Paying for the coronavirus

Michael Johnson

SMF Social Market Foundation

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ABOUT THE AUTHOR

Michael Johnson is one of Britain's leading authorities on pensions policy and taxation. After training at JP Morgan in New York, he worked in investment banking for more than 20 years before becoming an actuarial consultant. He is Adviser to Cushon, the fintech workplace savings platform. He has advised several leading politicians on economic policy and frequently been called to give expert evidence to Parliamentary select committees.

FOREWORD

There is no sense in trying to deny that the central proposals of this paper are bold, far-reaching and would be politically controversial. As Michael Johnson observes, older voters are electorally powerful, power that helps to shape policy. The property wealth that is largely held by older voters would be recognised by students of American political debate as the electrified “third rail” of British politics: anyone trying to touch it suffers fatal political consequences. For evidence, look no further than recent attempts to fund increased resources for social care.

Yet as Michael also notes, the coronavirus crisis has seen many old certainties of politics and policy discarded. We really are sailing into uncharted waters, where real dangers lie. Some of those dangers can be measured in terms of social cohesion and political stability: a post-crisis era where the costs of the crisis fall more heavily on the young than the old will strain the already-frayed social contract between the generations. Other dangers are economic, and this paper masterfully describes the unprecedented scale of Britain’s debt in the years ahead - and the potential consequences.

In an age when the State is prepared to borrow at unprecedented levels to inject unprecedented sums of money directly into the economy, it is surely only consistent that precedent should be accorded less importance when drawing up future policies. The old rules of politics and economic policy have already been ripped up and thrown away. What better time to address the imbalances in wealth that arise from Britain’s property market and recent economic history?

I have worked in and around Westminster for more than 20 years. I have discussed such questions as these with politicians of many parties. I am struck by how many of them will privately concede that “in an ideal world”, Britain would radically shake up its taxation of property and wealth to deliver a fairer and more sustainable regime. Yet precious few of them will say so publicly, for fear of antagonising the property-owning portion of the public and – perhaps – the media outlets that claim to speak for them. Having worked for some of those outlets, I am all the more convinced that that ideal world will never come about unless people who aspire to lead demonstrate a little more courage and adopt policies that they know very well would raise much-needed revenue in a fairer way.

If ever there was a time for such courage, it is now. Any politician, of any party, who wants a more fair society and a properly-funded, sustainable State should study Michael Johnson’s proposals closely, then act on them as soon as possible. These are bold ideas, but never has boldness been needed more.

Michael begins his paper by quoting Herbert Hoover. I would urge political readers of this paper wondering if they have the stomach for reform on this scale to look further back still and recall Horatio Nelson’s words to Sir Hyde Parker in 1801: "The measure may be thought bold, but I am of the opinion the boldest are the safest."

James Kirkup, SMF Director

SUMMARY

"Blessed are the young, for they shall inherit the national debt"

President Herbert Hoover (1936)

The Coronavirus crisis has given rise to significant economic challenges. When designing policies to meet those challenges, there are key considerations: intergenerational fairness and the ability to pay. These priorities underpin the policies outlined here.

Given that incomes have been battered, there may be limited political scope for broad-based increases in Income Tax, National Insurance or VAT. Culling tax reliefs and capital projects, and applying financial repression in a variety of guises, are likely to be *de rigueur*, but now is the time to also seriously consider taxing wealth.

A vast pool of wealth is tied up as home equity: some £5.1 trillion net of mortgage debt, 220% of GDP (pre-crisis). Unsurprisingly this wealth is heavily concentrated amongst the elderly.

We should scrap principal private residence relief and charge a new property capital gains tax (PCGT) set at, say, 10% of the difference between property purchase and sale prices. PCGT would be payable at the time of the sale of the main home, and settling an estate following the death of the last living owner. This means the tax would be levied only at the time when cash were available - unlike an annual "mansion tax". Some potential unintended consequences of a PCGT are discussed herein.

Given that inheritance tax (IHT) is, for most people, a proxy for some form of property tax, **the main home should, in future, be excluded from IHT liability assessment.** This would halve future IHT receipts. Unlike IHT, a PCGT would be hard to avoid (and evade).

In parallel, Stamp Duty Land Tax (SDLT) on the purchase of the main home should be scrapped. This change, combined with the new PCGT, would effectively move the tax burden of buying the main home from the buyer to the seller. The higher rate of SDLT (for second homes and buy-to-let property) should be retained.

This paper includes a conservative high-level assessment of the potential net additional revenue stream for the Treasury from this package. Assuming the new PCGT was set at 10%, these changes would raise £421 billion over the next 25 years, after taking into account the cost of a new incentive for first-time buyers.

An additional £250 billion could be readily generated over the same period by **replacing today's regressive regime of tax relief on pensions contributions with a flat bonus paid independent of tax-paying status.**

Furthermore, another £125 billion could be cut from Treasury expenditure by **scrapping the 25% tax-free lump sum (on pension pot withdrawals)**. This is excessively generous given that contributions already receive tax-relief.

Structure

Part 1 of this paper outlines a package of tax-related proposals to help repair the damage that the coronavirus is doing to the UK's national accounts. Its implementation would help preserve the nation's creditworthiness, reducing the risk that access to the gilts market could become unaffordable.

Part 2 provides supporting evidence for the proposals, by demonstrating the need for action on Britain's net debt position, analysing past and future issues of debt management, and considering alternative courses of action in economic and political context.

Part 1 - The package of proposals

1. AN OPPORTUNITY BECKONS

1.1 Guiding principles

The policy response to the long-term fiscal impact of the coronavirus crisis should:

- deliver, over time, revenue commensurate with the scale of the requirement (i.e. many tens of billions of pounds);
- acknowledge fundamental practicalities, notably concerning the timing of when cash is available to pay any tax due;
- be easy to administer (requiring no new technology), and difficult to evade or avoid;
- be structured so as to embrace the virtues of simplicity.[i]
- be politically viable, meaning – among other things - consistent with the elected government's manifesto pledge not to raise Income Tax, NICs or VAT; and
- pass some basic tests for fairness, especially intergenerational fairness, and stand a reasonable prospect of attracting cross-party support.

1.2 Scrap principal private residence relief

Today, principal private residence (PPR) relief exempts an individual from capital gains tax (CGT) on a disposal of their main home.[1] Given the vast amount of equity in homes, concentrated among the elderly, we should consider removing PPR relief from the existing capital gains tax regime. Scrapping PPR relief would, of course, provide a significant new revenue source for the Chancellor, as well as being consistent with his recent request of the Office of Tax Simplification (OTS) to carry out a review of CGT to identify areas where it could be streamlined (i.e. simplified).

Property capital gains tax (PCGT) would then be payable on residential property sales, the settling of an estate following the death of the last living owner, and any other form of passing of title to a third party (including gifting).[2]

In design, PCGT should be as simple as possible. A suggested calculation and application:

PCGT = (Sale Price – Purchase Price) x 10%

Other points:

- if there were a capital loss, then no PCGT would be due (obviously), but there should not be any "capital loss carry forward" to offset any future PCGT due;
- house price inflation should be ignored, not least because it would add to complexity;

[i] I sometimes open presentations by highlighting the merits of simplicity, showing the audience a copy of General Montgomery's (hand-written) one page note to his commanders, written on the eve of D-Day: see Appendix I. Note the bottom right-hand corner in particular.

- property sub-division should be exempt from PCGT; it needs to be encouraged because it is a relatively easy way to increase the number of separate units, but without the need to develop more land; and
- assessment of PCGT liability should be able to look through corporate (or trust) ownership structures.

Significantly, PCGT would only be due at a time when there is the cash available to pay it. Conversely, the occasionally mooted annual “mansion tax” (or higher Council Taxes) is impractical for one reason: cash flow. Many retired owner-occupiers have lived in their homes for decades, and their incomes have (massively) lagged rising property prices.

The rate of PCGT could be lower than 10%. Certainly a single digit rate would be more appealing (and more saleable, politically). Alternatively, PCGT could be introduced on a graduated scale, the rate of tax rising with the size of the homeowner’s capital gain. The effect would be that those with larger gains would then pay a higher percentage rate of PCGT on those gains.

PCGT would be progressive, since the wealthy tend to own the more valuable houses. Its introduction would help restore some inter-generational fairness. It would effectively socialise the uplift in land values across society, via Treasury revenues and public spending.

1.3 Inheritance Tax (IHT)

Given that inheritance tax (IHT) is, for most people, a proxy for some form of property tax, the introduction of a PCGT should be accompanied by removing the main residence from assessments for any IHT liability.[3]

The number of settled estates that pay any IHT charge is tiny. In 2016-17 only 28,100 estates paid any IHT (4.6% of the recorded 610,000 deaths), raising just over £5 billion. This is set out in Table 1.

Table 1: IHT-paying estates: assets, liability assessment, 2016-17, £ million

Assets	UK residential buildings	£12,100	
	Securities	£7,540	
	Cash	£5,450	
	Loans and other assets	£1,730	
	Other buildings and land	£1,310	
	Insurance policies	£774	
Less ***Liabilities***	Mortgages	-£280	
	Other debts, funeral expenses	-£787	
	Total net capital value	**£27,800**	
	Net movable assets	£14,700	53%
	Net immovable assets	£13,100	47%
	Tax liability	**£5,050**	

Source: HMRC [4]

Table 1 shows that the total net capital value assessed for IHT is almost evenly divided between "moveable" and "immovable" assets, the latter comprising UK residential property, other buildings and land, net of mortgage debt. Consequently, if a PCGT were introduced, IHT receipts could be expected to halve, approximately, given the exclusion of immovable assets from IHT assessments.

1.4 Scrap Stamp Duty Land Tax on the main residence

Last year SDLT[5] raised £8.4 billion (net of rebates), 45% of which was in respect of additional dwellings which pay the Higher Rates for Additional Dwellings[6] (HRAD). This is set out in Table 2.

Table 2: SDLT receipts, net of rebates, £ million

	Residential receipts, net		Net non-residential receipts	Total net SDLT receipts	Residential transactions	Non-residential transactions	Total SDLT transactions
	Standard SDLT	HRAD*					
2016-17	£5,310	£3,280	£3,176	**£11,766**	1,093,700	121,500	**1,215,200**
2017-18	£5,481	£3,795	£3,629	**£12,906**	1,106,200	120,800	**1,227,000**
2018-19	£4,934	£3,439	£3,569	**£11,941**	1,035,900	114,900	**1,150,800**
2019-20	£5,030	£3,356	£3,215	**£11,601**	1,024,000	107,600	**1,131,700**

Source: HMRC [7]

** Higher Rates for Additional Dwelling, as standard SDLT + 3%*

If a PCGT were introduced, then it would be reasonable to scrap SDLT paid on the purchase of the main residence, although the HRAD rates should be retained on purchases of second homes and those made by companies and foreign buyers.

1.5 Potential unintended consequences?

Lower housing prices?

Opponents of these proposals may claim that a PCGT would have an adverse impact on house prices. This is certainly not the intention, although many people would view lower prices is desirable. In reality, there is such a shortage of housing stock that the introduction of a PCGT is unlikely to trigger a material fall in prices. That aside, prevailing economic sentiment, including consumer confidence, is far more likely to be the dominant influence on prices. Any price effects from the new PCGT would also be balanced by the effects of scrapping SDLT. The net effect could be that prices *rise*.

What about down-sizing?

There is little doubt that the usage of our housing stock is increasingly inefficient; there are some 15 million "surplus" bedrooms in under-occupied homes. This is expected to rise to 20 million by 2040, mostly in family homes occupied by smaller pensioner households.[8] However, emotions rather than economics (or practicalities) often dominate the decision to move (or not), particularly in respect of older people. Consequently, the introduction of PCGT is unlikely to significantly reduce the rate of down-sizing (and the cost would be partially offset by the removal of SDLT).

First-time buyers

Most first-time buyers do not pay SDLT because of first-time buyers' relief (FTBR), so scrapping SDLT would be of no help to them.[9] If the Chancellor wants to maintain some form of incentive to help young adults get onto the property ladder, then the cost of today's FTBR (£542 million in 2019-20) could be redeployed in another guise.

Meanwhile, the average age of the first-time buyer has been rising steadily for decades. In 1960 it was 23; it is now 33 across England (excluding London) and 37 in London.

Interaction with equity release

Equity release schemes typically come in one of two forms. The first, home reversions, involve the sale of the property, so these would trigger a PCGT liability. Th second, lifetime mortgages, are a form of debt, and would reduce the borrower's equity interest in the property. The Equity Release Council's lending criteria are such that debt remains substantially below the historic purchase price, likely leaving sufficient equity to pay any capital gains liability upon eventual sale. The criteria are further underpinned by a no-negative equity guarantee; if breached, then perhaps the lender should be made liable for any PCGT.

Overall, relative to the amount of equity in homes, the equity release market is tiny, unlocking roughly £4.1 billion in 2018, some 0.08% of property wealth.[10]

The very wealthy

If the introduction of a PCGT were accompanied by the removal of the main residence from IHT assessments, as proposed, then the very wealthy would benefit, substantially. A 10% PCGT would replace 40% IHT on the primary residence, which would likely be widely regarded as unfair. That aside, the change would probably be unacceptable to the Treasury, which would probably prefer a banded rate structure, perhaps rising to 30% on capital gains in excess of £1 million, say.

1.6 Implementation

Timing: a transition period

The cashflow derived from the introduction of PCGT would follow the pattern of house sales and the settlement of estates. It may be appropriate to have a transition period in which the aforementioned changes to IHT and SDLT are gently phased in as the cashflow from the PCGT develops. In addition, the introduction of the PCGT could be staggered to incentivise properties sales sooner rather than later (increasing the short-term revenue stream), and also to overcome the cliff-edge problem (of sudden introduction). PCGT could, for example, be phased in with 2% annual increments over the next five years (if 10% were deemed to be the destination figure).

In the first few years, PCGT would be sourced almost exclusively from today's "stock" of existing capital gains (accumulated in respect of homes bought before PCGT were introduced). Subsequently, "flow" would make a growing contribution (i.e. capital gains accrued in respect of properties purchased after the introduction of PCGT).

Modelling required

Modelling would help to forecast potential PCGT revenue (net of the proposed changes to IHT and SDLT), and hence the shape of the transition period. This would require historic

price data and assumptions for future house prices and sales volumes, requiring underlying assumptions for economic performance and people's behaviour. Unfortunately, IHT, SDLT and PCGT are unlikely to be completely independent variables, adding to modelling complexity.

Beware of Occam's razor[11]

Models sometimes attach probabilities to the incorporated assumptions. Broadly speaking, because probabilities multiply, modelling accuracy deteriorates as the number of assumptions is increased. The author has embraced this (convenient) thinking to justify a very crude assessment of what a PCGT may deliver in the future. The Treasury will, hopefully, want to conduct its own rather more sophisticated (stochastic) modelling.

1.7 PCGT: a crude estimate of revenue potential

Today's "stock" of capital gains

Home equity is primarily accumulated through rising prices (i.e. capital gain) rather than mortgage repayments. Over the last 20 years the *gross* value (i.e. including debt) of the UK's housing stock increased from £2,627 billion[12] to £7,390 billion[13], while outstanding mortgages rose from £485 billion to £1,453 billion. Consequently, capital gains accounted for approximately 80% of the increase in market values over the period.

Over the next 25 years it is likely that almost all homeowners' equity will be "realised" through sale or death, including some £4,200 billion of historic capital gains (as 80% of total equity of £5,239 billion. See Table 7 below).[14]

"Future flow" capital gains

Given the uncertainty over future house prices, it is appropriate to make a very conservative assumption in respect of further capital gains from hereon. We could reasonably expect prices to fall in the near-term, and then to slowly recover. Over a 25 year time horizon, let us assume that, *on average,* prices merely track inflation, with the latter being 1% per annum. Consequently, we could expect another £2,087 billion in "future flow" capital gains, say.[15]

By way of comparison, over the last 25 years, cumulative CPI and RPI were 65% and 94% respectively, yet house prices rose by 314%.[16]

A guesstimate for additional tax receipts

Combining the capital gains "stock" (£4,200 billion) and "future flow" (£2,087 billion), over the next 25 years a PCGT rate of 10% would produce some £629 billion, to be reduced by three items.

1. Scrapping SDLT, *excluding* the Higher Rates for Additional Dwellings component (Table 4) which would be retained, would cut the Treasury's annual revenue by £5 billion.
2. Future IHT receipts could be expected to halve, approximately, if residential property were excluded from assessments for any IHT liability. Based upon 2018-19's IHT paid of £5.4 billion, this would cost the Treasury roughly £68 billion over the next 25 years.

3. Some form of first-time buyers' incentive to help young adults get onto the property ladder, at an annual cost of £600 million, say (FTBR cost £542 million in 2019-20).

The net sum left with the Treasury would be roughly £421 billion over the 25 year period, albeit not evenly distributed over time. Given the age distribution of homeowners' equity, we could expect most of it to be "realised" within the next 20 years (as the older age group dies and younger age groups move home). If the rate of PCGT were set lower, at 8%, say, then the net revenue would be some £295 billion over a 25 year period.

This is a very crude analysis. In practice, it is likely that house price growth will exceed inflation over the envisaged timeframe, after taking into account a fall in prices in the forthcoming, likely, post-coronavirus recession. This would mean PCGT revenues would actually be higher than suggested here.

1.8 Using the PCGT revenue

The primary purpose for these policies is to generate addition tax revenue to reduce the size of the gilts issuance programme (and with that, the debt-to-GDP ratio). However, given the PCGT's focus on residential property, there will be many voices requesting that at least some of the new revenue be directed back into building new housing.

Others, perhaps representing pensioners, may like to see something given back to the older generation; some of the PCGT revenue could, for example, be used to address the long-term care crisis.

Part 2 - Supporting evidence

2. YOUNGER GENERATIONS: ON THE RACK

2.1 Pre-coronavirus

Even before the coronavirus, the younger generations[17] were economically disadvantaged relative to older people. Numerous statistics indicate that they could be the first generations to experience a lower quality of life than that of the baby boomers. They are faced with unaffordable housing, earnings and productivity stagnation, zero hours contracts, relatively thin defined contribution (DC) pension provision (plus a defined benefit (DB) desert in the private sector), and a rapidly-rising State Pension age. Many of the under-35s are also loaded with student debt, of which previous generations have no experience. In addition, they will increasingly have to support the costs of an ageing population.

2.2 Beyond 2020

Given the current crisis environment, meeting the cost of policy interventions becomes a problem for later and, from a political perspective, the later the better. This is potentially disastrous for the young, whose voices are largely unheard in Westminster. The effects of interrupted educations and (potentially) the deepest recession in history will put young people at further disadvantage.[18]

House prices may now be falling but, even with a 20% reduction, housing will remain unaffordable to many people. Unemployment, certainly in the near-term, is likely to rise significantly, concentrated amongst young adults, with the Office for Budget Responsibility (OBR) forecasting that two million workers will lose their jobs as the furlough scheme is unwound.[19]

Meanwhile, politicians, irrespective of hue, continue to fawn before today's pensioners. The State Pension's unwise triple lock guarantee is a good example; retaining it was a 2019 manifesto commitment from all parties.[20] (See another recent SMF paper for the case against the triple lock[21].) Similarly the panoply of ancillary pensioner benefits remains intact, including the winter fuel payment, the Christmas bonus, free prescriptions from 60 (England), free TV licences and subsidised (or free) travel.

Further evidence of the threat to the younger generations' economic wellbeing is provided by a cursory examination of the nation's financial health.

3. HM TREASURY'S PERSPECTIVE

3.1 Before coronavirus: a rising tax burden

Frightening long-term forecasts

The OBR produces regular long-term forecasts concerning the nation's financial position. Its baseline projections in July 2020 show:[22]

- public sector net debt (PSND, excluding public sector-owned banks) increasing from 86% of GDP in 2017-18 to 283% of GDP in 2067-68. If interest rates turn out to be 1% higher than modelled, then PSND would rise to over 350% of GDP (235% if 1% lower);[23]
- public sector net borrowing (PSNB) increasing from 2.2% of GDP to 20.2% of GDP in 2067-68. The UK has never run a deficit in excess of 10% of GDP, except in wartime; and
- net interest expenditure increasing from 1.8% of GDP to 11.6% of GDP in 2067-68. This huge rise is due to growing government borrowing, required primarily to fund rising health expenditure against a backdrop of an ageing population. In addition, the OBR's model assumes higher interest rates in the longer term.

Granted, there are significant modelling uncertainties in the OBR's forecasts, notably in respect of underlying assumptions for productivity growth (which drives GDP forecasts), demography (impacting the tax base) and interest rates (particularly in respect of their relationship with economic growth).[24] But there are also some major omissions because PSND, for example, excludes future and contingent liabilities arising out of past activity. These include future:

- public service pension payments;
- PFI-related payments in respect of assets not on the National Accounts' balance sheet;
- student loan write-offs (widely expected); and
- an array of provisions, contingencies and guarantees.

Consequently, the OBR's (pre-coronavirus) projections understate the tax burden that future generations are likely to have to bear. Sensibly, it ignores the Government's claimed "Brexit dividend", not least because it is unquantified. Similarly, the OBR's projections do not take account of any potential adverse post-Brexit consequences, although it has declared that "our provisional analysis suggests that Brexit is more likely to weaken the public finances than strengthen them".[25]

The recent past: soaring liabilities

To assess the long-term sustainability of our public finances, let us consider the Whole of Government Accounts (WGA). These provide more detail than the National Accounts because they include provisions and quantifiable contingent liabilities relating to the risk of future costs arising from past activities. These are unfunded, and have more than quadrupled to £422 billion in recent years, mostly as nuclear decommissioning costs (£264 billion) and £78 billion for NHS clinical negligence claims.[26]

Table 3 shows that total WGA-reported liabilities have increased by 89% in the last eight years, representing a growth rate far in excess of per capita economic growth. This

matters because growth drives the ability to meet liabilities, through tax receipts from future generations (the invisible asset that plugs the balance sheet hole). But tax receipts grew by only 36% over the same period; it is therefore no surprise that the nation's net liability (the extent to which liabilities exceed assets) more than doubled, to £2,565 billion. This is clearly unsustainable: future generations' ability to meet their own needs is being undermined by the tax burden they will inherit.

Table 3: The UK's net liability, excluding the State Pension, £ billion

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	% change, 8 years
Total assets	£1,207	£1,234	£1,270	£1,298	£1,338	£1,683	£1,742	£1,903	£2,014	67%
Total liabilities	£2,419	£2,419	£2,618	£2,926	£3,190	£3,558	£3,728	£4,324	£4,579	89%
Net liability	**£1,212**	**£1,185**	**£1,348**	**£1,628**	**£1,852**	**£1,875**	**£1,986**	**£2,421**	**£2,565**	**112%**
as % GDP	70%	67%	75%	89%	99%	97%	101%	121%	126%	81%
Taxation revenue	£485	£515	£524	£524	£556	£567	£592	£628	£662	36%
as % total liability	20%	21%	20%	18%	17%	16%	16%	15%	14%	-28%

Source: HM Treasury[27]

Note, however, that WGA reporting *excludes* the unfunded State Pension, the justification being that "it is a non-contractual commitment funded out of current receipts and is judged to fall outside of financial reporting standards. The government could withdraw or change the benefit in future*".*[28] Given that any Government is *extremely* unlikely to make any dramatic changes to the State Pension, it would be prudent to formerly acknowledge the significant long-term risk that it presents to the public finances. Indeed, in 2018 the OBR forecast that spending on the State Pension will increase by over 26% by 2023-24, due to the increasing number of people in retirement and eligible for government-funded pensions. If the State Pension were included in the WGA, then the net liability would leap to over £6,900 billion, some £259,000 per household.

Clearly, well before the coronavirus arrived, financial commitments (and provisions) were racing ahead of the growth in the nation's assets and tax revenues. Recurring short-term political considerations would appear to have trumped the interests of future generations, evidenced by the OBR's long-term projections for the catastrophic state of our public finances.

3.2 After coronavirus: austerity undone

A smaller economy

The numerous government policies aimed at maintaining a degree of societal wellbeing and public confidence during the current crisis would appear to be politically expedient and moral. Yet, at least in normal times, they would be considered economically incoherent. Their consequences are economically devastating.

The OBR's recent Fiscal Sustainability Report (FSR) suggests that GDP could fall by more than 12% in 2020, a consequence of both the economic impact of the coronavirus, and the costs associated with the Government's policy response.[29] This would mark the

biggest economic decline in 300 years; the OBR suggests that the economy would not get back to its pre-crisis size until the end of 2022.

Unemployment is expected to rise to 8.8% by the end of 2020 (it was 3.8% in December 2019) and 10.1% in 2021, before falling back to 6.9% in 2022.

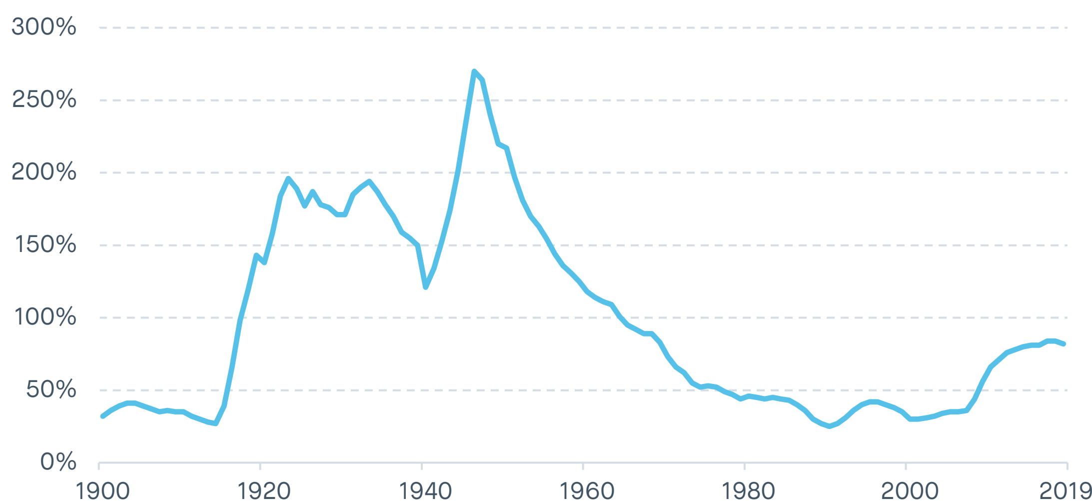
Tax receipts in 2020-21 are expected to be £133 billion lower, with spending some £135 billion higher, than the OBR forecast in March 2020. Unsurprisingly, the OBR expects Public Sector Net Borrowing (PSNB, "the deficit") to rocket to £322 billion this fiscal year (16% of GDP), a result of collapsing transaction taxes (such as VAT[30]) and escalating expenditure.[31] However, this *excludes* the Chancellor's £30 billion package of measures announced in the summer economic statement (8th July), aimed at catalysing consumer spending and saving millions of jobs. In the March 2020 budget the Treasury expected the budget deficit to be £55 billion.

Government debt

History

At the end of the Second World War the UK's debt-to-GDP ratio reached 270%, to then fall back to under 50% by the late-1970's, before rising to around 85% in 2019, following the financial crisis (Figure 1).

Figure 1: UK government debt-to-GDP, %



Source: ONS

This would suggest that today the Treasury has substantial headroom to borrow a lot more, while preserving a semblance of fiscal sustainability. But before the Treasury could confidently leap to such a conclusion, we need to understand *how* the 30 years of post-war debt reduction (1946-76) was achieved.

During the 1946-76 period, GDP grew by an average 8.8% per year in *nominal* terms (2.3% real GDP growth plus 6.5% inflation), some 3.6% higher than the average effective interest rate paid by the government on public debt. This, combined with a cumulative primary (i.e. before paying debt interest) surplus that averaged 1.6% of GDP a year, meant that debt increased by 137% over the period in nominal terms, while nominal GDP increased by more than 1,200%. Outcome: a huge fall in the debt-to-GDP ratio.[32]

2020-21

The huge leap in PSNB is expected to take Public Sector Net Debt to £2,205 billion (104.1% of GDP), a peacetime record.[33] France and the US are also likely to join the growing number of countries whose debt exceeds GDP. Prior to this crisis, only Greece, Italy, Japan and Portugal had levels of debt above 100% among advanced economies.

More specifically, using an accruals measure, the ONS estimated that the Government borrowed £62.1 billion in April 2020 (a monthly record), £51.1 billion more than in April 2019, taking total debt to £1,887.6 billion (97.7% of GDP).[34] However, using a cash measure, PSNCR[35], the IFS puts April 2020 borrowing at £89 billion (the comparable figure for April 2019 was a *surplus* of £7 billion).[36] The IFS's approach is more robust because PSNCR is more accurate and less subject to subsequent revision. To be fair to the ONS, it acknowledges the shortcomings of accrual-based measures, and also reports the Central Government Net Cash Requirement (CGNCR), which was just under £80 billion for April 2020.[37]

On top of that, the Debt Management Office (DMO) has to roll over existing debt as it matures, so gross financing needs exceed the CGNCR. The OBR's March 2020 gross financing forecast for 2020-21 was £164 billion; its more recent central scenario is over £450 billion.

Suffice to say, any forecast made in the current, volatile, economic environment is no more than an educated guess. The Government has, for example, also granted tax deferrals and loan guarantees worth £123 billion, some of which will never be recovered. But whatever the precise outturn, such is the scale of the economic damage that the coronavirus's legacy will be long-term.

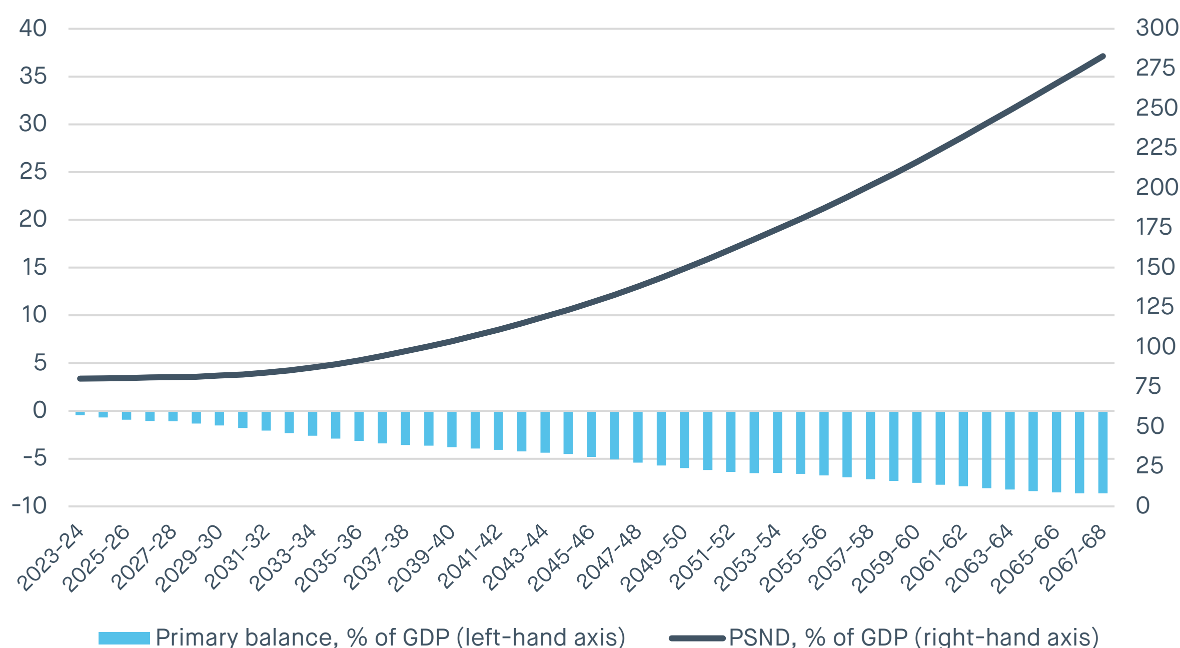
Beyond 2020-21

We can reasonably expect the deficit to diminish over the next few years, as the economy recovers, the emergency fiscal support is withdrawn, and tax revenues revive. However, ongoing (albeit declining) deficits imply that the total *debt* will continue to accumulate, raising the risk profile of our public finances. More specifically, the Treasury (i.e. taxpayers) will become increasingly exposed to a rise in interest rates. Granted, with inflation in abeyance this is not an immediate risk, but a reduction in the appetite for gilts, for example, would likely push up the cost of issuance, widening the budget deficit.

However, interpretation of the market for gilts is confused by the Bank of England's quantitative easing (QE) programme, not least because there is no consensus about how a QE programme may be unwound (or indeed whether it ever needs to be). Established in 2009, following the global financial crisis, it enables the Bank to inject cash into the market by purchasing gilts, thereby monetising government debt (and potentially making the Bank the buyer of last resort for gilts). In March 2020 it expanded the programme by £200 billion which, using the previous Governor's rule of thumb, is a stimulus equivalent to almost 2% off interest rates (once fully deployed).[38] Subsequently (on 20 May 2020), a sale of gilts sent average three-year yields to below zero for the first time, to -0.003%.

From the Treasury's perspective this is very encouraging; the Chancellor's challenge is to maintain the market's confidence. Unfortunately even before the coronavirus ravaged the economy, the primary balance was expected to show a growing deficit, so the PSND was expected to rocket. See Figure 2.

Figure 2: OBR's *pre-coronavirus* baseline projections, PSND and Primary Balance[39]



Source: OBR

We now need to add at least £250 billion to *just this year's* budget deficit, and additional huge deficits will follow, having a cumulative impact on net debt. Consequently, the UK economy will *increasingly* be sustained by debt: the question is how high will the debt-to-GDP ratio be permitted to climb before the confidence of the gilts market is shattered. No one knows.

Meanwhile, we risk Japanification. Japan has experienced sclerotic growth (almost continuously since 1991), deflation, a huge debt-to-GDP burden (240%+) and low interest rates (all aggravated by an ageing population). The coronavirus has, probably, merely accelerated our progress towards a similar destination. However, unlike Japan, we run a current account deficit and rely on large amounts of foreign capital to finance our debt, with allied cross border (currency) risk, as do other developed nations. There is likely to be escalating competition for international capital, putting upward pressure on gilt yields.[40]

The Bank of England could step in to fund the Treasury directly (obviating the need to issue gilts), but for how long? Or are we actually destined for quantitative easing in perpetuity?

3.3 Demography: a shrinking workforce relative to dependents

Britain's workforce is expected to continue to contract relative to the number of dependents (children and pensioners). In 2019 there were roughly 170 people of working age for every 100 dependents; this is expected to fall to 130 by 2065.[41] Most of this change is due to population ageing, i.e. a growing pensioner population (rather than there being lots more children). Today there are 355 people of working-age for every 100 pensioners; this is expected to fall to perhaps 250 by 2067.[42] This is *after* taking into account future legislated increases in the State Pension age (SPA).[43] But simply relabelling people as "workforce" rather than "pensioner" does nothing for their physical capacity to work, nor does it facilitate the necessary re-skilling.

Such ratios have to be treated with caution (immigration policy may change, and there are likely to be more working “pensioners”). However, given that the (workforce) tax base is likely to shrink relative to the (rising) demand for public services, notably healthcare, the Chancellor will have to look elsewhere for revenue.

3.4 The UK’s financial prospects: conclusion

The 30 years of post-war reduction in the debt-to-GDP ratio was achieved against a very different economic backdrop to that which is now forecast to be our future. Consequently, a sharp increase in the debt-to-GDP ratio in the (post-coronavirus) short term is most unlikely to be followed by a falling ratio over the longer term. The long-term trends of ballooning PSND and a frightening, and growing, primary deficit will more than demolish the shorter-term benefit of a very low cost of public debt. Barring a productivity miracle, after smoothing out GDP’s 2020 trough and 2021-22’s recovery, GDP growth is likely to remain anaemic, not least because the record budget deficit is likely to place a burden on future taxpayers, thereby slowing growth. Sharp future tax increases are the principal risk, not high inflation.

The net effect is that the debt-to-GDP ratio is likely to deteriorate from here, a trend that was evident pre-2020, and now accelerated by the economic wrecking ball that is the coronavirus. If we are to avoid a debt-to-GDP ratio that will prove unacceptable to the markets, substantial imagination and radical action are required. This paper’s proposals are an answer to that need.

4. POLITICAL PERSPECTIVE

4.1 The public mood: this is not 2009

During the 2007/08 financial crisis and its immediate aftermath, most voters favoured balancing the books by cutting public spending, and significant cuts to public expenditure ensued. Today, however, public opinion is very different; a YouGov polling shows that 47% of respondents prefer tax rises, whereas only 27% favour cuts to public spending.[44]

4.2 Taxes: boxed in

The Conservative Party's 2019 election manifesto includes a commitment not to increase Income Tax, VAT and National Insurance, substantially limiting the Government's ability to boost tax revenue through traditional means. That aside, conventional tax increases are politically unpalatable at a time when many people's incomes (earned *and* unearned, i.e. dividends and capital gains) have been battered. Similarly with Corporation Tax, given that many businesses are now in serious difficulty.[45]

Consequently, the Government is likely to place greater reliance on additional borrowing but, as debt increases, the Treasury (i.e. taxpayers) becomes increasingly exposed to the prospect of rising borrowing costs. Prudence suggests that it pays to diversify, as much as possible, the sources of Treasury funding. It is no surprise that the (Government-owned) National Savings & Investments has just been ordered to dramatically increase customer deposits to £35 billion by April 2021; the original target was £6 billion.

Cuts to expenditure and tax reliefs are inevitable, and culling capital projects is tempting because they rarely deliver much by way of immediate political capital. But neither approach would deliver the large scale *annuity* savings, i.e. those which will repeat every year, required to counter what will otherwise be large, annually recurring, budget deficits.[46]

4.3 The need to buy time

As every business knows, cashflow is paramount. The Chancellor should aim to defer the repayment of liabilities for as long as possible, thereby buying time to restructure the economy. One notable example from history is 1989's Brady Plan, which substantially helped to resolve the lesser-developed countries' sovereign debt crisis that emerged in the early-1980s.

5. SOURCES OF FUNDS: ALTERNATIVES

5.1 Perpetual gilts

Given the grim prospects for the debt-to-GDP ratio, it would be extremely risky for the Chancellor to rely on ready access to the gilts market *ad infinitum.* Pre-coronavirus, 2020-21's net financing requirement was £156 billion, 63% of which is in respect of refinancing gilt redemptions (£97.6 billion).[47] Post-coronavirus, barring direct Bank of England funding of the Treasury, 2020-21's net financing requirement could be in excess of £400 billion, given that the budget deficit could be £250 billion larger than anticipated.

One approach could be to extend the maturity profile of the stock of gilts, thereby slowing the refinancing requirement. But with nearly £600 billion of gilts coming due within the next seven years, this would only reduce the need to access the market in the medium- to long-term.[48]

Direct issuance

That notwithstanding, the Treasury could extend its gilts maturity profile by issuing perpetual gilts, i.e. without a maturity date. With capital never having to be repaid, such a strategy would be sustainable for as long as the economy remained strong enough to service the interest payments. This is not a new idea; the Bank of England first issued perpetuals in 1751, redeemable at the option of the government.[49] More recently, in the 1980's, the banks started issuing perpetual bonds because they qualify as a form of equity-like capital. Investors (particularly institutions with long-term liabilities) like perpetual bonds for their steady, predictable, coupon income, derived from issuers usually considered to be of very low credit risk.[50]

If, for example, the Treasury were to issue a total of £100 billion of perpetual gilts with a 1% coupon, say, it would cost £1 billion a year to service. Today this running yield would probably be considered "above market" for UK Government credit risk, but there would be no refinancing concern on the horizon.[51] Alternatively, the coupon could be more directly aligned with the Treasury's ability to pay, i.e. linked to annual GDP growth, with a floor at 0.25%, say.

Meanwhile, the net public sector debt interest cost is expected to total £38.2 billion[52] in 2019-20, 4.8% of total public spending; public sector net debt stood at £1,819 billion at end-December 2019.[53]

As an aside, George Soros recently proposed that the EU should issue perpetual bonds as the easiest, fastest, and least costly way to establish a €1 trillion Covid-19 recovery fund[54].

Verdict: Issuing perpetual gilts would buy a lot of time for the Chancellor. Potential market volume constraints could be overcome by a delicate process of "market price discovery" and multi-tranche issuance. Worth considering.

Gilt exchanges

In parallel, the Treasury could encourage institutional investors holding gilts with redemptions within the next three to five years, say, to exchange them for new gilts with much longer maturities, ideally perpetual. Alternatively, it could target the current gaps in the gilt redemption profile of the outstanding stock, beyond 25 years, say.[55]

Verdict: Gilt exchanges would incur a price through higher coupons, but they would take pressure off the Debt Management Office's new issuance calendar.

5.2 Financial repression

An old favourite

Every Chancellor's toolbox includes a variety of mechanisms that effect "financial repression". This is a form of fiscal subterfuge that often relies on under-indexation relative to the growth rate of the referenced parameter. One well-used example, commonly known as fiscal drag, is to raise an Income Tax rate threshold by less than the rate of wage growth, thereby increasing the *average* tax rate paid.

Another form of financial repression can help facilitate low interest rates on government debt.[56] The outcome is particularly damaging to savers and investing institutions, and can be considered a form of taxation. In addition, if gilt yields were to stay below the rate of inflation, there is the added bonus of debt erosion. So, not only is the Treasury then able to pay a "sub-market" rate of interest, but the size of its debt shrinks in real terms. Gilt yields were lower than the rate of inflation in 24 of the 30 post-war years that the debt-to-GDP ratio contracted.

Inflation: from where?

Much as the Chancellor would like inflation above 2% (and putting aside the question of Bank of England independence), it is unclear where it will come from.[57] Consumer confidence is likely to be low given the expected rapid rise in unemployment and, notwithstanding the supply-constraints of lockdown, there are few signs that aggregate demand will overwhelm the supply of essential goods. Energy prices are incredibly low, offsetting upward pressure on food prices.

The Bank of England's QE programme injects liquidity into the market; over £500 billion since inception.[58] Money creation ordinarily leads to inflation, but inflation has fallen, not risen, since central banks undertook QE to counter the global financial crisis. Indeed, CPI slowed to 0.8% year-on-year in April 2020 as spending was slashed. Clearly, we are not living in "ordinary" times. And perhaps QE is actually masking what would otherwise be a period of deflation.

However, the money supply generated by earlier QE was largely counterbalanced by increased reserve requirements for banks. In 2020, the rules governing bank reserves are being eased to encourage lending, so the extra money should feed into the economy rather than remain on bank balance sheets. That said, part of the additional money supply is being absorbed as higher savings and cash balances, the traditional hedge against uncertainty. The financial markets continue to view disinflation as the real risk. Beyond five years, who knows?

Verdict: Financial repression, in a variety of guises, will inevitably feature in the Chancellor's deliberations. But given that inflation is likely to be very subdued for at least the next few years, the potential for material debt erosion is minimal.

5.3 Household wealth

Follow the money

The total net wealth of all households was £14,628 billion in early 2018, predominately concentrated in pension and property assets (Table 4). This is nearly eight times larger than the £1,887 billion of outstanding government debt (April 2020).

Table 4: Total household wealth and distribution, April 2016 to March 2018

	£ million	
Private Pension Wealth	£6,098	42%
Property Wealth (net)	£5,090	35%
Finance Wealth (net)	£2,124	15%
Physical Wealth	£1,315	9%
Total Wealth	£14,628	100%

Households	% total wealth	Wealth threshold
Top 1%	13%	> £4,214,600
Top 10%	45%	> £1,403,100
Top 20%	64%	> £884,100
Bottom 50%	8%	< £240,100
Bottom 20%	1%	< £39,600
Bottom 10%	0%	< £13,600

Source: ONS [59]

Wealth data will change, post-coronavirus, but the relative sizes of the components of household wealth are likely to be pretty static. Clearly, the distribution of household wealth is extremely skewed. The top 10% of households hold 45% of total wealth, their aggregate wealth being 5.6 times larger than the combined bottom 50% of households. In addition, unsurprisingly, household wealth is concentrated amongst older households, although it is noticeable that pensioners' wealth declines as they consume their pension assets, downsize their homes and make gifts. See Table 5.

Table 5: Average wealth by age group, April 2016 to March 2018

	Physical wealth	Property wealth (net)	Pension assets	Financial wealth (net)	Total
16-24	£17,200	£32,100	£8,500	£7,600	**£65,400**
25-34	£31,500	£53,700	£32,300	£8,200	**£125,700**
35-44	£45,700	£139,100	£112,000	£35,300	**£332,100**
45-54	£55,300	£189,400	£268,600	£133,900	**£647,200**
55-64	£60,300	£255,800	£449,100	£94,000	**£859,200**
65+	£55,500	£272,900	£260,800	£103,100	**£692,300**

Source: ONS [60]

If household wealth were to attract Treasury attention, then pensions and equity in homes (i.e. the capital value net of mortgage debt) present the largest opportunities.

Pension pots

Successive chancellors have chipped away at the up-front incentive to save within a pensions product, by cutting the annual and lifetime allowances, for example. The author has long proposed that all tax relief and employer NICs rebates (total cost: £48 billion in 2017-18) on pension contributions should be replaced with a simple contributions-based

bonus.[61] Paid irrespective of tax-paying status, this would put an end to the complicated, regressive, framework of tax relief. In addition, it would leave the Treasury with scope to make an annual cost saving in excess of £10 billion.

However, the existing stock of pension assets has not, to date, attracted the Chancellor's attention. The current tax treatment is generous; all capital gains and investment earnings within a pension pot are tax-exempt. They are, however, taxed in other countries, including Australia and New Zealand. In addition, the 25% tax-free lump sum (on withdrawals) is excessively generous given that contributions already receive tax-relief. Scrapping the tax-free lump sum would save the Treasury roughly £5 billion per annum.

Appendix II provides some more detail of long overdue changes to the pensions framework.

Homeowners' equity

Table 6 shows how home ownership is, unsurprisingly, concentrated amongst older households. Nearly 80% of households headed by someone aged at least 65 are owner-occupiers, and almost all of them have no mortgage. Conversely, more than 90% of the youngest households live in rented accommodation.

Table 6: Residential status by householder age, England, 2018-19

	16-24	25-34	35-44	45-54	55-64	65+
Renting	91%	59%	45%	34%	27%	21%
Owned with mortgaged	7%	38%	48%	49%	28%	5%
Owned outright	2%	3%	7%	17%	45%	74%
	100%	100%	100%	100%	100%	100%

Source: MHCLG [62]

The distribution of home equity by age is obviously closely correlated with ownership, with the over-55 households holding 65% of all equity; Table 7.

Table 7: Homeowners' equity distribution by age, 2018-19

	# households	Average home equity	Total equity £ billion
16-24	543,000	£32,100	£17
25-34	3,801,000	£53,700	£204
35-44	4,615,500	£139,100	£642
45-54	5,158,500	£189,400	£977
55-64	4,887,000	£255,800	£1,250
65+	7,873,500	£272,900	£2,149
	26,878,500		**£5,239**

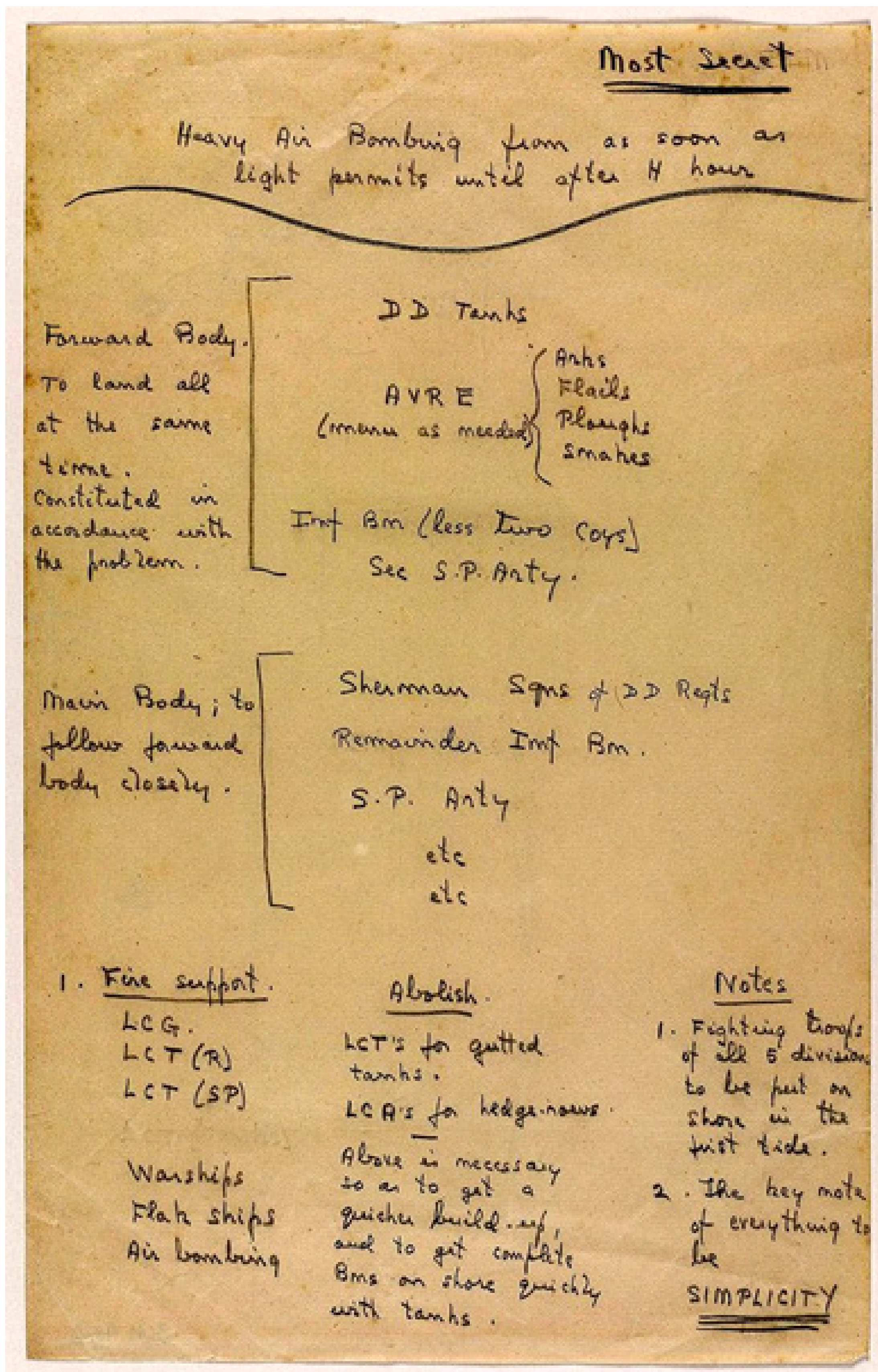
Source: MHCLG [63]

More recently the *Financial Times* reported that the over-65s account for almost half of all UK housing wealth.[64]

CONCLUSION

The equity in homes (much of it unearned) presents the Treasury with a huge opportunity to pay for the economic damage wrought by the coronavirus, accessed through the introduction of a capital gains tax on property. The alternative is that the young will have to pay for a debt-laden future, and they are already hugely disadvantaged, financially, relative to older generations. That would be unreasonable.

APPENDIX I - GENERAL MONTGOMERY'S NOTE TO HIS COMMANDERS, WRITTEN ON THE EVE OF D-DAY



Most Secret

Heavy Air Bombing from as soon as light permits until after H hour

Forward Body. To land all at the same time. Constituted in accordance with the problem.

DD Tanks

AVRE (menu as needed) — Arks, Flails, Ploughs, Snakes

Inf Bn (less two Coys)

Sec S.P. Arty.

Main Body; to follow forward body closely.

Sherman Sqns of DD Regts

Remainder Inf Bn.

S.P. Arty

etc

etc

1. Fire support.

LCG.

LCT (R)

LCT (SP)

Warships

Flak ships

Air bombing

Abolish.

LCT's for gutted tanks.

LCA's for hedge-rows.

Above is necessary so as to get a quicker build-up, and to get complete Bns on shore quickly with tanks.

Notes

1. Fighting troops of all 5 divisions to be put on shore in the first tide.

2. The key note of everything to be

SIMPLICITY

APPENDIX II - PENSIONS: A REVOLUTION IS LONG OVERDUE

A1. The vision

Given the UK's dependence on imported capital, and the prospect of rising international competition for it, particularly from other (developed) nations with ageing populations, we need to catalyse a *broad-based* savings culture, i.e. more people saving more (as opposed to just the wealthy saving more). We should aspire to increase the nation's household savings ratio from 4.9% (2017, the lowest annual figure since records began in 1963) to, say, the 1980's average of 11.3%.[65]

To achieve that, we should cease tinkering and sweep away the whole ludicrously complex pensions framework. In 2014, I proposed the Lifetime ISA to the Treasury, as the first step towards a purely ISA-centric framework; it was launched in 2017, albeit not in the form originally proposed, a victim of pensions industry lobbying.

A2. Bonuses, not tax relief

Since the millennium, the Treasury has provided over £465 billion in tax relief on pensions contributions, and another £222 billion in NICs rebates on employer contributions. Given that fund managers generate income on the basis of the size of assets under management, that makes the Treasury their largest client. Outcome? The UK has almost the lowest household savings ratio in the developed world, which raises a major question about the effectiveness of the Treasury's spend. This is the lowest-hanging fruit in Whitehall, not least because fewer than 50% of adults even know what tax relief is. As for NICs rebates, they benefit shareholders directly; invisible to employees, they are an ineffective incentive to save.

- **Conundrum**: Income Tax is progressive, so tax relief is inevitably regressive. The wealthiest get the largest incentive to save….and they least need it.
- **Solution**: Detach the incentive to save from tax-paying status, through the introduction of contribution-based bonuses.

We should replace all tax relief and NICs rebates with a simple bonus paid on individual and employer contributions, capped at £2,500 per year. A bonus rate of 25% would facilitate an incentivised annual savings capacity of up to £10,000, more than adequate for 99% of all adults. Alternatively, to encourage those who find it hardest to save anything at all, we could pay a 50% bonus on the first £1,000 or £2,000 saved, and 25% thereafter. This would be politically attractive because a 50% bonus is *double* the incentive provided to today's basic rate taxpayers through tax relief, who make up 84% of working adults; this is not intuitive.

Replacing tax relief with a bonus holds many benefits:

- the tapered annual allowance threshold issue would vanish (NHS doctors, *et al*);
- the "net pay" debacle, which disadvantages over 500,000 workers (epitomising the damaging complexity of today's tax relief-based incentives framework), would be immediately addressed;
- those with low-paid, or multiple, jobs (particularly women) would become eligible for bonuses, whereas today they cannot aggregate earnings for tax relief purposes. Note that bonuses would be paid *even if total earnings were below the Personal Allowance;*[66]

- the £40,000 annual allowance would become redundant, as would the Lifetime Allowance on a forward-looking basis (or it could be scrapped entirely, albeit at a high opportunity cost to the Treasury);
- salary sacrifice schemes (unfairly unavailable to the self-employed) would immediately terminate (NICs rebates having ceased), saving the Treasury at least £2 billion per year; and
- after redeploying tax relief and NICs rebates as bonuses, the Treasury should be able to save a further £5 - £10 billion per annum, depending upon the precise bonus structure.

In summary, pensions' tax relief is expensive, incompatible with the end of the annuitisation requirement (due to "round tripping" risks), inequitable, illogical, incomprehensible to many and, consequently, an ineffective use of scarce Treasury resources.

A3. Automatic enrolment (AE)

AE is a highly successful policy but, because of the £10k minimum earnings threshold, many of the low paid miss out on employer contributions, as well as tax relief on their own AE contributions. In addition, the use of "band earnings" to determine contributions makes for derisory pots for the low paid. These rules are unjust and serve no consumer purpose.

The threshold should be scrapped, and "band earnings" should be replaced by "total aggregate earnings" for determining AE contributions. The associated increase in £ contributions could be covered by enhanced bonuses. Employers may complain, which would be an appropriate time to remind them that Corporation Tax has been cut from 30% in 2008 to 19% today.

The key to achieving employee "buy-in" is personalisation. Savings derived from the workplace should be as personal as a bank account, ideally without all the jargon and paraphernalia of pension pots. Some within the pensions industry would appear to have forgotten that this is the age of the customer.

Personalisation should be combined with limited early access to fund what younger adults care most about: home ownership. Consequently, a bonus-eligible Workplace ISA should be introduced within the AE legislative framework, to house employer contributions. It could reside inside the Lifetime ISA: one savings vehicle to serve from cradle to grave, with the saver, not the industry, in control. Simplicity to the fore.[67]

(There is much to be said for Singapore's CPF model of personal accounts. It is also galling to recall that this was designed by the British in 1955.)

A4. The State Pension[68]

Total annual expenditure on the State Pension has, for years, been growing at a rate that exceeds that of our economy. Last fiscal year it cost £95.5 billion, up from £61.3 billion a decade earlier, a 56% increase, in part fuelled by rising longevity, our ageing population (quite different) and the triple lock. Yes, the State Pension age is being sent into retreat, but far too slowly. According to the Government Actuary, the NI Fund will be exhausted by the early 2030's, so unless we address the State Pension within the next few years, fiscal calamity beckons.

In addition, due to widening distribution in life expectancy, a universal State Pension age (SPA) is increasingly unjust. Those with the shortest lives get least pension in return for their contributions. For example, on average Tottenham Green man's return on his NICs, in the form of his State Pension, is only about a quarter of that of Chelsea man's. This is terrible value for money for those who can least afford it.

The State Pension should be put into "run-off", so that from 2024, say, no further "entitlements" would be created. Past "entitlements" would be honoured, as the legacy State Pension, which should be means-tested, along with the whole range of other pensioner benefits. (Australia, for example, aggressively means-tests its Old Age Pension, by income and assets.)

In its stead, a residency-based Senior Citizens' Pension (SCP) should be introduced, payable from the age of 80. All non-pensioners in 2024 would be eligible for it, thus the first payments would be made in 2038. Set at perhaps £220 per week, it would be 30% larger than today's full State Pension.

The income gap between retirement and receipt of the SCP would be covered by drawings from the Workplace ISA, as described above, and today's means-tested Income Support, extended beyond the SPA and enhanced to reflect the proposed demise of the State Pension. Pension Credit could then be scrapped, producing a significant simplification of the benefits arena.

A5. Use the LGPS to seed an infrastructure-focused sovereign wealth fund

I have studied the LGPS in detail.[69] In aggregate, it is one of the world's largest funded schemes (assets exceed £300 billion), but it has become a bloated, grossly inefficient self-serving empire of mind-numbing structural complexity, overseen by a dysfunctional governance framework, absent of accountability.[70]

The LGPS pays over £1 billion annually in fund management fees[71], profligacy that is consistent with the FCA's robust, independent and damning evidence that skewers any justification that active fund management of *listed* assets is worth the candle. The industry is underpinned by a web of meaningless terminology, pseudo-science and sales patter. Profitable inefficiencies abound. Over the last decade the LGPS's total operational costs *per member* have more than doubled – and this in the digital era.

We should put an end to this nonsense, and use the LGPS's assets to seed an infrastructure-focused sovereign wealth fund. This would spread the benefit of the assets across the whole of society: we all use airports, roads and railways. Thereafter, LGPS obligations should be met on a pay-as-you-go basis, in the same manner as almost all other public service pensions.

A6. Other overdue pension reforms

(a) The private pension age: too early

Access to private pensions from the age of 55 is an anachronism, out of step with post-war improvements in life expectancy. It encourages people to leave the workforce early (potentially leaving them short of savings later in life), at a time when we need to encourage working for longer. It should be immediately raised to 60.

(b) The tax-free lump sum: scrap it

We should consider scrapping the 25% tax-free lump sum: retirement incomes would then be 33% larger. It is acknowledged that this proposal is likely to be politically challenging to implement.

ENDNOTES

[1] PPR relief applies if the property is occupied by the individual as their only (or main) home for their entire period of ownership. It exempts main homes from Capital Gains Tax on gains made on property disposals (18% for basic rate gains, 28% for higher rate gains).

[2] The author first proposed a PCGT in an aural evidence session with the Treasury Select Committee, as part of their investigation into the state of household finances (14 November 2017).

[3] The standard IHT rate is 40%, charged on the part of the estate in excess of a £325,000 threshold. It is not paid if everything above the threshold is left to a spouse, civil partner, a charity or a community amateur sports club.

[4] *Inheritance Tax Statistics 2016-17, Table 12.6c;* HMRC, September 2019. IHT raised £5.4 billion in 2018-19 (further detail not yet available) and £ 7.1 billion in 2024-25; *Budget 2020, Table C.5*; HM Treasury, March 2020.

[5] Rates of SDLT: up to £125,000 - zero; £125,001 to £250,000 - 2%; £250,001 to £925,000 - 5%; £925,001 to £1.5 million - 10%; above £1.5 million - 12%.

[6] HRAD: the standard rate of SDLT plus 3%. It applies to second homes and buy-to-let properties purchased by individuals, and residential properties purchased by non-individuals.

[7] *Stamp Duty Land Tax Statistics;* HMRC, April 2020. Data excludes Scotland and, after Q2 2018, Wales.

[8] *Too Little, Too Late? Housing for an ageing population;* Professor Les Mayhew, Cass Business School, June 2020.

[9] First-time buyers' relief (FTBR) results in no SDLT being paid on the first £300,000, and 5% on the next £200,000.

[10] The Equity Release Council's members represent over 95% of the market, accounting for £3.9 billion of unlocked equity in 2018.

[11] A problem-solving principle that “entities should not be multiplied without necessity”. The idea is attributed to English Franciscan friar William of Ockham (c. 1287–1347) who preferred simplicity to defend his ideas; paraphrased by “the simplest solution is most likely the right one”.

[12] Derived from *HM Land Registry's* UK House Price Index (HPI) for all property types increasing from 43.3 (December 1999) to 121.8 (December 2019, when the gross market value was £7,390 billion).

[13] *Savills Research*, January 2020.

[14] This total figure is at April 2019. It is marginally larger than the £5,090 billion quoted in Table 4, which is for March 2018.

[15] As £7,390 billion x $(1.01^{25} – 1)$.

[16] *HM Land Registry's* UK House Price Index (HPI) for all property types.

[17] To include the latter part of Generation X (early 1960's to 1979 births), millennials (aka Generation Y, born between c. 1980 and 2000) and Generation Z (born post-2000). They are all preceded by the (post-war) baby boomers, born between 1946 and the early 1960's.

[18] *The Covid-19 crisis and Educational Inequality*; Professor Simon Burgess, University of Bristol and Professor Anna Vignoles, University of Cambridge, 22 May 2020.

[19] *Coronavirus analysis chart 1.3, April 2020*; OBR. The unemployment rate would then be above 10%.

[20] The “triple lock” increases the State Pension each year by the higher of the CPI measure of inflation, average earnings growth or 2.5%. (Theresa May pledged to scrap the 2.5% guarantee in the 2017 election, and was forced to abandon the pledge to win support from the DUP.)

[21] https://www.smf.co.uk/publications/intergenerational-fairness-coronavirus/

[22] *Fiscal Sustainability Report Table 3.14, page 94; July 2018*; OBR.

[23] See https://obr.uk/choose-long-term-projections/

[24] For long-term policy assumptions, see *Fiscal Sustainability Report pages 9-10*; OBR, July 2018.

[25] *Fiscal Sustainability Report, July 2018.* OBR.

[26] *Whole of Government Accounts*; HM Treasury, 31 March 2018. Note that recent years' cuts to the discount rate have significantly increased the present value of provisions and other liabilities.

[27] *Ibid*. Data for 2018-2019 is not expected until late-2020.

[28] *Report of the Comptroller and Auditor General to the House of Commons, 20 May 2019*. *Part Two: Examining the changes and risks to the public finances, paragraph 2.12.* NAO.

[29] *Fiscal Sustainability Report, 14 July 2020, Table 1;* OBR. The OBR's Central scenario for 2020's GDP is a 12.4% drop on 2019. Its Upside and Downside scenarios produce -10.6% and -14.3%, respectively.

[30] VAT receipts in April 2019 were over £11 billion. In April 2020 they were below zero on a net basis.

[31] Including the furlough scheme, costing roughly £14 billion per month, as well as £15 billion of grants for small firms and £10 billion of support for the self-employed.

[32] For a fuller description, see the OBR's *Fiscal sustainability report, July 2013, Box: 5.1, page 124 Post-World War II debt reduction.*

[33] *Fiscal Sustainability Report, 14 July 2020, Table 2;* OBR.

[34] Public sector net debt excluding public sector banks (PSND ex). *Public sector finances, UK: April 2020,* published 22 May 2020. ONS.

[35] The Public Sector Net Cash Requirement (PSNCR). The ONS uses PSNB.

[36] *Cash borrowing by the public sector was £89 billion in April 2020, far more than in any previous month on record*; IFS, Carl Emmerson and Isabel Stockton, 22 May 2020.

[37] The CGNCR measures how much cash the DMO needs to raise from financial markets to finance any spending or other outlays not covered by taxes and other receipts.

[38] Mark Carney; January 2020.

[39] *Fiscal sustainability report July 2018: Chart 2,* OBR.

[40] In 2016 the author flagged this risk in an evidence session with the Work and Pensions Select Committee, as a part of it investigation into intergenerational fairness.

[41] *ONS data.*

[42] This is the Old Age Dependency Ratio. *Living longer and old-age dependency – what does the future hold?* ONS, 24 June 2019.

[43] The State Pension age for men and women is set to rise from 65 to 67 between now and 2028.

[44] Poll commissioned by Times Radio and reported in the Times: https://www.thetimes.co.uk/article/support-grows-for-tax-rises-over-more-years-of-austerity-zwbjplkv2

[45] Corporation Tax raised £57 billion in 2018-19: a very large percentage increase would be required to bring any material benefit to the Treasury.

[46] There are exceptions, including HS2, the project cost being distributed over a long timeframe.

[47] *Debt management report 2020-21, Table 3.A;* HM Treasury, March 2020.

[48] *Ibid, Chart A.3.* At end-December 2019, the average maturity of the total stock of gilts was 15.9 years, *Chart A.4.*

[49] Referred to as "Consols" ("consolidated annuities"). The final Consols were redeemed in July 2015, partly because they paid what was considered to be too high a coupon (2 3/4% and 2 1/2%) relative to the prevailing market conditions for HM Treasury credit risk.

[50] Prices are based upon the coupons' present value. This requires taking a view on when the issuer may redeem the bonds (connected to the interest rate environment and prevailing credit spreads).

[51] The 30 year gilt is currently yielding 0.66% (mid-July 2020).

[52] *Economic and fiscal outlook, Table 3.13: Total managed expenditure;* OBR, March 2020. This figure is net of interest received on gilts held in the Bank of England's Asset Purchase Facility.

[53] *Debt management report 2020-21, Table A.1;* HM Treasury, March 2020.

[54] https://www.georgesoros.com/2020/05/22/perpetual-bonds-could-save-the-european-union/

[55] Such as 2050-51, 2053-54 and 2058-59. See *Debt management report 2020-21, Chart A.3 Gilt redemption profile;* HM Treasury, March 2020.

[56] Tools include high bank reserve requirements; explicit or indirect capping of interest rates; Government ownership or control of domestic banks and financial institutions; requiring banks to hold government debt via capital requirements; and, *in extremis*, the imposition of capital controls.

[57] The Bank of England is tasked with targeting 2% inflation.

[58] The QE programme's capacity is £645 billion, following the £200 billion increase in March 2020 (£70 billion of which had been deployed by early May).

[59] *Total Wealth in Great Britain: April 2016 to March 2018*; ONS, 5 December 2019. Age refers to the person who is the sole or joint householder, or who is responsible for household affairs.

[60] *Ibid.*

[61] See *Five proposals to simplify saving*; Michael Johnson, Centre for Policy Studies, August 2018.

[62] *English Housing Survey Headline Report, 2018-19;* Ministry of Housing, Communities and Local Government, January 2020

[63] *Ibid.* The total figure of £5,239 billion is at April 2019, marginally larger than the £5,090 billion quoted in Table 2, which is for March 2018.

[64] *Financial Times*, 27 December 2019.

[65] ONS.

[66] Further discussed in *Reinforcing automatic enrolment; a response to the DWP's consultation*; Michael Johnson, CPS, July 2017.

[67] See *The Workplace ISA; Reinforcing Auto-Enrolment*; Michael Johnson, CPS, 2016, and *Five proposals to simplify saving*; Michael Johnson, CPS, 2018.

[68] See *The State Pension: no longer fit for purpose*; Michael Johnson, CPS, 2016.

[69] See *The LGPS: opportunity knocks* (2013); *What price localism?* (2014); *The LGPS: unsustainable* (2015); *LGPS 2018* (2016); and *The LGPS: a lost decade* (2017), all via the Centre for Policy Studies.

[70] *Asset Management Market Study*; FCA, 2017.

[71] https://www.ipe.com/lgps-investment-costs-hit-1bn-as-cost-code-sheds-light-on-fees/10031209.article