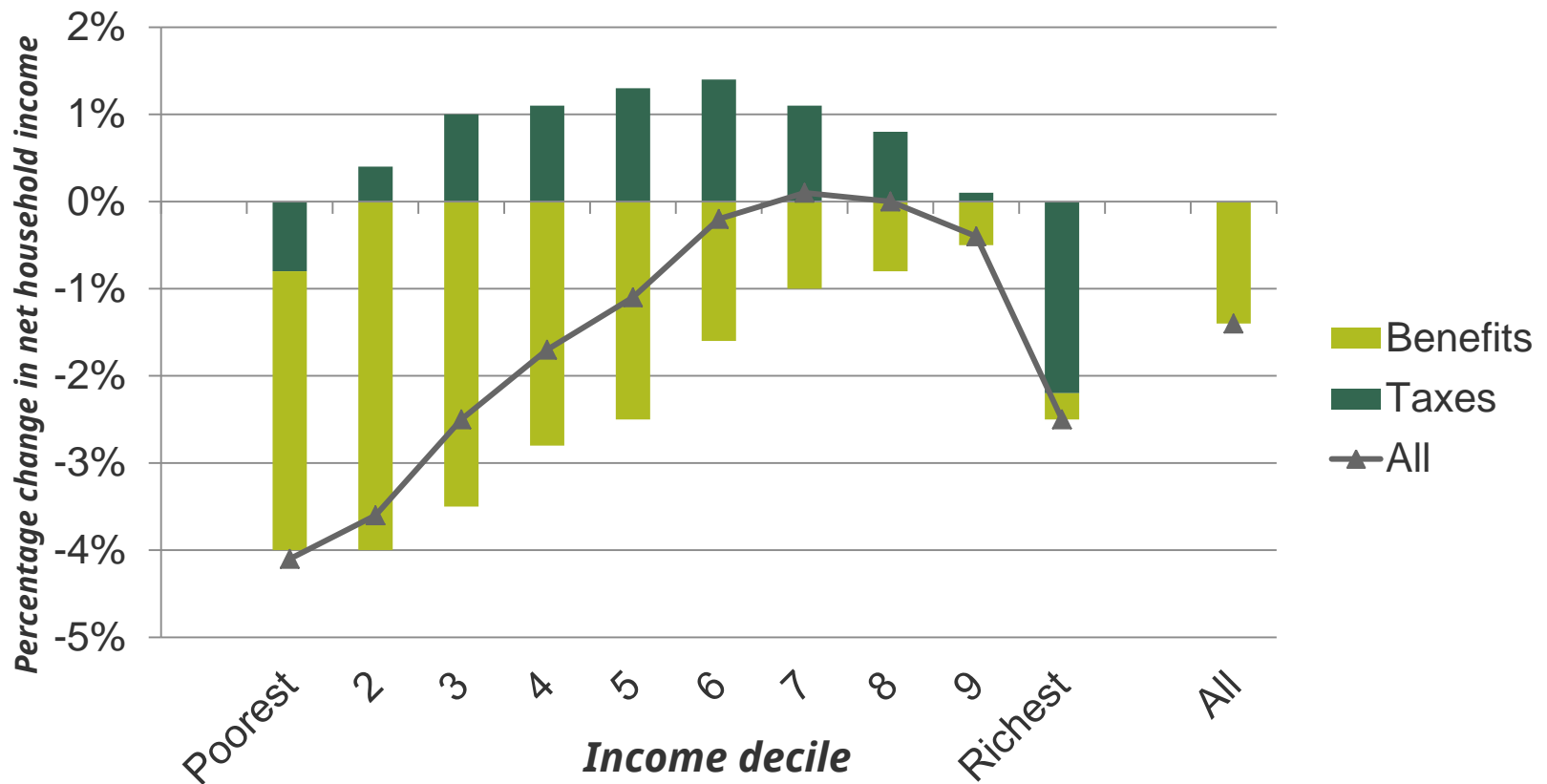


# Increases in spending on pensions and health offset cuts elsewhere



# Tax and benefit changes have hit the bottom half and the very top

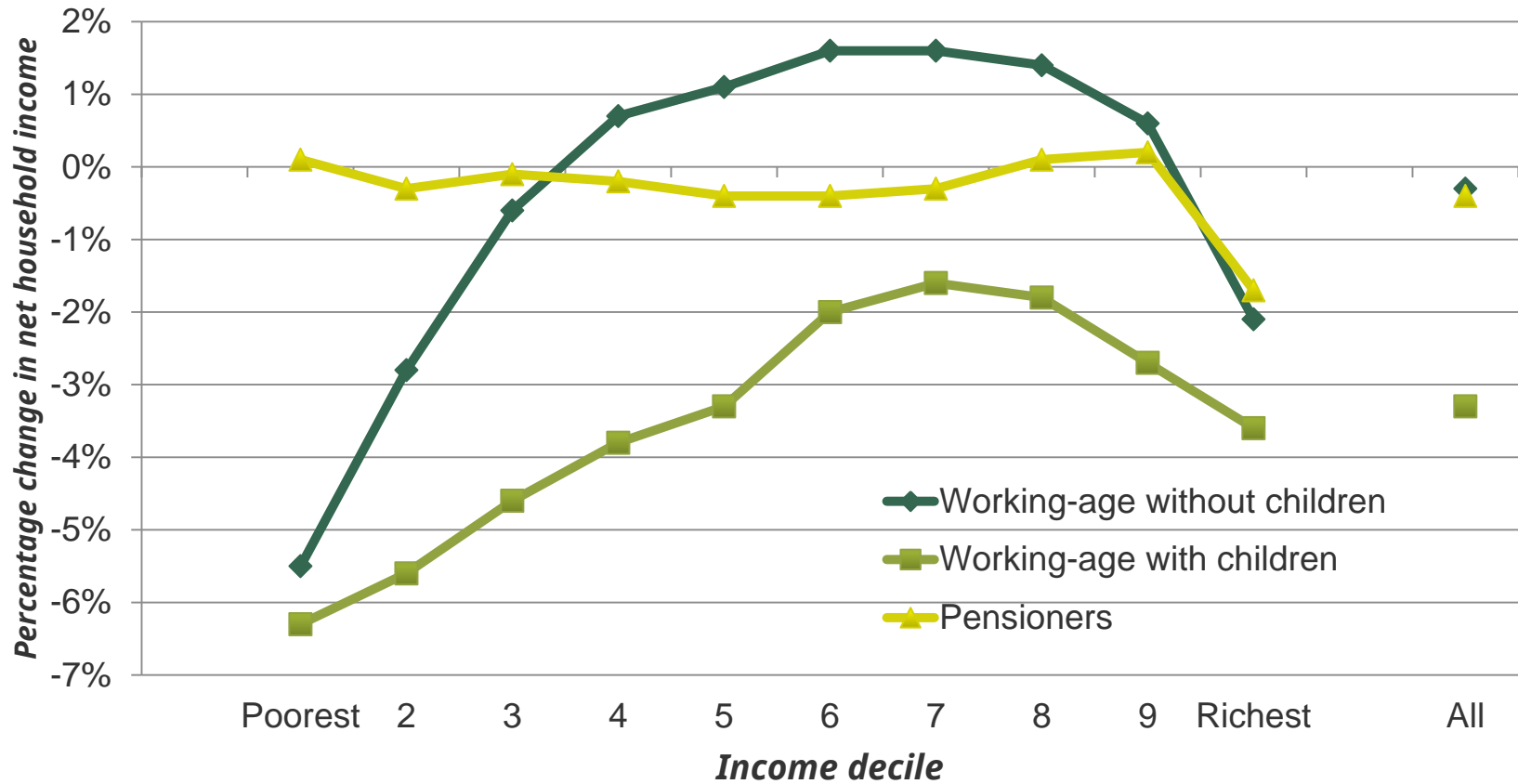
**Percentage change in net household income as a result of tax and benefit policies implemented under the coalition government**



Source: IFS

# Pensioners protected, those with children hit hardest

*Impact of coalition government tax and benefit policies by group*



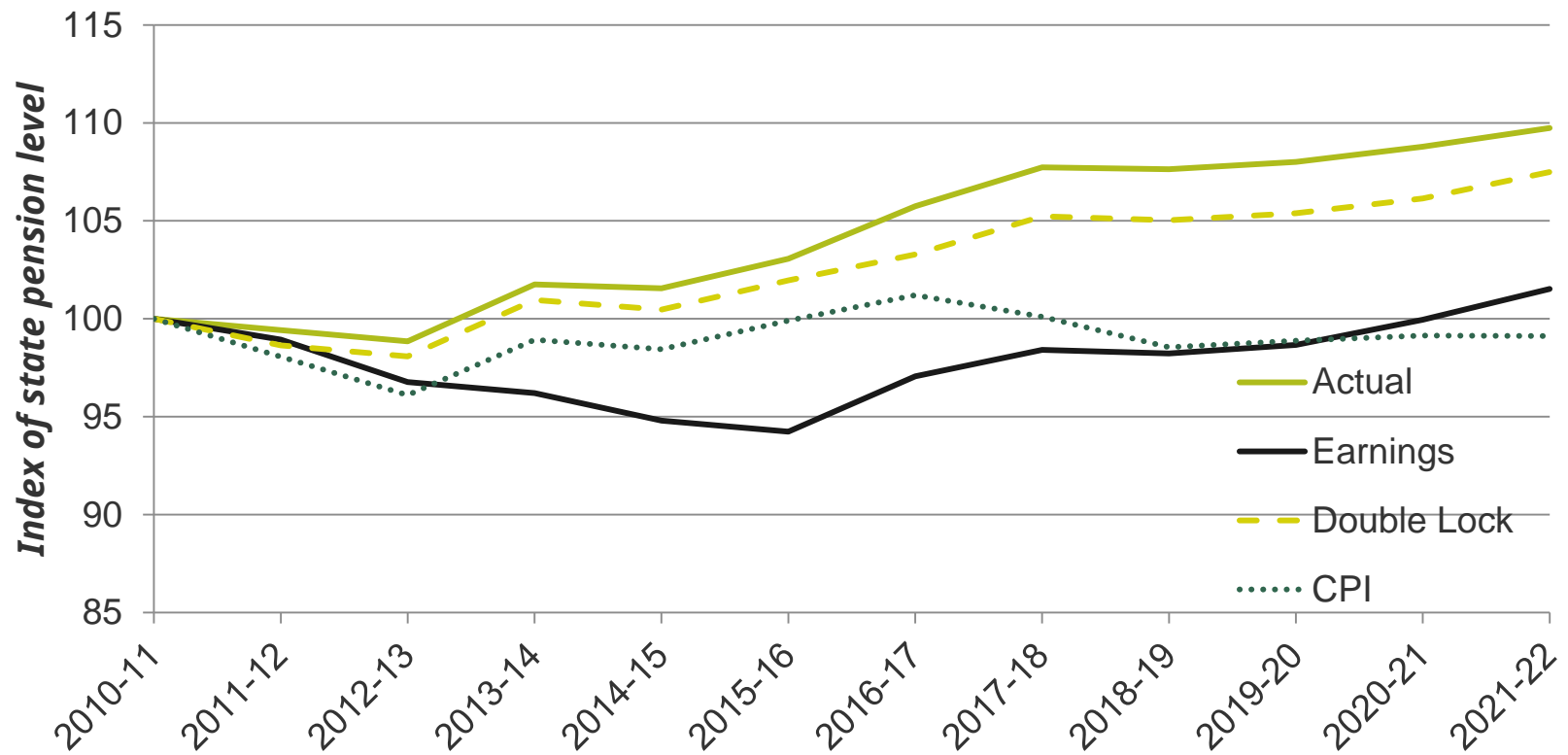
Source: IFS

# *Fiscal policy has worked with monetary policy and underlying trends to protect the old and hit the young*

- 1. **Triple lock** means basic state pension has grown 9%pts more than average earnings since 2010-11.*

# The triple lock

**Growth rate of basic state pension compared to average earnings (2010-11 level = 100)**



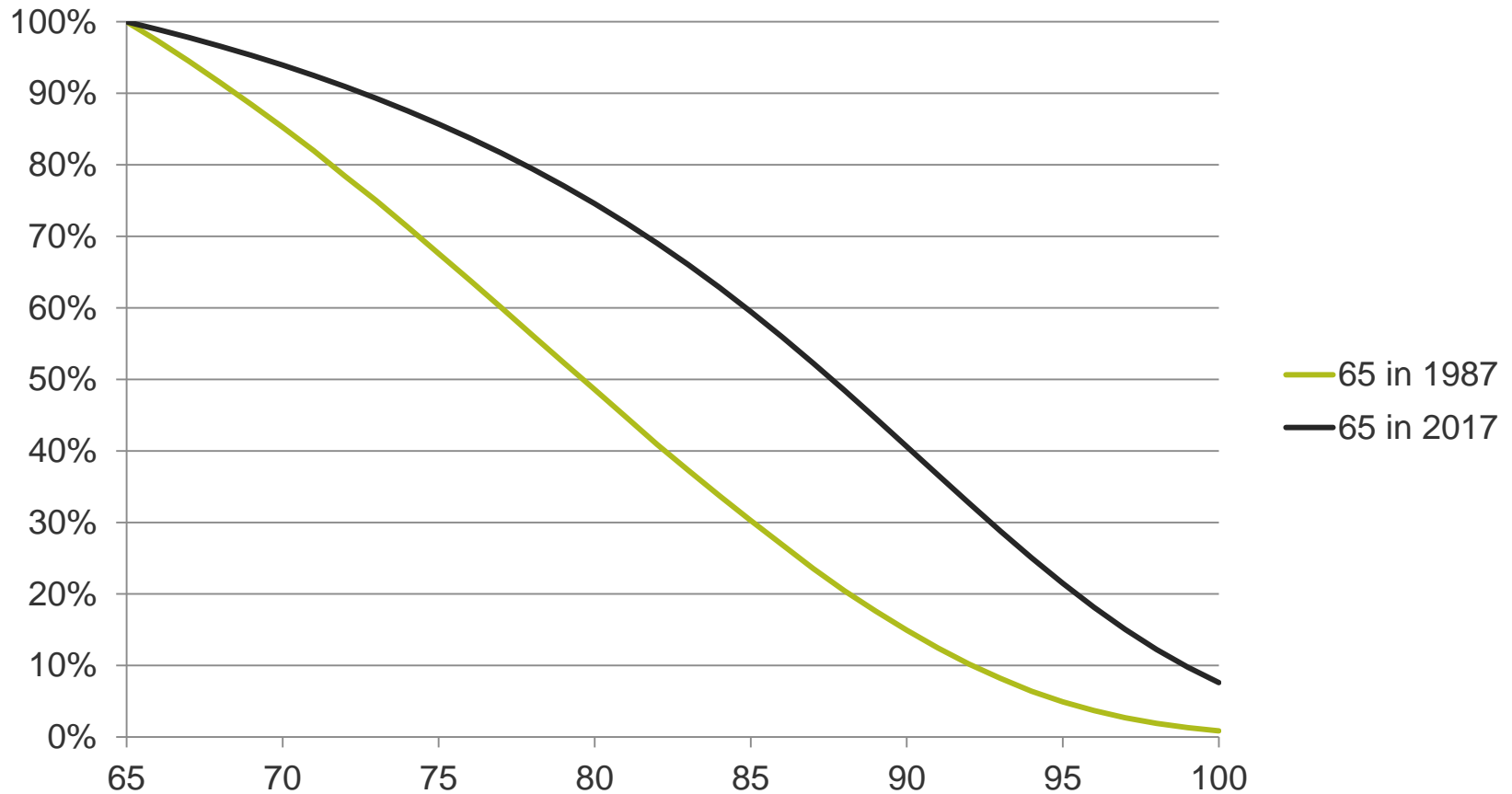
Source: OBR and author's calculations

## ***Policy changes have exacerbated existing trends***

- 1. **Triple lock** means basic state pension has grown 9%pts more than average earnings since 2010-11.*
- 2. **The state pension** age for men has not kept up with increasing longevity*

# Dramatic increase in numbers living longer in recent decades

**Proportion of male 65-year-olds surviving to given age**



Source: ONS Life Tables

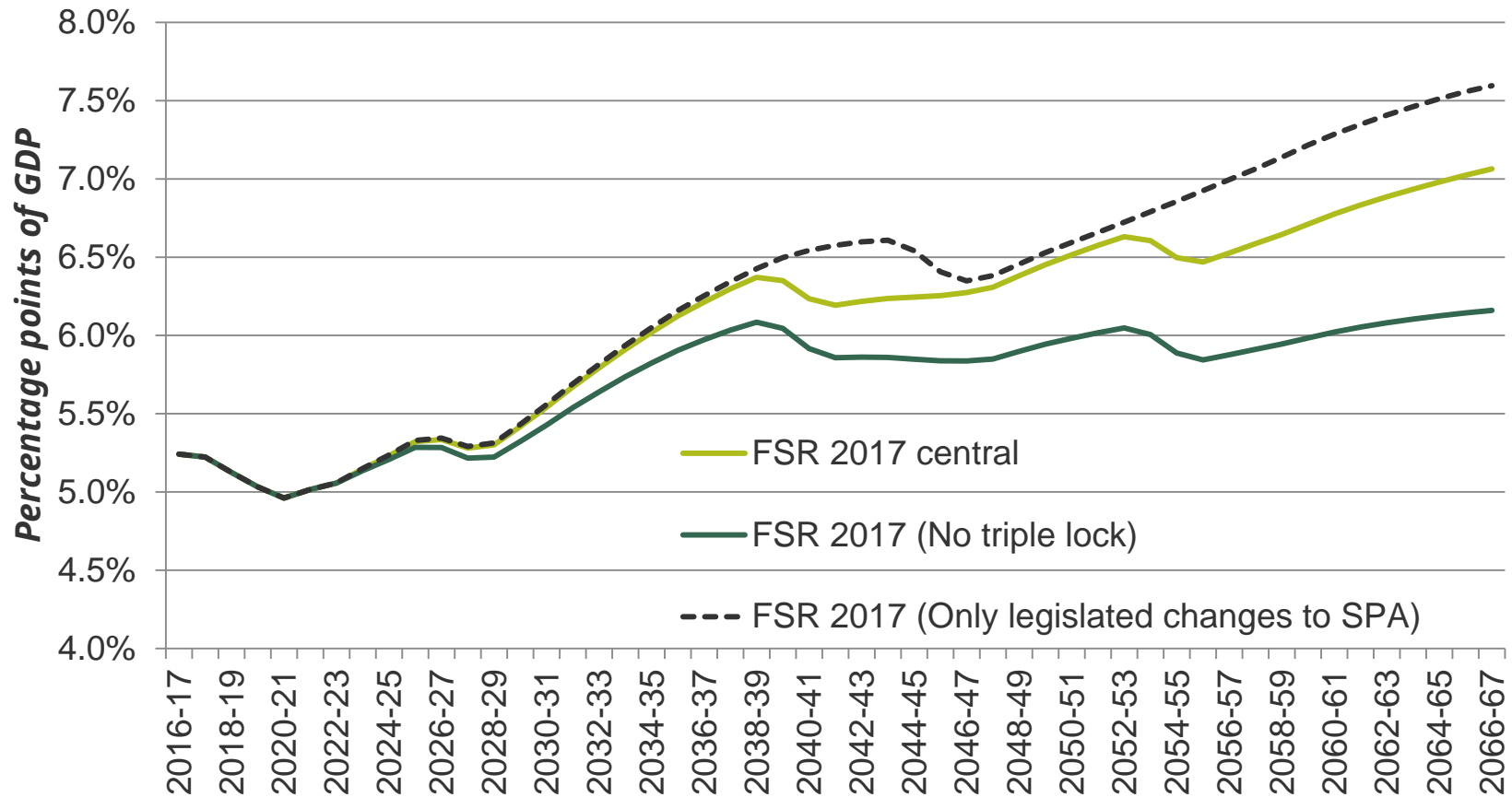


## *Policy changes have exacerbated existing trends*

- 1. **Triple lock** means basic state pension has grown 9%pts more than average earnings since 2010-11.*
- 2. **The state pension** age for men has not kept up with increasing longevity*
  - Without further rises in the state pension age, pension spending will rise rapidly as a share of GDP, and require other spending cuts or tax rises.*

# Even without triple lock, state pension spending will rise as a share of GDP

### Long-term State Pension Spending Projections



Source: OBR Fiscal Sustainability Report

## ***Policy changes have exacerbated existing trends***

- 1. **Triple lock** means basic state pension has grown 9%pts more than average earnings since 2010-11.*
- 2. **The state pension** age for men has not kept up with increasing longevity*
- 3. **Reductions in pensions lifetime allowance** have not hurt current pensioners but those who are currently of working age.*
- 4. **Cuts to public service pensions** mostly impact those of working age*
- 5. **Taxation of housing** continues to favour those who already own*

## ***Fiscal attempts to offset have been minimal, counter-productive or ineffective***

1. *Ending requirement to annuitise pensions  
response to low interest rates*
2. *“Help-to-buy” intended to help first time buyers  
has likely raised prices*
3. *Attempts to increase housebuilding ineffective*
4. *Taxes on buy-to-let as a ‘third best’ response*

# ***Fiscal and monetary policies together***

## ***Distributional effects of fiscal policy regularly analysed:***

- *Increasing focus on impact by age, not just income*

## ***Impacts of monetary policy less easy to define:***

- *What is the counterfactual?*
- *Would need to know impact of monetary policy on asset markets*

## ***Attitudes matter***

- *Changes to asset values seen as “act of God”*
  - *Impacts via e.g. DB schemes may not be visible*
- *Those who already have money notice changes to interest rates*
  - *But bigger impact on those looking to build savings*
- *Fiscal policies reducing entitlements of old seen as “retrospective”*
- *Tax increases/benefit cuts for working age deemed acceptable*