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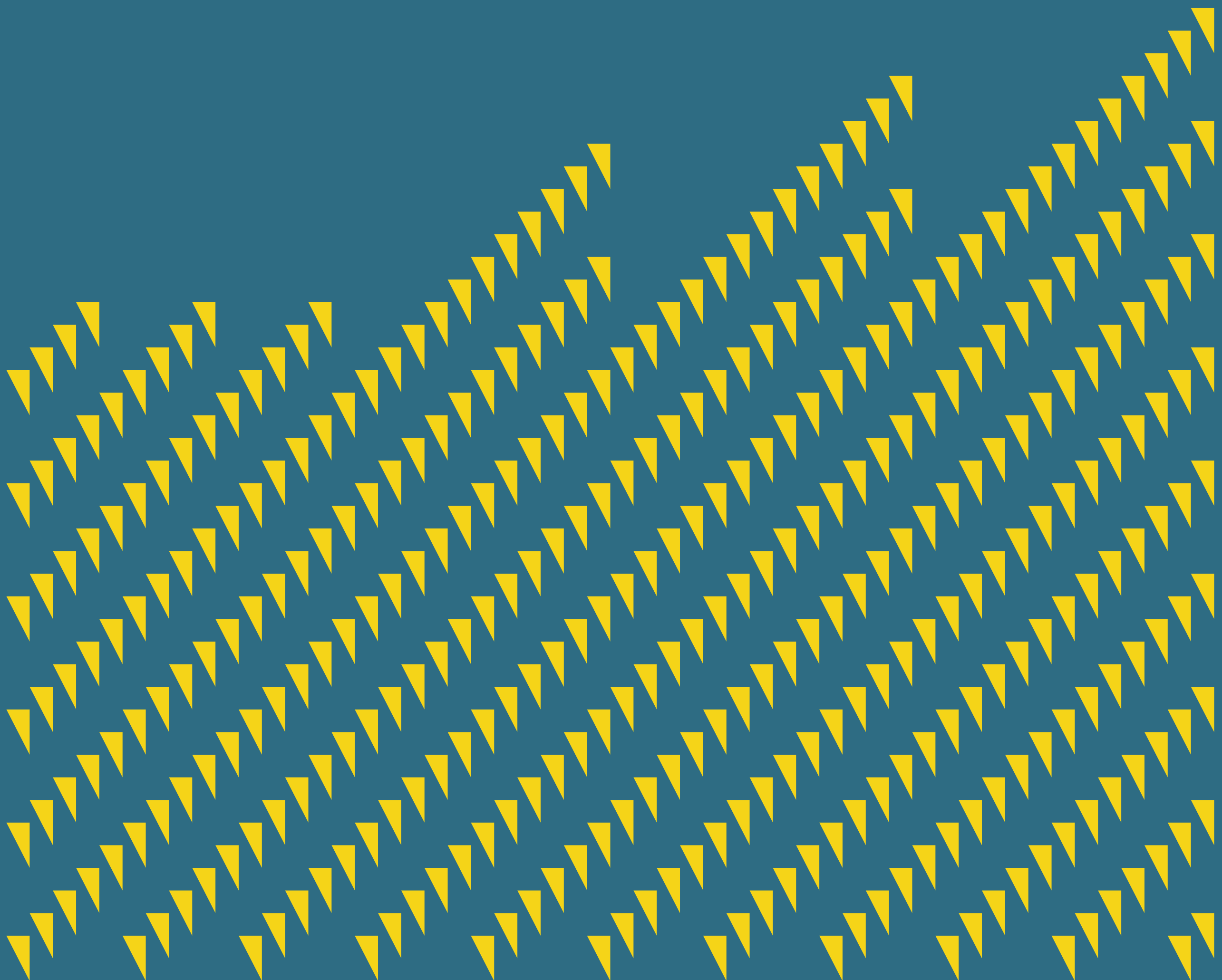
# ISA ISA Baby

## Assessing the Government's policies to encourage household saving

**Molly Broome, Adam Corlett & Jack Leslie**

January 2023



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## Summary

The current cost of living crisis has done much to highlight the fragilities in the UK economy, not least the lack of financial security millions of families face day to day. Inadequate savings is a central part of that, and one which is a long-standing and acute issue for the UK: on average since 1980, the UK has had the lowest aggregate saving rate in the G7 in four out of every five years. One implication of this is that many households have low financial resilience. So in this paper we focus on the lack of savings which can readily be used to cope with shocks – that is, households' liquid financial assets, generally held with a bank or investment company.

Low savings is not a reflection of policy neglect: there have been many schemes over recent decades to encourage families to save more. But there is currently little attention paid to who does – and does not – benefit from the current schemes. This report fills that gap and builds on earlier Resolution Foundation research which has explored the scale and distribution of savings and wealth in the UK.

Low savings create a myriad of issues. Families with no savings are 18 times more likely to report being unable to cover an unexpected expense than families with savings greater than one month of income (28 per cent compared to 2 per cent). And people with no savings are three times more likely to report very low levels of happiness (9 per cent compared to 3 per cent).

But the issue of low savings is particularly acute for those on low incomes. First, the lowest income tenth of families are four times as likely to have no savings as the richest tenth of families. Second, lower-income families are far less likely to have other sources of financial resilience, not least because low income itself reduces resilience levels, but also because things like a higher share of consumption being on essentials and less access to low-cost credit. This is having a real-world impact in the cost of living crisis: recent survey data shows that almost a quarter of the poorest fifth of families had missed a payment of at least one priority bill at the end of November (more than five times higher than the equivalent 4 per cent of families in the richest fifth). And third, lower-income families get a lower return on their savings than higher-income families (almost 70 per cent of financial assets owned by families in the second-lowest income decile is held in the form of current accounts, where interest returns are non-existent, compared to just 5 per cent for the highest decile). It is also the case that those on lower incomes in the UK are relatively more likely to have low savings compared to other countries: in 2017, nearly two-thirds (65 per cent) of people in Great Britain in the lowest income fifth of families had savings worth less than one month of income, compared to 56 per cent for the same group in Germany and France.

Low family savings is common despite significant policy support. Here there are two broad categories of policy: first, measures which eliminate tax liabilities on some form of savings, boosting effective returns dependent on marginal tax rates and interest rates (a key example here is Individual Savings Accounts, known as ISAs); and measures which provide direct payments contingent on saving levels for specific social functions, boosting returns directly (these include Lifetime ISAs (LISAs) which are for house purchases or retirement and Help to Save, a scheme for people in work but receiving benefits). These measures, particularly ISAs, are not small: with rising interest rates set to significantly boost savings returns, we expect that the total fiscal cost of foregone tax revenue and direct payments to households will be around £7.0 billion per year by the end of 2023-24.

To understand the efficacy of these policy measures and schemes, it is important to understand who benefits from them.

One way savings are effectively incentivised is through an allowance for some savings interest income to be received tax free. Specifically, these are the 'starting rate for savings' (a largely irrelevant policy legacy from when savings' returns attract an initial tax rate of 10 per cent) and the Personal Savings Allowance (PSA). These tax-free allowances have a progressive structure, being withdrawn as individuals move up the Income Tax bands. Despite this, 41 per cent of the total benefit from reduced tax liability is projected to go to the top decile of the income distribution in 2023-24, reflecting the upward skew to the savings distribution and the fact that the progressive structure applies to individuals rather than households.

Tax-free ISAs represent a much larger policy intervention. They are designed to encourage people to raise the level of their long-term savings by providing 100 per cent tax relief on all interest or capital gains. In 2019-20 there were 27 million adult ISA holders in the UK. It is largely higher-income people that benefit the most from ISAs, as they tend to have larger pots of such savings. For example, for working-age adults, around £3 in every £10 saved in ISAs (29 per cent) are held by those in the top income decile and just under three quarters (74 per cent) is held by those in the top half of the income distribution. And within this group, the value of ISAs is highly skewed: around 1.5 million people live in families with ISAs worth over £100,000 per adult. ISAs have an annual limit on the amount which can be added to these tax-free accounts; the current level of £20,000 is high – over four times the median level of the total stock of savings (i.e. including current accounts and other savings products) per adult.

The problem is not just who benefits from ISAs, but also who does not. People who are young, women, and those living outside the south of England – all characteristics

associated with lower incomes and wealth levels – are less likely to benefit from the tax-free savings support provided by ISAs.

So there are clear questions over the efficacy of ISAs in encouraging broader levels of saving: when the ISA annual savings allowances were raised significantly in 2014, there was a significant inflow into ISAs but no discernible impact on the total stock of savings, consistent with the idea that much of the flow into ISAs would have otherwise gone into other savings products and so been subject to tax. For those with low levels of savings, ISAs create no benefit compared to the existing tax-free allowances for savings. And those earning below the threshold of paying Income Tax receive no benefit from an ISA, while those paying the top rate of Income Tax benefit from avoiding an effective 45 per cent reduction in gross interest income.

Tax-free savings is not the only way the Government supports savings – it also uses direct payments. The key policy here is LISAs, in which the direct cost to government is expected to be £671 million by 2023-24. These are largely intended to benefit those hoping to become a first-time homeowner, and money can only be paid in by those under 40 years old. Despite this restriction, almost half (47 per cent) of the payments from government are to individuals in the top income quintile. Once again, government spending on this policy is clearly highly regressive and unlikely to help boost saving much for lower-income people who are less likely to be able to purchase a home in the future.

The final targeted saving policy scheme is Help to Save. This scheme is open to anyone in receipt of Universal Credit (UC), Working Tax Credit, or eligible for Working Tax Credit and receiving Child Tax Credit, and is the only policy targeted at lower-income families. Individuals receive a bonus on their savings over two two-year saving periods equal to 50 per cent of the maximum savings level, with a £50 per month cap on deposits. The maximum bonus someone can receive is £1,200 over four years. Given this high level of generosity, Help to Save accounts are very popular with those who benefit: only 3 per cent report being dissatisfied with the scheme. However, take-up is low, with a total cumulative 350,000 accounts opened since 2016 – representing well under 10 per cent of eligible participants. The scale of the direct cost to government is also very low: at present, total bonus payments from the Government amount to an estimated £43 million per year in the period covered by the most recent HMRC data.

Taking the existing schemes together, current policies are either poorly targeted with significant deadweight cost (particularly all forms of ISAs), or are too small in scale to achieve a significant broadening in the distribution of household savings (Help to Save).

Economic crises happen and, if we want to go into the next one with more resilient family finances, we need a step change in the support for savings. It is sensible to start with

policies which build on existing successes, such as Help to Save, while reducing the scale of those policies which are less effective. The first step should be to extend the Help to Save scheme beyond 2023, when it is due to close for new applicants; increase the monthly saving limit above £50 (which has fallen by 20 per cent in real terms since the policy was first announced); and allow people who remain on benefits after the four-year limit on the account to continue using the account for another two years.

However, the biggest barrier to Help to Save being more successful is the relatively low take-up. Clearly, low incomes limit families on benefits' ability to save money and, without raising benefit payments, that will remain a constraint. However, the relatively low share of open accounts which have not had deposits (around 50,000 out of 350,000 total accounts) and that 92 per cent of deposits are at the £50 limit, suggest that low incomes are not the only barrier. Therefore, we propose that new UC applicants are automatically given an account, with regular high-quality information to encourage people to use the accounts. Added to this, to encourage use of the accounts, it would be a good idea to add an initial starting 'bonus' (e.g. of £50) which could be accessed after three (not necessarily consecutive) months of deposits made. Furthermore, it would also be helpful to consider creating a scheme with a wider set of eligibility criteria in order to allow more low-income individuals to benefit from supported savings.

The extension and widening of Help to Save could be paid for by reducing the generosity of ISAs, which largely benefit the already wealthy. For example, capping the overall lifetime value an individual is allowed to save into an ISA at £100,000 would only affect a small minority of people (thus minimising administrative and economic costs). With rising interest rates, it is projected that the Government will be 'spending' the equivalent of £2.2 billion per year by the end of 2023 on the foregone income and capital gains tax for people with ISA savings over £100,000. Capping total ISA holdings at £100,000 would reduce that cost by around half to £1.1 billion (before accounting for behavioural changes). This is far in excess of any plausible estimate of the cost of expanding Help to Save.

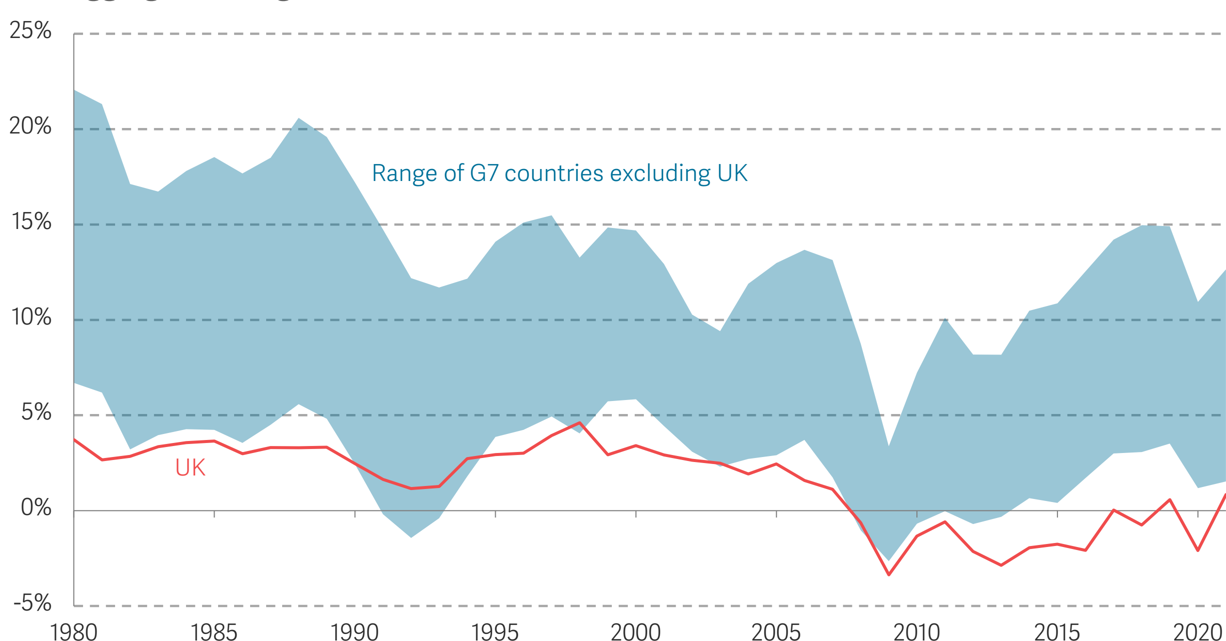
The effects of the cost of living crisis have been amplified by the past decade-and-a-half of slow income growth combined with the legacy of rising inequality after the 1980s. Low savings are, in part, merely a symptom of this economic stagnation. Policy makers now need to recognise the economic reality in which we live and therefore refocus savings policy towards providing more support for a broader range of families to build up savings, and at the same time reduce the ineffective tax advantages that the very wealthy enjoy.

## The UK has a long-standing problem of low saving, particularly for those on low-to-middle incomes

The UK has a well-documented and well-understood problem with pervasive levels low of saving with the UK standing out relative to other comparable countries.[1] For example, comparing the aggregate saving rate, a macroeconomic measure calculated as the proportion of total disposable income (i.e. income after taxes) that does not go towards final consumption expenditure, across G7 countries, it is clear that the UK has had a persistently lower level of saving over time (Figure 1).[2] In fact, since 1980, the UK has on average had a lower saving rate than all other G7 countries in four of every five years.

FIGURE 1: **The UK has had a persistently low level of aggregate saving**

Aggregate saving rate as a share of GDP: G7 countries




NOTES: The saving rate is calculated as the difference between disposable income and final consumption expenditure – as a share of GDP. The swathe excludes Japan in 2021 as no data is currently available. This is an aggregate measure rather than household-specific.
SOURCE: RF analysis of OECD, Saving rate (indicator).

This low level of saving creates issues both at the macroeconomic level and for individuals. For the macroeconomy, low levels of saving may contribute to the UK's low levels of investment.[3] These problems have persisted over decades despite significant variations in economic conditions and real interest rates, suggesting there are structural

1 See for example a comparison of financial resilience across the UK, France and Germany: M Gustafsson et al., After shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.
2 Not all of the value of this macroeconomic saving will end up in household's liquid financial wealth, the core focus of this paper, but it does provide a reasonable way to compare countries – and the G7 countries provide a reasonable comparator group where all countries are a high level of development with a (broadly) similar age structure.
3 For more on the UK's investment challenge see: The Economy 2030 Inquiry, Stagnation nation: Navigating a route to a fairer and more prosperous Britain, Resolution Foundation, July 2022.

barriers at play in the UK economy.[4] A low stock of savings also pose a problem for the macroeconomy as society ages; this is because supporting consumption, and living standards, for a greater number of retirees will require higher stocks of wealth.

Naturally, those individuals with low savings face a range of potential financial problems and negative impacts on wellbeing. Most obvious is that low levels of savings reduce financial resilience: in 2018-20, a family with no savings (here defined as liquid financial assets like current and savings accounts) was 18 times as likely to report not being able to cover an unexpected major expense as a family with at least one month of income in savings (28 per cent compared to 2 per cent).[5] Because the ability of households to respond to unforeseen income shocks is so important, in this paper we focus households' liquid financial assets – that is, savings held with a bank or investment company that can be accessed quickly (see Box 1).

But there is also a wider utility value in saving. Previous Resolution Foundation research has highlighted that low levels of savings, and no savings in particular, are associated with a higher likelihood of someone reporting low levels of happiness and high levels of anxiety: in 2018-20, individuals with no family savings were three times as likely to report low happiness (9 per cent versus 3 per cent) and more than twice as likely to report high anxiety (17 per cent versus 7 per cent).[6] This is not causal evidence that low savings are the primary driver of these differences. However, the divergence remains when controlling for a wide range of personal and economic characteristics.[7]

## Low savings are most concerning for those with low-to-middle incomes

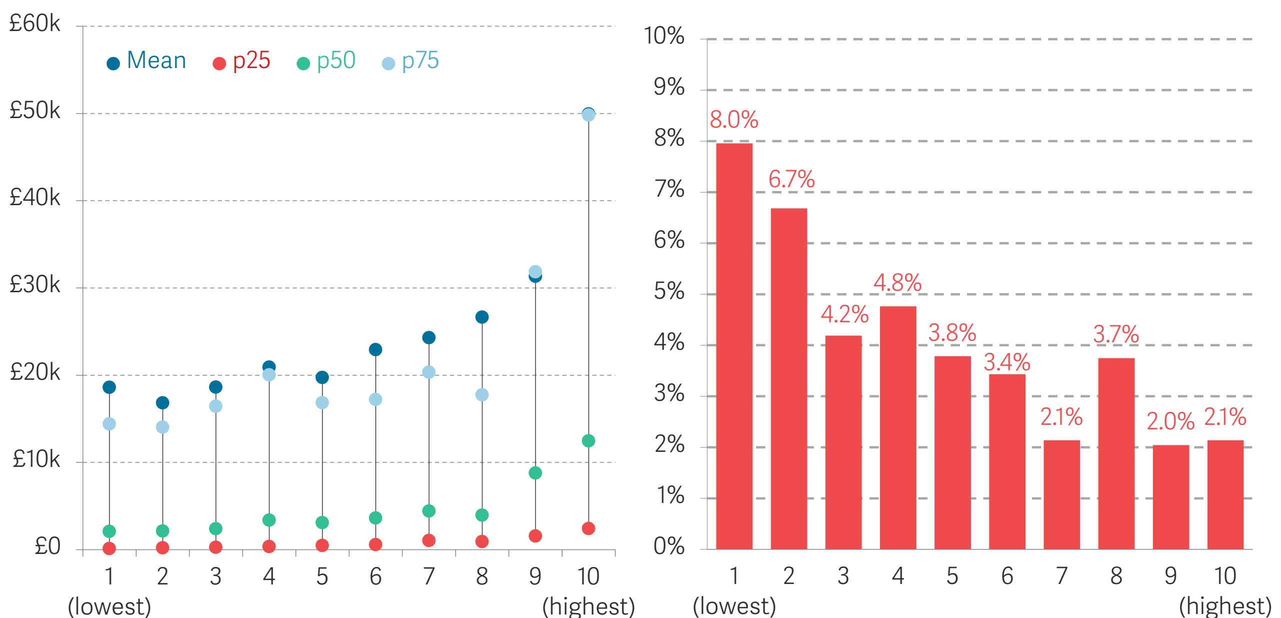
A key and often-overlooked problem is that the problem of low savings is most acute for those on low-to-middle incomes. This is because the lowest levels of savings are, unsurprisingly, more prevalent for those at the bottom of the income distribution. As shown in the left chart of Figure 2, the presence of low savings levels is something that is common across all UK households, including high-income families. Indeed, the average median value of savings within income deciles in the top half of the distribution is just under £5,500 per adult, not hugely higher than the £3,000 for the bottom half of the income distribution.[8] However, when we consider the prevalence of no savings at

4 Some of the variation in saving rate reflects difficulties in comparing on a like-for-like basis across countries. For an in-depth discussion of why saving rates vary see: S Rocher & M Stierle, Household saving rates in the EU: Why do they differ so much?, INFER, Working paper 2015.01, 2015.
5 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022. The multiple is not 14 times due to rounding.
6 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.
7 For a more detailed discussion of this evidence, see: M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.
8 One inference from the relative lack of variation across the income distribution which should inform later policy conclusions is that economic opportunity is not the only factor affecting propensity to save. But a key driver is that pensioners tend to have the highest savings levels but often have lower incomes than equivalent working-age households, this 'equalises' the savings distribution across income groups.

all (right chart of Figure 2), this is much more common for those in the bottom half of the income distribution, with 8 per cent of the lowest income tenth of families reporting no savings in 2018-20 – four times the rate for the richest fifth of families. The issue of low savings in the lower parts of the income distribution are more prevalent in the UK than other countries. For example, in 2015, the highest income fifth of families in the UK had a slightly higher saving rate than the equivalent group in Ireland, but the saving rate was around 10 percentage points lower for those in the second income quintile in the UK compared to Ireland.[9] And low-income people in the UK are more likely to have a low stock of savings as well: in 2017, 65 per cent of people in Great Britain in the lowest income fifth of families had savings worth less than one month of income, compared to 56 per cent for the same groups in Germany and France.[10]

FIGURE 2: **Low savings is common across income groups but acute low savings is most common for low-income families**

Values of family savings per adult at various points of the distribution (left chart) and share of individuals with no family savings (right chart), by income decile: GB, 2018-20




NOTES: Saving defined as current accounts in credit, value of savings account, value of ISAs and value of national savings products.
SOURCE: RF analysis of ONS; Wealth and Assets Survey.

9 M Gustafsson et al., After shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.
10 M Gustafsson et al., After shocks: Financial resilience before and during the Covid-19 crisis, Resolution Foundation, April 2021.

## BOX 1: The definition of savings

There is no universally agreed definition of the stock of savings.[11] Indeed, the boundary of what should be counted as savings can vary depending on how a particular measure is used. There are, for example, debates about the types of assets that should be included – in particular whether corporate and government assets should be included; there is a question about whether only assets that can be accessed quickly – often referred to as liquid – should be included; and there is an issue about whether savings should only comprise financial assets, or whether they should incorporate physical assets such as housing assets.

For the purposes of this paper we define savings in a way which matches most closely the focus of the paper: the efficacy of government policy to support saving. Therefore, we focus on household assets and, unless otherwise stated, focus on financial assets which might be used to cope with unexpected income shocks. This means we exclude pension wealth as this is not a source of day-to-day financial resilience for working age families. We include assets which might not be perfectly liquid, such as fixed-term savings bonds, but exclude physical assets (e.g. housing) which have high transaction costs and are therefore also less useful as a source of financial resilience. In effect, this definition encompasses all assets which the Government are, in various forms, supporting the accumulation of via existing policy schemes to support saving.

In practice, the exact definition of savings chosen makes relatively little difference for any broad conclusions because most measures are well correlated: for example, various measures from different data sources including the Bank of England's banking sector statistics, the ONS's aggregate and survey-level statistics and non-ONS survey measures all point to broadly similar trends.

Low savings is a larger problem for lower-income families because they have fewer other sources of financial resilience. Income itself is a major source of financial resilience because higher incomes provide a cushion for dealing with unexpected shocks. Indeed, some of the sources of income volatility (such as varying hourly contracts) are more

11 For a discussion of measuring saving, see: T Crossley & C O'Dea, The wealth and saving of UK families on the eve of the crisis, Institute for Fiscal Studies, July 2010.

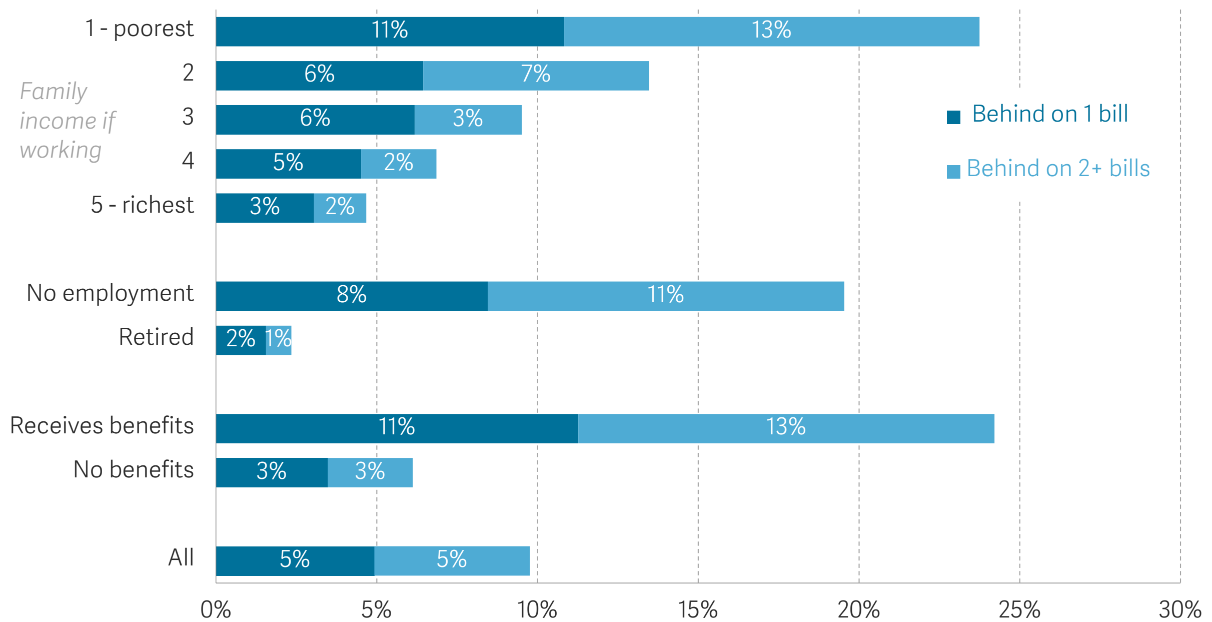
prevalent for those with low labour income.[12] It is also the case that having higher incomes is correlated with being able to access other forms of financial resilience, such as being able to access low-cost credit.[13] And higher incomes are also associated with being more likely to be an owner occupier, a tenure for which housing costs have typically been lower and more stable when compared to those living in the private rented sector.[14] It is also the case that a higher share of the consumption of high-income families is on non-essential items which are easier to cut back without significantly affecting material living standards.[15]

The current cost of living crisis is highlighting the negative impacts of low savings for lower-income families. Figure 3 shows recent estimates of the prevalence of bill arears by various household characteristics. Here, 24 per cent of the lowest-income fifth of families were reporting missing at least one debt payment at the end of November 2022. This is over five-times the share for the highest income fifth (where just under 5 per cent reported missing payments).[16] Survey evidence also shows that the cost of living crisis is compounding the broader issue of low savings. For example, according to the Financial Fairness Tracker, 26 per cent of people reported having no savings in October 2022, up from 21 per cent a year earlier.[17] A key driver of the differential experience of families in the cost of living crisis comes from the fact that consumer prices have risen fastest for essential goods and services – i.e. products that have a higher share of expenditure for low-income families and where it is harder to reduce consumption.[18] At present, one of the legacies of this crisis looks to be a long-lasting increase in the price of domestic energy, particularly gas; that will result in a long-term increase in the share of spending on essentials. Therefore, for a given level of savings for low-income families, in the next crisis they will be less resilient because there will be fewer ways to cut back non-essential spending.

12 D Tomlinson, Irregular Payments: Assessing the breadth and depth of month to month earnings volatility, Resolution Foundation, October 2018.
13 Financial Conduct Authority, Financial Lives survey 2020.
14 For more on housing costs see: L Judge & J Leslie, Stakes and ladders: The costs and benefits of buying a first home over the generations, Resolution Foundation, June 2021. And for more on the connection between financial resilience and asset ownership see: G Bangham & J Leslie, Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain, Resolution Foundation, June 2020.
15 ONS, Family spending in the UK: April 2020 to March 2021, July 2022.
16 E Fry & L Try, The Living Standards Outlook 2023, Resolution Foundation, January 2023.
17 This definition of "no savings" does not match the definition used in Figure 2, hence the difference in the proportion of people reporting no savings. For more detail see: J Evans & S Collard, Prices Rising, Temperatures Falling: The Financial Wellbeing of UK Households in October 2022, abrdn Financial Fairness Trust and University of Bristol, December 2022.
18 J Leslie, Cap off: Understanding the April 2022 inflation release, August 2022.

FIGURE 3: **Lower-income families have lower levels of financial resilience**

Proportion of individuals reporting missing one or more payments of priority bills, by characteristic: UK, November 23-30



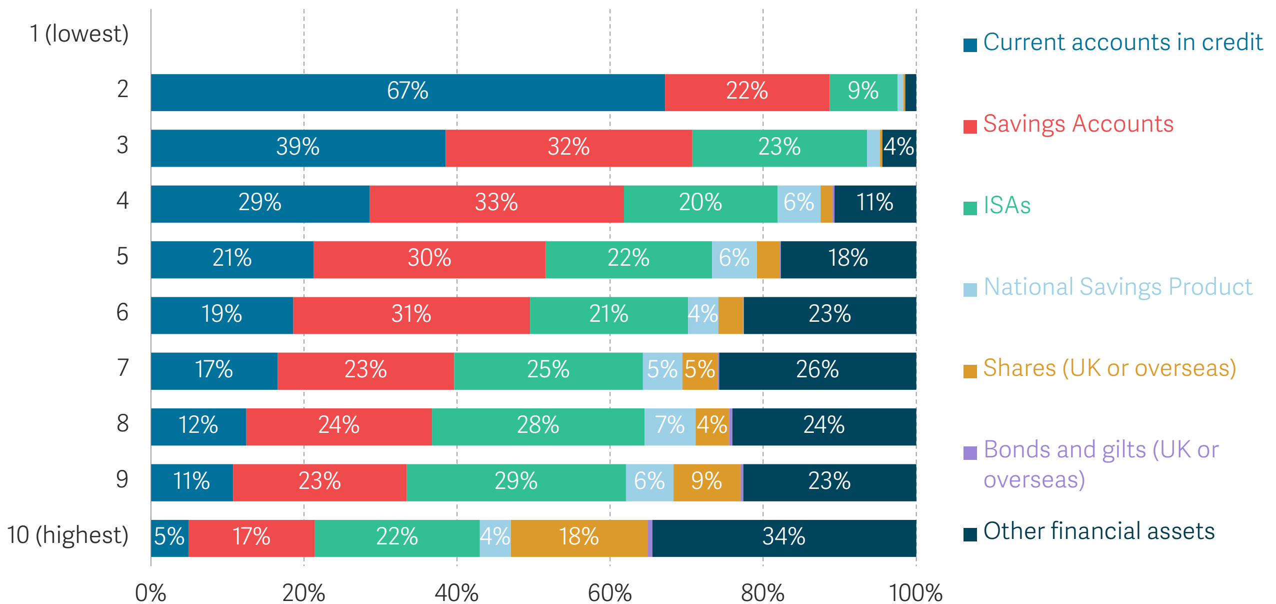

NOTES: All adults aged 18+. Base is (n=10,470). Receives benefits (n= 2,507) No benefits (n= 7,963). Lowest income quintile (n=988), q2 (n=740), q3 (n=897), q4 (n=703) and highest income quintile (n=1128). No employment (n=1631), Retired (n=2,824). A version of this chart originally appeared in E Fry & L Try, The Living Standards Outlook 2023, Resolution Foundation, January 2023.
SOURCE: RF analysis of YouGov, adults age 18+ Cost of Living Crisis November 2022 wave.

A final driver of why the pattern of savings is, on average, most harmful for poorer families is that they tend to receive lower returns from the savings that they do hold. Figure 4 shows that 67 per cent of financial wealth held by individuals in the second wealth decile was in current accounts and 22 per cent in savings accounts. The UK has seen low interest rates for over a decade meaning that the returns on current accounts and savings accounts have been minimal in recent years. Individuals in the top wealth decile are more likely to hold their wealth in shares and other financial assets, and while returns on these assets are uncertain, over time they have markedly outpaced returns on basic savings accounts.[19]

19 The rates of return within-asset classes can also vary across the wealth distribution, with evidence from Norway indicating that higher wealth families can achieve higher than average returns for the same type of assets than lower wealth families. See: A Fagereng et al., Heterogeneity and Persistence in Returns to Wealth, IMF working paper 18/171, July 2018.

FIGURE 4: **Lower wealth families hold more financial wealth in low-return assets**

Proportion of financial wealth, by asset type and net wealth decile: GB, 2018-20




NOTES: The lowest decile is excluded because the average asset breakdown is dominated by a small number of families with low net wealth and high gross wealth which are not reflective of the typical low-wealth family.
SOURCE: RF analysis of ONS; Wealth and Assets Survey.

## The low saving problem isn't for want of Government support

Recognising the low level of saving overall, successive governments have put in place a range of policies to address the issue. There are two broad categories of policy here; first, tax incentives (usually exemptions) which raise the post-tax return on specific amounts and types of savings; and second, paying direct bonuses or transfers on a narrower definition of saving to further raise the incentive to save. Specifically, the first of these methods is found in the tax-free savings allowances and Individual Saving Accounts (ISAs). The second method is used in two extant schemes: Lifetime ISAs (LISAs) and Help to Save.[20] As discussed below, we estimate that with rising interest rates the total support for savings is expected to rise to £7.0 billion per year by the end of 2023.

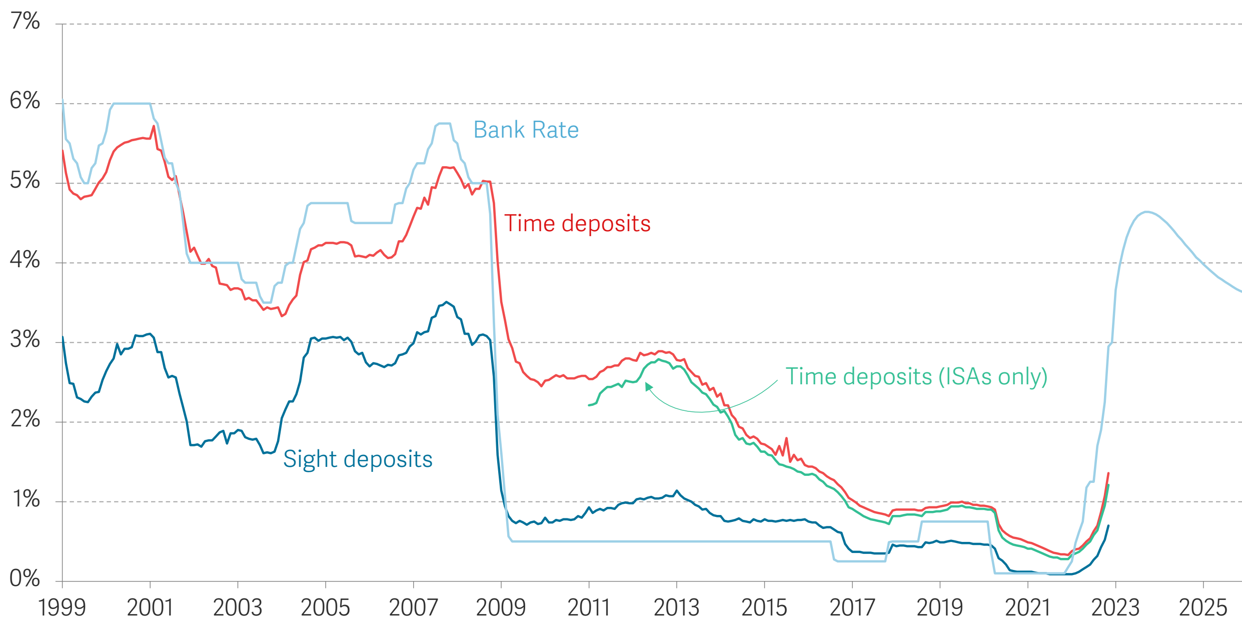
Despite widespread attention to the issue of low saving, there is remarkably little focus on the efficacy of these schemes. This note considers whether they are achieving their objectives, whether they represent value for money, and whether they can be improved. These questions have become more pressing during the cost of living crisis, and will become more so as interest rates rise. Indeed, as shown in Figure 5, household saving

20 There are older schemes which still exist such as Child Trust Funds, where accounts still exist although no further government transfers will be made, and Help-to-Buy ISAs which have effectively been subsumed within Lifetime ISAs and so we do not consider as a separate scheme. LISAs also benefit from the tax-free saving on other ISA accounts but, given the stock of savings in these accounts to date and the lower annual limit, the tax-free part of the scheme is much smaller in scale relative to the direct bonuses.

rates vary (imperfectly) with the Bank of England's policy rate (Bank Rate). The Bank has sequentially raised rates throughout 2022 and markets expect it to rise further in 2023. As discussed below, this will, in time, feed through into higher household deposit rates, significantly boosting interest income. Tax-free savings therefore will become more 'expensive' for the Government in the form of foregone tax revenue.

FIGURE 5: **Rising interest rates means this is the right time to consider how to best support saving in the UK**

Household deposit rates, by type of savings account, and Bank Rate: UK




NOTES: All household deposit rates are measured on the stock of deposits for households, with the exception of ISAs from 2016 where rates are measured at an individual level. Market interest rate expectations are as of 5 January 2023.
SOURCE: RF analysis of Bank of England, Yield Curve; Bank of England, Bankstats.

The following sections consider each of the types of government support for savings in turn, first looking at what evidence we have on who benefits and how successful the schemes are. The final section then turns to the policy implications.

## The advantages of tax-free savings flow mostly to the already-wealthy

### Tax free savings allowances are small in scale

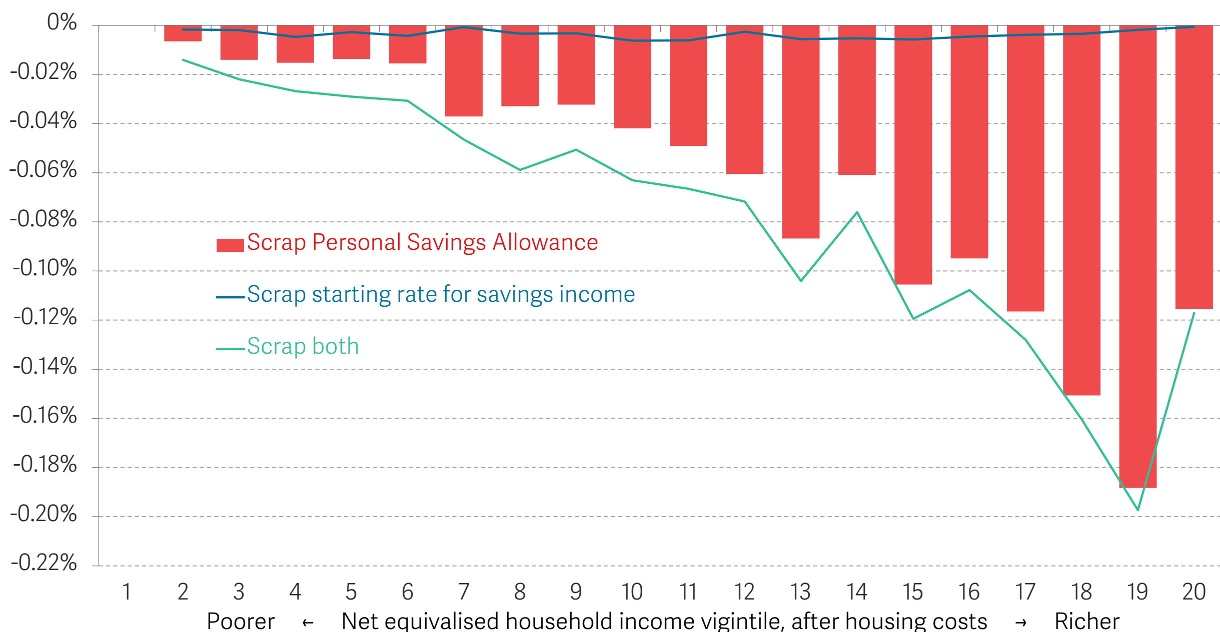
Widespread low savings in the UK exists despite mechanisms built into the tax system to incentivise saving, such as the 'starting rate for savings' and the Personal Savings Allowance (PSA).[21] The starting rate for savings applies to individuals with non-savings income below £17,570 and allows them to earn interest on their savings tax-free up to a

21 These policies are also intended to reduce administrative burden of reporting and collecting taxes on low levels of saving returns.

maximum of £5,000. The 'starting rate for savings' is tapered away for every £1 of income above the Personal Allowance (£12,570). Most taxpayers can also earn tax-free interest on savings under the PSA. However, the allowance received depends on the rate of Income Tax paid. Basic-rate taxpayers can earn £1,000 in savings interest per year with no tax and higher-rate taxpayers can earn £500 in savings interest per year with no tax. Additional-rate taxpayers are not entitled to a tax-free allowance.[22] Clearly, these existing mechanisms are designed to be progressive with lower-income individuals in receipt of the largest tax-free allowances and to ensure that higher rate payers get the same effective tax relief as basic rate payers (this is because higher rate payers have twice the marginal tax rate but half the allowance).

FIGURE 6: **Tax free savings allowance advantages mostly flow to higher-income families despite the progressive structure**

Estimated impact of savings allowance on income, by income vigintile: UK, 2023-24




SOURCE: RF analysis of OBR, Economic and Fiscal Outlook – November 2023; IPPR tax-benefit model.

The estimated fiscal cost of the PSA is expected to be £590 million in 2022-23, but as interest rates rise this cost will increase sharply.[23] To understand who benefits from these policies, Figure 6 shows the estimated impact of scrapping the starting rate for savings and the PSA on income in 2023-24. The starting rate for savings income has almost no effect on income, indicating that there are few individuals with non-savings income of less than £17,570 who have significant income from savings. Similarly, the impact of the PSA on income is also small. However, while they may be designed to reduce support as incomes rise, tax-free savings allowances mostly help those with high income with

22 For more information see: https://www.gov.uk/apply-tax-free-interest-on-savings, accessed January 2023.
23 HMRC, Non-structural tax relief statistics, January 2023.

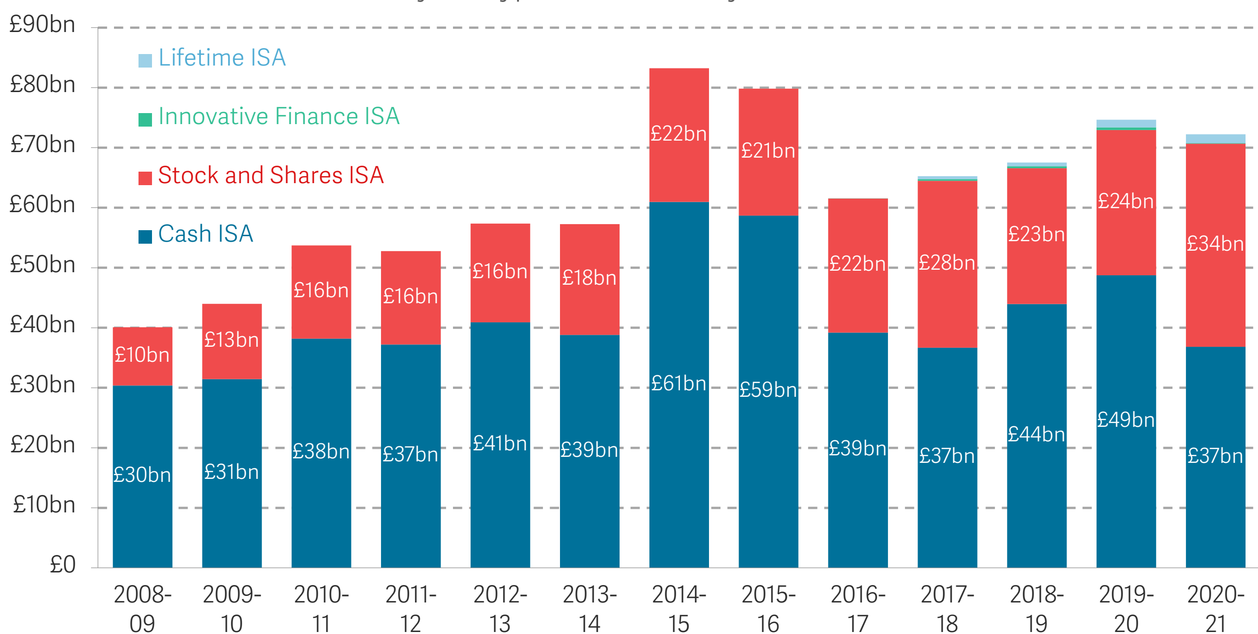
individuals in the top income quintile expected to see the biggest income falls if the PSA was scrapped.

## Individual Savings Accounts (ISAs) are larger in scale and also mostly benefit people with high existing savings

There are additional tax incentives to save through ISAs. There are three main types of ISA products (cash ISA, stocks and shares ISA and innovative finance ISA)[24]. An individual can save up to £20,000 across these products in each tax year and the interest and/or capital gains on these savings are exempt from tax.[25] ISAs are a very widespread and popular method of saving: HMRC estimates that in 2022-23 the total fiscal cost of ISAs will be £4.3 billion.[26] Given the scale of ISAs, the following section will focus on who benefits most from this type of savings support.

FIGURE 7: **The total amount deposited into ISA accounts in each financial year has been climbing**

Amount invested in ISAs, by ISA type and financial year: UK




NOTES: From 2017-18 the annual subscription limit has been £20,000. 2017-18 was also the first year for which Lifetime ISAs became available. The annual subscription limit for Lifetime ISAs is £4,000, although those with Help to Buy ISAs could transfer in their account balance without affecting their annual subscription limit up until 5 April 2018. The Government provides a 25 per cent bonus on this amount, which is not reported in these statistics.
SOURCE: HMRC, Annual savings statistics 2022.

24 Lifetime ISAs are also under the ISA umbrella but given the much larger importance of the direct payments relative to the tax relief, we discuss these accounts in a later section.
25 Lifetime ISAs have a lower individual limit.
26 Note this figure includes the relief on Lifetime ISAs. For more information see: HMRC, Non-structural tax relief statistics, January 2023.

In 2020-21, £72 billion was deposited into Adult ISAs, a decrease of £2.4 billion on 2019-20. This decrease was driven by a fall in cash ISA deposits, which decreased by £12 billion between 2019-20 and 2020-21. However, over the same period, the amount deposited into to stocks and shares ISAs increased by £10 billion. In general, the amount deposited into ISA accounts has been climbing steadily since 2008-09 which will in part be driven by increases in the ISA investment allowance.[27]

First, looking at income, ISAs tend to provide the most support (via tax relief) to higher-income individuals, as this group tends to have larger ISA savings' pots. Figure 7 shows that the average market value for ISA holders with incomes of £150,000 or more was around £75,000 in 2019-20 compared to £22,000 for ISA holders with incomes of £20,000-£29,000. Similarly, over two fifths (44 per cent) of ISA holders with incomes over £150,000 had ISA savings of £50,000 or more – considerably higher than all other income groups. Despite the stated aim of ISAs being to encourage people, particularly those on low incomes, to raise the level of their long-term savings, this group has the lowest levels of ISA savings.[28] The majority of ISA wealth is held by those in retirement, reflecting lifetime saving patterns and, as pensioners tend to have relatively low incomes, this masks some of the skew in the distribution between ISA savings and income. This is because some wealthy pensioners may fund retirement more through drawing down on savings rather than through pension income. When we consider only working-age adults, close to a third (29 per cent) of all ISA savings are held by those in the top income decile.

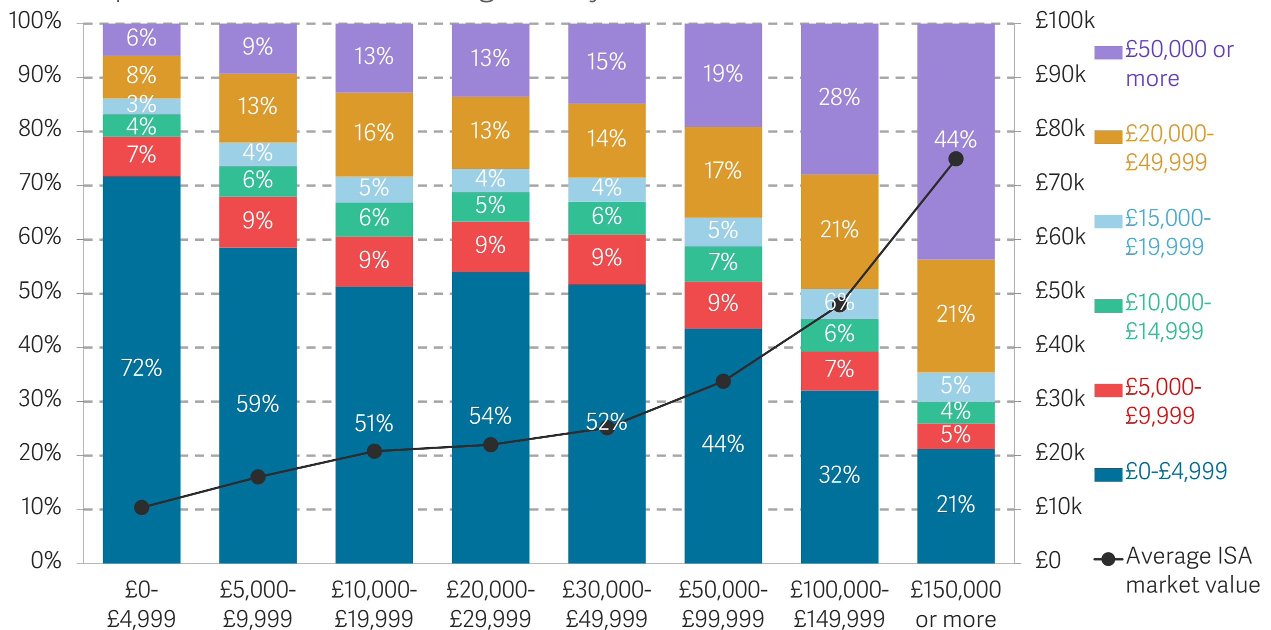
However, it is not just individuals on low incomes that are less likely to have ISA savings. Uptake of ISAs varies by personal characteristics such as gender, age and region and thus some groups are less likely to benefit from the tax-free allowances provided by ISAs.. For example, more women than men were ISA holders in 2019-20: 14.2 million women had an ISA compared to 12.9 million men. However, men typically held more valuable ISA savings on average and this is true across all age groups. For example, in 2019-20, the average market value for male ISA holders was £23,800 while the average market value for female ISA holders was £21,800. One explanation for this is than men were more likely to hold risker ISA products that provide greater returns such as stocks and shares ISAs. Consistent with this, 10 per cent of male ISA holders made a deposit into a stocks and shares ISA in 2019-20 compared to 7 per cent of female ISA holders.

27 The ISA investment allowance was £7,000 between 1999-00 and 2007-08, increasing to £7,200 in 2008-09, £10,200 in 2010-11, £10,680 in 2011-12, £11,280 in 2012-13, £11,520 in 2013-14, £15,000 in 2014-15, £15,240 in 2015-16, and finally to £20,000 in 2017-18 where it has remained since.

28 The Investing and Saving Alliance, Historic Schemes, https://www.tisa.uk.com/all-tisa-publications/isas/historic-schemes/, accessed January 2023.

FIGURE 8: **Some individuals have very high ISA savings, with those individuals likely to be high-income**

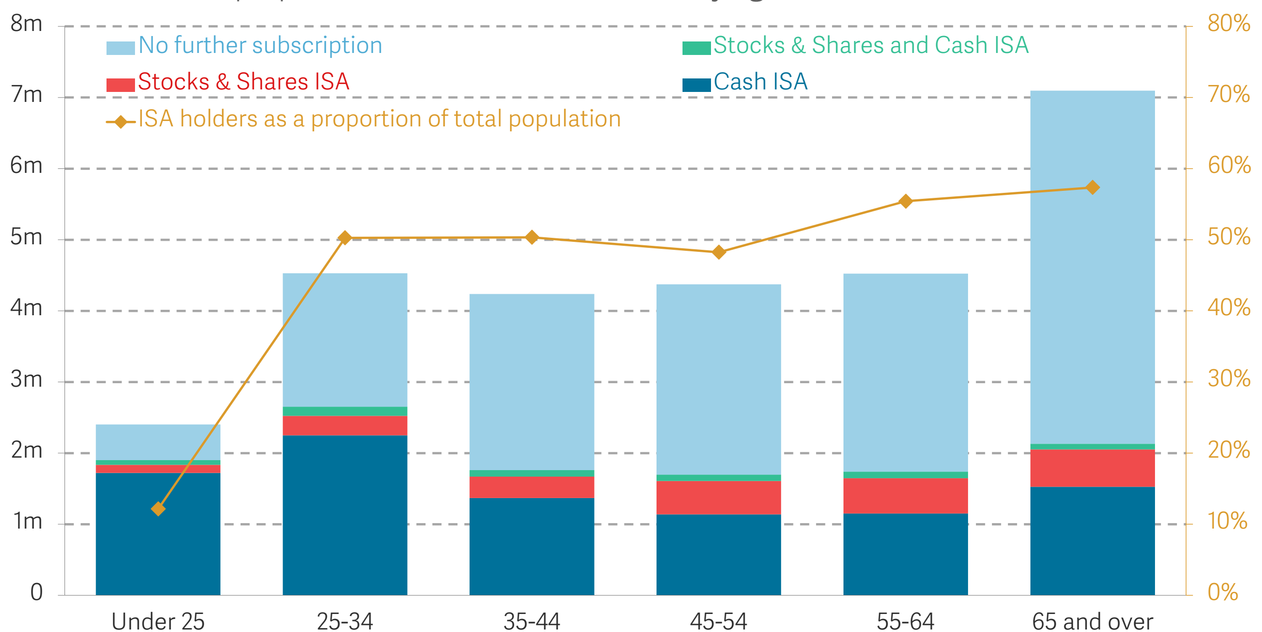
Proportion of individuals holding ISAs, by income and ISA market value: UK, 2019-20




NOTES: The 2019-20 tax year relates to dates of 6 April 2019 to 5 April 2020.
SOURCE: HMRC, Annual savings statistics 2022.

FIGURE 9: **Older people are the most likely to have savings in ISAs**

Number and proportion of individuals with ISAs, by age, 2019-20: UK



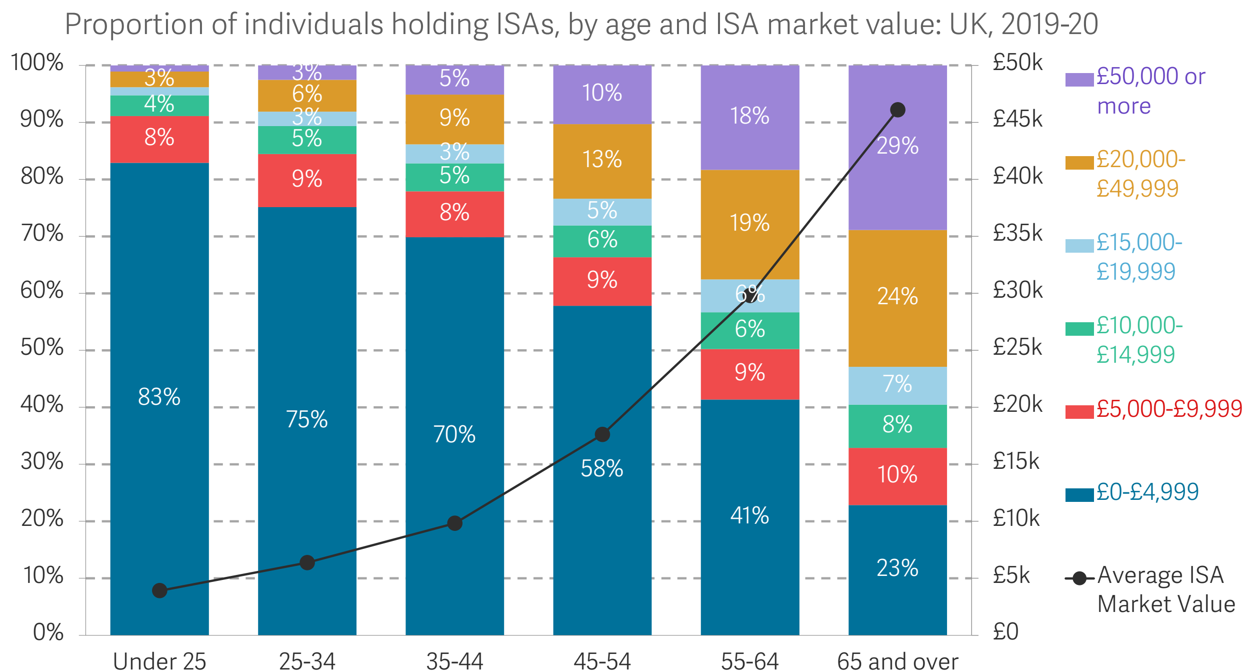

NOTES: The 2019-20 tax year relates to dates of 6 April 2019 to 5 April 2020. Includes individuals holding one or more ISA accounts that did not make a further subscription during the 2019-20 year. No further subscription refers to those with ISA accounts but making no deposits within the tax year.
SOURCE: HMRC, Annual savings statistics 2022; ONS, Population estimates 2019.

Older age groups are more likely to be ISA holders. Over 7 million people aged 65 and above had an ISA in 2019-20. However, a large portion of this group (70 per cent) were not active savers, i.e. they had not made a deposit into their ISA account in 2019-20. The youngest age group had the smallest number of ISA holders: there were around 2.4 million ISA holders under the age of 25. This group were the most likely to be active savers with approximately 79 per cent making a deposit in 2019-20.

Unsurprisingly, the value of ISA savings increases with age. This follows the strong lifecycle pattern to wealth where young people tend to start with very little wealth and accumulate it as they age.[29] This is shown in Figure 10 whereby the proportion of ISA holders valued at £50,000 or more is highest amongst those aged 65 or more (29 per cent). Saving for retirement is a key function that ISAs play – for more on this see Box 2.

FIGURE 10: **Older people tend to have the most savings in ISAs**

Proportion of individuals holding ISAs, by age and ISA market value: UK, 2019-20




NOTES: The 2019-20 tax year relates to dates of 6 April 2019 to 5 April 2020.
SOURCE: HMRC, Annual savings statistics 2022.

29 M Broome et al., An intergenerational audit for the UK: 2022, Resolution Foundation, November 2022.

## BOX 2: The role ISAs play in lifetime financial management

While pensions remain the first port of call in lifetime financial management, ISAs can also be used to provide diversification and greater flexibility in sustaining consumption in retirement. Data from the Wealth and Assets Survey shows that in 2018-20 those who were retired had, on average, £23,000 in ISAs (Figure 11). Figure 11 also shows that ISA savings are higher among self-employed individuals than among employees – £10,000 and £6,000 respectively. One reason for this is that, in some cases, an ISA – and particularly LISAs – can provide greater investment returns than a pension given that self-employed people are not entitled to workplace pension contributions in the same way as employees. However, tax incentives of a pension versus a LISA will depend on earnings. For example, higher-rate taxpayers who are self-employed will usually benefit more from a pension than lower self-employed earners because they will be entitled to 40 per cent tax relief on their pension savings which is higher than the LISA bonus paid by government (25 per cent). Furthermore, ISA savings are higher among self-employed individuals compared to employees when controlling for other characteristics such as income decile, gender and age.

FIGURE 11: **Savings, including ISAs, are used in part to support consumption during retirement**

Mean total family ISA wealth per adult, by employment status: GB, 2018-20

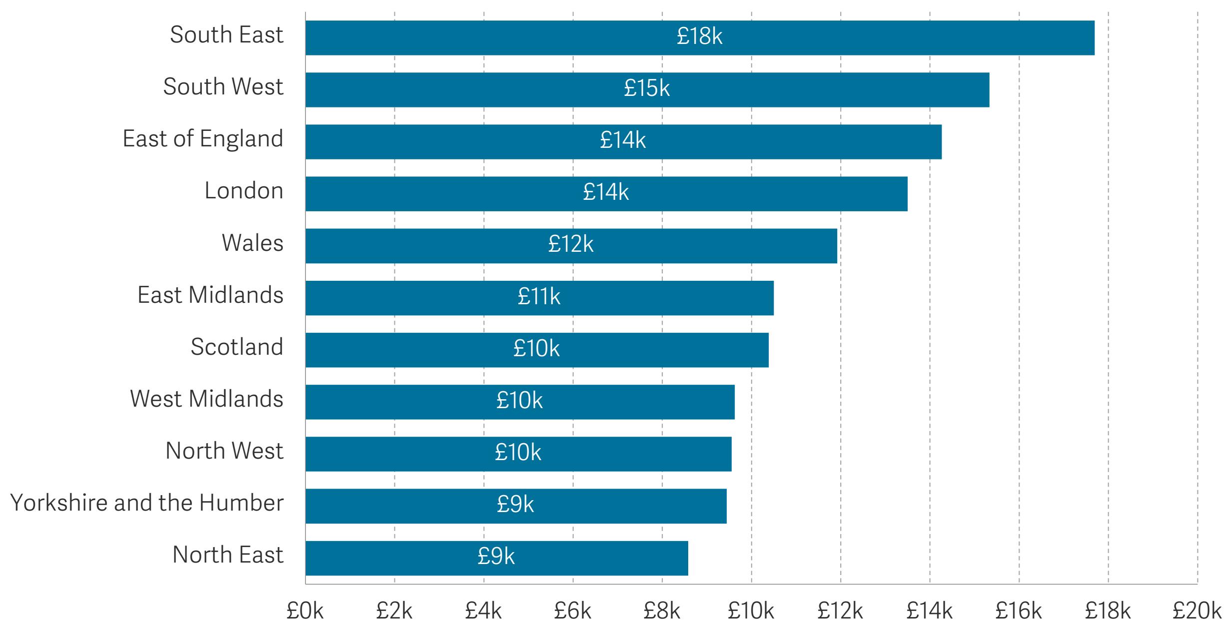
NOTES: Data is adjusted using CPIH into 2021-22 prices. Those under the age of 20 have been excluded from the analysis.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

There are large North-South divides in average ISA savings. Individuals in the South and East of England had the most family ISA wealth per adult in 2018-20 while individuals in the North of England had the least. Figure 11 shows that in 2018-20, an individual living in the South East had on average £9,000 more family ISA wealth per adult than an individual living in the North East. These regional differences in ISA wealth mirror wider differences in total wealth.

This analysis above shows that young people, women and individuals outside the South of England are less likely to benefit from the tax-free savings support provided by ISAs. However, this is a function of these groups also having lower incomes on average, suggesting that policy that increases ISA savings among low-income individuals will to some extent also improve the saving position of these groups too.

FIGURE 12: **ISA values are correlated with existing wealth disparities across regions**

Average family ISA wealth per adult, by region: GB 2018-20



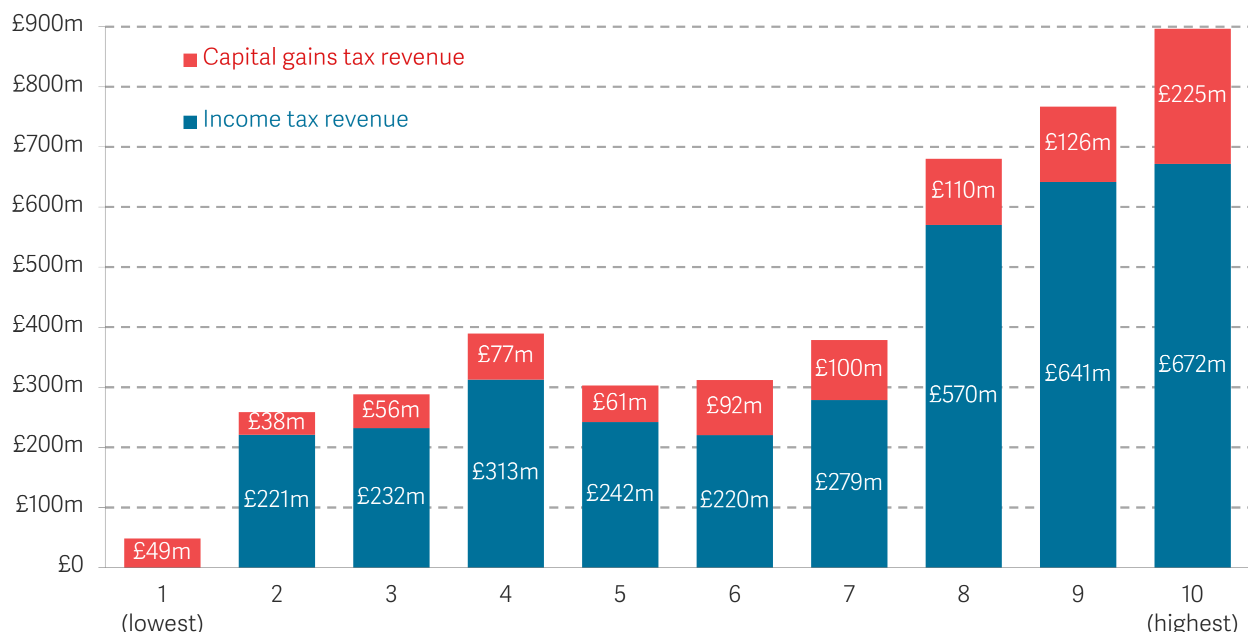

NOTES: Data is uprated to match HMRC published totals. Those under the age of 20 have been excluded from the analysis.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

Although the tax-free returns available from ISAs do not entail payments made by the Government, they do amount to a considerable amount of tax revenue foregone. This is important in a world of rising interest rates where the returns on ISAs (particularly cash ISAs) are expected to rise substantially, and so too will possible tax revenue. Using estimates of returns on cash ISAs and stocks and shares ISAs from the Bank of England and the OBR respectively, we estimate that 16 per cent of the total returns on cash ISAs and stocks and shares ISAs in Q4 2023 will go to the top tenth of the income distribution.

Figure 13 shows that, based on these projections, approximately £4.3 billion could, in principle, be raised by taxing returns on cash ISAs and stocks and shares ISAs as income in 2023-24, assuming no significant behavioural changes. Taxing returns would be progressive with higher-income individuals paying the most: this thought experiment suggests that, on average, those in the top income decile would pay £319 as tax on their ISA returns while those in the middle-income decile would pay £108 and those at the bottom of the distribution would pay £17. Nevertheless, it provides a helpful indication of the tax revenue foregone and the top-heavy nature of the tax relief available.

FIGURE 13: **Tax free returns from ISAs are set to increase significantly with 15 per cent of the total received by the top tenth of the income distribution**

Estimated tax revenue raised from taxing the returns on cash ISAs and stocks and shares ISAs, by household income decile: GB, Q4 2023




NOTES: Analysis assumes the returns on cash ISA will be 4.8 per cent and the returns on stocks and shares ISAs will be 1.5 per cent in Q4 2023. Uses total ISA values and average household income from the Wealth and Assets survey 2018-20. Total ISA values from the Wealth and Assets survey have been uprated to equal HMRC admin data. Those under the age of 20 have been excluded from the analysis. Marginal tax rates are based on average income within deciles. Innovative Finance ISAs are excluded from this analysis.
SOURCE: RF analysis of ONS, Wealth and Assets Survey.

In addition to the starting rate for savings, the PSA and ISAs, there are other schemes that individuals can take advantage on for further tax advantages. These are summarised in Box 3.

## BOX 3: **Other tax exemptions can be used to reduce tax liabilities from savings returns**

Beyond bank deposits and ISAs, investors might expect to pay Income Tax and/or Capital Gains Tax (CGT) on their financial investment returns. However, there are additional government schemes that can benefit investors. Three of the most notable are:

Investments made under the 'Enterprise Investment Scheme' attract multiple tax benefits. Not least: they are free of CGT and also provide up-front relief against Income Tax. It is possible to receive up to £600,000 in Income Tax relief if one is wealthy enough to make a £2 million investment and high-income enough to benefit from the full relief. The scheme cost an estimated £525 million in 2022-23 – spread across around 40,000 people.[30]

The 'Seed Enterprise Investment Scheme' is similar and cost £95 million in Income Tax in 2022-23, spread across around 9,000 people.

Investors' Relief lowers the CGT rate to 10 per cent (from the 20 per cent that would otherwise be payable) for up to £10 million of gains across someone's lifetime. At present there are no available costings for this relief, but it was initially forecast to cost £60 million per year.[31]

These reliefs are not framed as policies to boost the savings of the wealthy. Rather, the goal is to help relatively small, unlisted companies attract (risky) investment – and perhaps thus spur innovation or competition. Eligible investments may include some companies traded on the London Stock Exchange's 'AIM' market, as well as the activities of 'angel' investors. It is beyond the scope of this note to explore how effective the reliefs are in their economic goals. Nonetheless, they represent a form of support for those with the greatest financial wealth, and the scale of their fiscal cost is significant (particularly compared to the Help to Save scheme for low-income households, explored later).

30 HMRC, Non-structural tax relief statistics, January 2023.
31 HMRC, Capital Gains Tax: Entrepreneurs' relief: extension to long-term investors, March 2016.

One final minor issue to highlight is that the current system of ISAs and tax-free allowances creates a complicated environment for individuals' financial planning. In particular, typical quoted ISA rates are below the equivalent rates for similar savings products (as indicated by the wedge between time deposit rates and ISA time deposit rates in Figure 5).[32] This means that for lower-income people, particularly when rates are low, it might be more financially beneficial to save in a non-ISA savings account. Added complexity is itself a barrier to people choosing to save money efficiently.

## The Government has also used direct transfers to incentivise saving with mixed results

### Lifetime ISAs are generous for the specific cohort benefitting

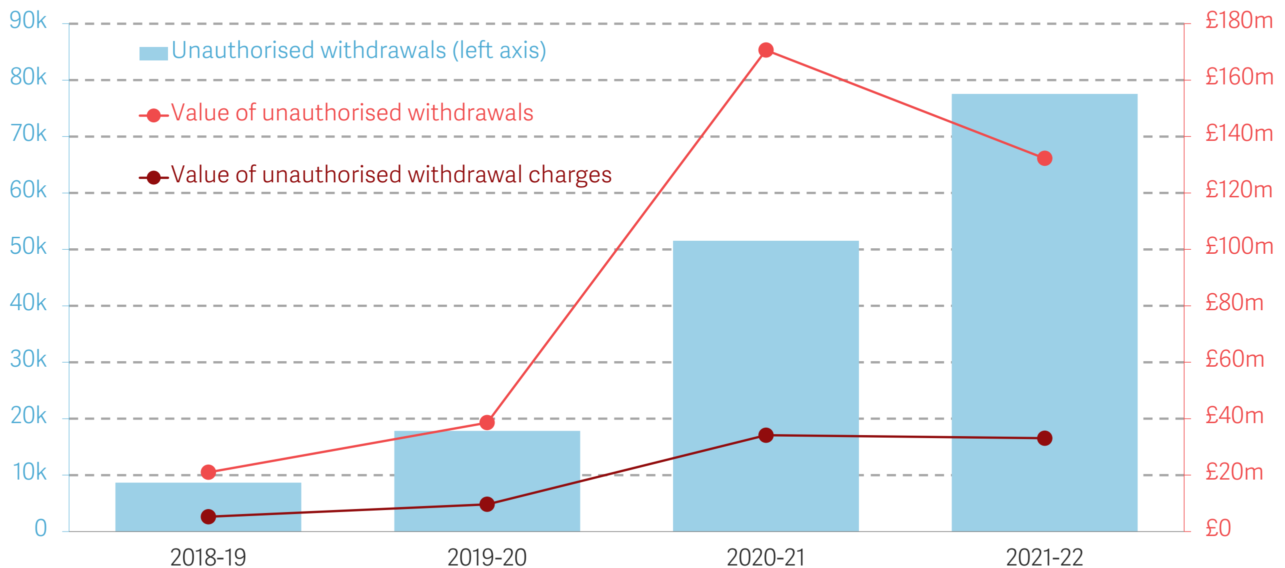
Unlike other ISAs, LISAs are a direct cost to government. A LISA is available to those aged between 18 and 40. An individual can put up to £4,000 each year into a LISA and the government will add a 25 per cent bonus, up to a maximum of £1,000 per year. LISAs have strict restrictions under which savings can be withdrawn. LISA savings are only withdrawable (without penalty) for retirement, buying a first home, or if terminally ill. To withdraw for any other reason, individuals face a withdrawal charge of 25 per cent – meaning they lose more than the government bonus.[33]

LISAs appear to be being used for their intended purpose. Over 50,000 people withdrew from their LISA in order to purchase a first-time property in 2021-22, an increase of around 15,000 on 2020-21.[34] However, there is also evidence to suggest that there are individuals who would like to access their LISA savings but are prevented from doing so as a result of the withdrawal charge. For example, in 2021-22 there were more unauthorised LISA withdrawals than house purchase withdrawals – 77,550 and 50,800 respectively. However, the total value of unauthorised withdrawals (i.e. withdrawals subject to the penalty) was less than the total value of house price withdrawals, meaning that unauthorised withdrawals are, on average, for smaller amounts. Figure 14 also shows that there was a spike in the value of unauthorised withdrawals in 2020-21, a year in which the withdrawal charge was temporarily reduced to 20 per cent in response to the Covid-19 crisis. Again, this suggests that there is a desire to access LISA savings without being penalised.

32 Holly Mead, My husband was excited about saving — then he learnt about the tax, The Times, January 2023.
33 The penalty rate exceeds the bonus rate because it applies to the stock of savings post-bonus. For more information see: https://www.gov.uk/lifetime-isa, accessed January 2023.
34 HMRC, Commentary for Annual savings statistics: June 2022, November 2022.

FIGURE 14: **Restrictions around withdrawals are preventing individuals from accessing savings**

Number and value of unauthorised Lifetime ISA withdrawals, by financial year: UK




NOTES: The withdrawal charge for LISAs is 25 per cent for all years except 2020-21 when the withdrawal charge was reduced to 20 per cent.
SOURCE: HMRC, Annual savings statistics 2022.

The total fiscal cost of the LISA bonuses is projected to be to £671 million in 2023-24.[35] Data from the Wealth and Assets Survey suggests that, in 2018-20, 47 per cent of LISA wealth was held by individuals in the top household income quintile. This suggests that government spending on this policy is highly regressive. However, there is LISA take up among lower income quintiles. It is not clear whether LISA holdings in the lower income groups reflect the age profile of eligibility rather than position in lifetime income distribution. For example, younger age groups – who tend to have a lower income – could be using a LISA for a first-time house purchase, but then go on to higher income quintiles later on in life.

There is, however, limited data on the take up LISAs with which to understand the impact of the policy. The Wealth and Assets Survey, while a large-sample survey, has relatively few individuals with LISAs. This is mostly because the first LISA accounts were opened in April 2017 and the most recent WAS data covers the period from April 2018 to March 2020.[36] It is possible that a particular cohort of individuals, including those on high incomes, were more likely to be early-adopters, and this may mean that the WAS data is giving us a skewed impression of the characteristics of LISA account holders when the policy matures. Without additional data it is difficult to be confident in estimating the distribution of balances across the income distribution, so this analysis should be treated

35 OBR, Economic and Fiscal Outlook – November 2022.
36 HM Treasury, The new Lifetime ISA, April 2018.

with caution. The limited data also prevents us making conclusions on whether LISAs are meeting other objectives, such as helping to close intergenerational wealth gaps and supporting more people to become homeowners.

FIGURE 15: **47 per cent of the total fiscal cost of LISA's is concentrated among high-income households**

Estimated total fiscal cost of Lifetime ISAs, by household income quintile:: GB, 2023-24

NOTES: NOTES: The share of total Lifetime ISA holdings by household income decile has been applied to OBR fiscal cost estimates of Help to Buy ISAs and Lifetime ISAs
SOURCE: RF analysis of OBR, Economic and fiscal outlook November 2022; ONS, Wealth and Assets Survey.

## The exception to policy failure is Help to Save, although it has benefited few

The other policy involving targeted payments is Help to Save. This is the only scheme which explicitly aims to help improve savings for those on low incomes. It has been in place since 2018 (although it replaced previous, similar, schemes), and it is currently open to new applications until September 2023.[37]

The way the scheme works is that someone can apply to open an account and can then save up to £50 per month; no interest is paid but, after two years, the account holder receives a bonus of 50 per cent of the peak savings level over the previous two years. This is then repeated for a final two-year period. Account holders can make withdrawals at any time and for any reason, but payments can take up to three working days, which effectively prevents its use as a current account. Someone is eligible to open an account

37 For details on the policy see HM Treasury, Help to Save: Policy Design, October 2016.

if they are receiving UC (and have take-home pay above £658.64 per month), Working Tax Credit, or eligible for Working Tax Credit and receiving Child Tax Credit.

As shown in Figure 16, there has been a steady increase in the take up of the scheme over time with over 350,000 accounts opened since the start (with 300,000 of those accounts having had at least one deposit made). Take up increased during the first year of the pandemic, coinciding with an increased inflow of families onto UC and a period of 'enforced' saving where people were less able to spend.[38] The pace of account opening has now returned to previous typical levels.

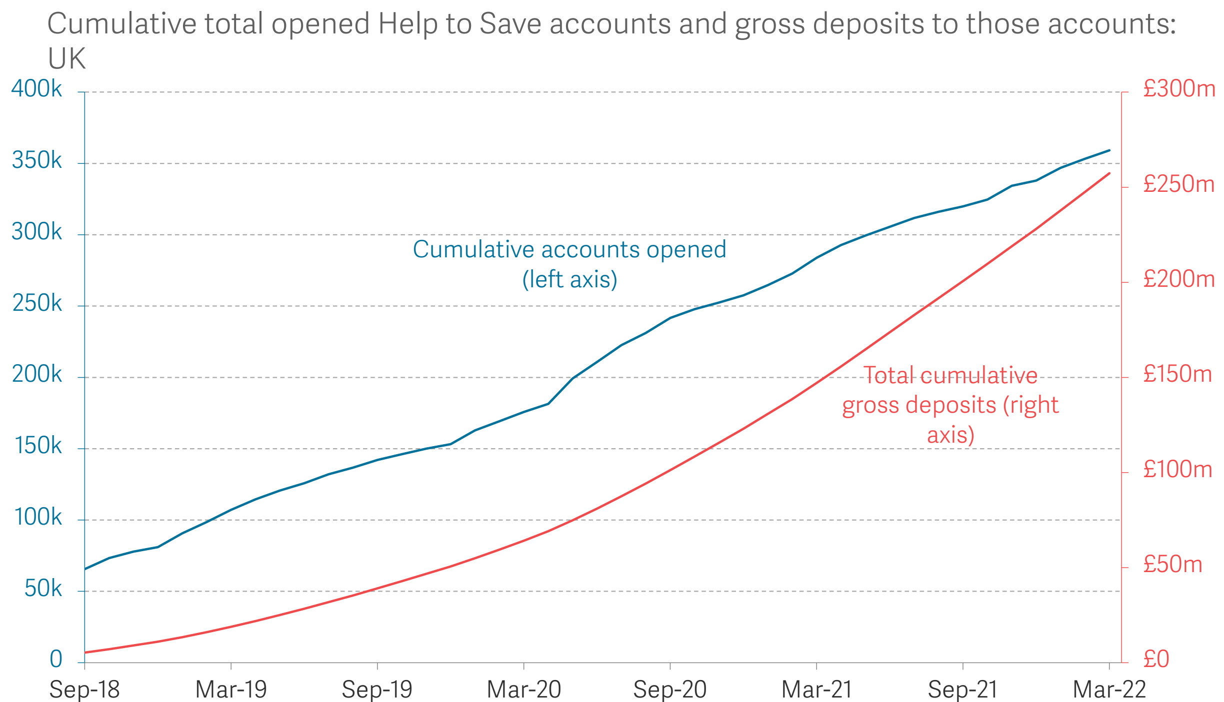
Although significant numbers of people are benefitting from the scheme, many people who are eligible are not opening a Help to Save account. At the outset of the scheme, the Government estimated that as many as 3.5 million people could benefit.[39] This suggests that at most 1 in 10 of those eligible have opened an account – and the 3.5 million estimate will almost certainly be an underestimate, given how the pandemic boosted the numbers receiving UC.[40] Clearly, one significant barrier to higher take up is that the income levels for people claiming benefits is often too low for saving to be possible. However, given that there is little downside to opening a Help to Save account in case someone is unexpectedly able to save money in a given month, the low number of accounts opened suggests there are other barriers to higher use of the scheme.

Nevertheless, the scheme has clearly been successful at an individual level. First, and most importantly, it has encouraged additional saving for many of those who have used the scheme.[41] Total bonus payments from the Government are low given the relatively small amount of money saved into the scheme (Figure 16) – an estimated £43 million per year in the period covered by the most recent HMRC data.[42] But the individual payments could be significant: someone saving £50 a month and never making a withdrawal would receive £1,200 over four years, which represents a significant transfer for those on low incomes.

38 By 'enforced saving', we are referring to the fact that there were fewer opportunities for consumption during some periods of the pandemic and that left some people with additional resources that could be put into savings. For more, see: J Leslie & K Shah, (Wealth) gap year: The impact of the coronavirus crisis on UK household wealth, Resolution Foundation, July 2021.
39 HM Treasury, Budget 2016, March 2016.
40 Public data is not available on the cumulative number of people that are claiming or eligible to claim UC or Working Tax Credit. This means it is not possible to estimate an actual take-up rate given there will be flows into and out of the stock of benefits claimants over time. 10 per cent is an approximate figure based on the 3,5 million original estimate for eligibility.
41 HMRC, Help to Save Customer Experience Research: Quantitative and qualitative findings from research with Help to Save customers, Research Report 623, August 2021.
42 It is not possible to know ex ante the value of bonuses that will be paid on deposits given that bonuses are paid on the peak deposit level and individuals can withdraw money from the scheme. We have estimated the cost by taking the level of net deposits within a year as a proxy for the likely average amount the bonus will apply to.

FIGURE 16: **Take up of Help to Save is relatively low**

Cumulative total opened Help to Save accounts and gross deposits to those accounts: UK




NOTES: Around 50,000 accounts have been opened but no deposits made.
SOURCE: RF analysis of HMRC, Annual savings statistics 2022.

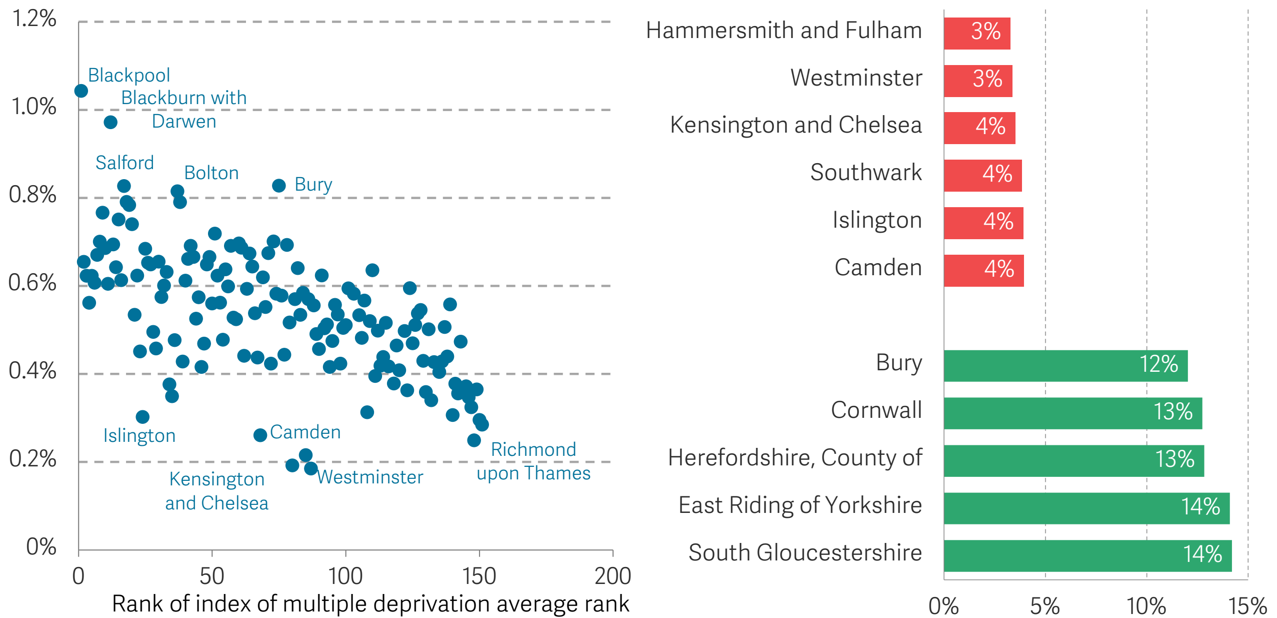
Second, satisfaction with the scheme is high. Research commissioned by the Government conducted in 2020 and 2021 found that 73 per cent of scheme users were very satisfied with the scheme and a further 18 per cent were fairly satisfied; only 3 per cent reported being dissatisfied to some extent.[43] Respondents were likely to cite it providing a good incentive to save, a high bonus rate, and the relative ease of setting up and using an account as reasons for their satisfaction.

Third, the scheme seems well targeted at groups it most need of support. The vast majority of the scheme beneficiaries are women, mostly with children.[44] And, as shown in the left chart of Figure 17, use of the scheme is higher in areas which are more deprived – for example, the number of Help to Save accounts opened in Blackpool exceed 1 per cent of the population. This is not surprising given that there are more benefit claimants in a more deprived area. But when looking at a pseudo-measure of take-up relative to UC claimants (right chart of Figure 17), it is some of the most affluent areas of the country that have the lowest relative take-up, i.e. central areas of London (although some of the most deprived areas of London also have low take up). In other words, this policy appears to be transferring money effectively towards more deprived places and people.

43 HMRC, Help to Save Customer Experience Research: Quantitative and qualitative findings from research with Help to Save customers, Research Report 623, August 2021.
44 HMRC, Help to Save Customer Experience Research: Quantitative and qualitative findings from research with Help to Save customers, Research Report 623, August 2021.

FIGURE 17: **Help to Save targets support at more deprived areas, and the North West of England in particular**

Cumulative opened Help to Save accounts as a share of population, by local authority, compared to rank of index of multiple deprivation (left chart) and cumulative opened accounts as a share of current UC claimant families (highest and lowest local authorities): England, March 2022



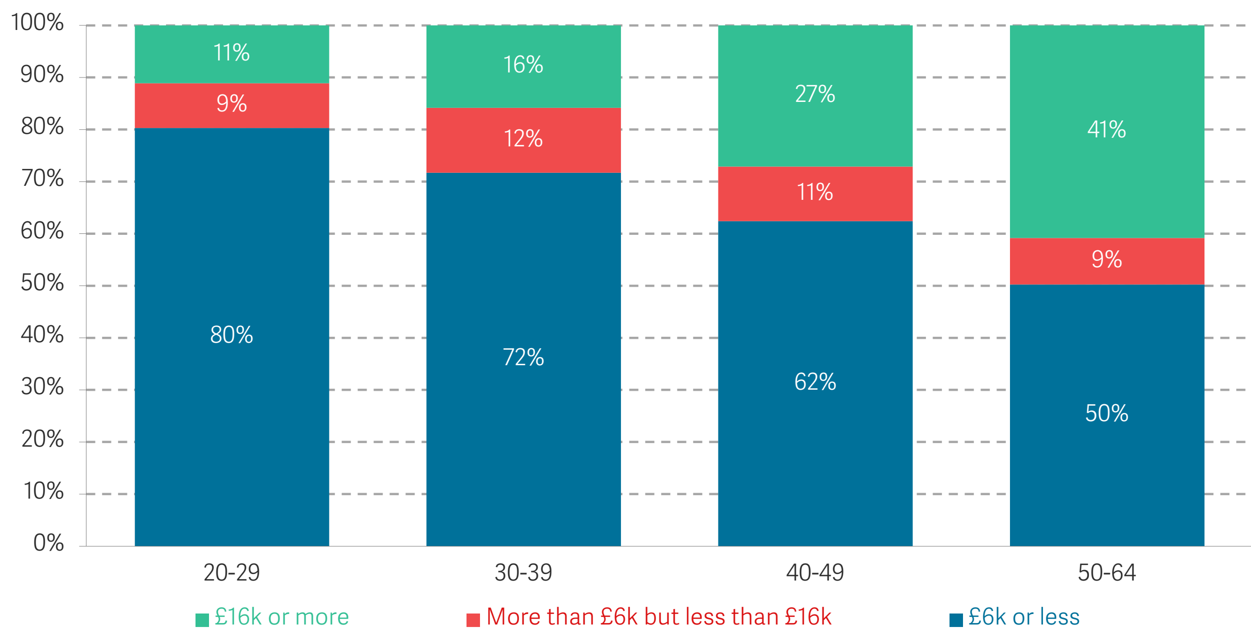

NOTES: Index of multiple deprivation is based on 2019 data. UC claimant family numbers are from August 2022.
SOURCE: RF analysis of HMRC, Annual savings statistics 2022; MHCLG, English indices of deprivation 2019; DWP, Stat-Xplore.

Although Help to Save is a useful tool for individuals in receipt of UC, this policy is at risk of being undermined by the design of UC discouraging claimants to save. UC contains 'capital rules'. Any capital or savings over £6,000 steadily reduces a claimants UC entitlement; if they have assets over £16,000, they are not entitled to any UC. Around 1.7 million people aged 20-64 in the bottom income quintile were above the £16,000 threshold in 2018-20, meaning that they were not entitled to claim UC despite having a low income – this was equivalent to 29 per cent of the bottom income quintile aged 20-64.

Older low-income individuals are more likely to have capital or savings above the £16,000 threshold. For example, as shown in Figure 18, 41 per cent of 50-64-year-olds in the bottom income decile were above the UC capital requirement in 2018-20. It is also important to note that these capital thresholds have been frozen since 2006, which has effectively pushed more claimants onto smaller UC entitlements; if the thresholds had kept up with consumer price inflation, they would currently be over £9,000 and £24,000 respectively.

FIGURE 18: **1.7 million low-income people have too much in savings to claim UC**

Proportion of individuals in the bottom household income quintile that meet Universal Credit savings/capital criteria, by age group: GB, 2018-20




NOTES: Savings and capital defined as gross financial wealth and gross other property wealth (i.e. not main residence property).
SOURCE: RF analysis of ONS; Wealth and Assets Survey.

Although many UC claimants may find it difficult to save, particularly during the current cost of living crisis, the 'capital rules' act as a disincentive to build up a financial safety net to draw down in the face of an unexpected expense or an income shock worsening financial resilience among low-income individuals.

LISAs and Help to Save are the only currently active policies which provide a direct payment to individuals to encourage saving. However, there have been previous schemes, some of which still have active beneficiaries. In particular, Child Trust Funds are an instructive former policy, and are discussed further in Box 4.

## BOX 4: **Child Trust Funds**

A Child Trust Fund (CTFs) is a long-term tax-free savings account for children born between 1st September 2002 and 2nd January 2011. They were introduced in April 2005 to encourage long-term saving and provide a sum of money upon reaching adulthood. The scheme was closed to new entrants in January 2011 and has been superseded by Junior ISAs.[45] Much like a Junior ISA, any income and gains generated by CTF investments are exempt from Income Tax and Capital Gains Tax. However, CTFs differ from Junior ISAs

45 For more information see: https://www.gov.uk/child-trust-funds.

because the government also made an initial endowment of £250, or £500 for children from lower-income families.

Data from HMRC show that, as of April 2021, there were 5.5 million CTF accounts. of which around 320,000 accounts had matured. Some 175,000 adults had claimed their CTF. The average market value of all CTF accounts (continuing and matured) was around £1,900. In 2020-21, the average amount deposited into a CTF was £457 over the financial year. However, the majority (84 per cent) of CTF accounts did not received a deposit in 2020-21.

CTFs were a novel attempt at spreading asset ownership more equitably. The policy was grounded in the evidence that the positive impact of owning some financial assets on a person's future economic and social prospects has grown. However, the CTF policy was too small to make a dent in the wider distribution of wealth, and so the challenges that sparked the creation of this agenda still remain. It is also too early to ascertain whether CTFs did achieve their other objective of encouraging people to develop a long-term saving habit. Nevertheless, CTFs are an example of how government can distribute money directly to a cohort of people in an attempt to reduce inequality and promote financial resilience.[46]

## Total support for savings is currently poorly targeted and could be made more effective

The analysis above shows that there are significant long-standing issues with low savings in the UK, and that the various policies currently in place are poorly targeted or relatively small in scale. A common failing of UK policy making over decades has been not recognising that economic crises happen, and that, when they do happen, they have long-lasting negative consequences. If we want to go into the next crisis with a more resilient economy and with households being better protected from idiosyncratic income shocks, then we need a step-change in the support for savings.[47]

There are a range of macroeconomic and individual-level issues created by low levels of saving. But we have highlighted two critical issues that savings policy should be focused on: first, that there are too many families with low savings; and second, that low savings are most harmful, and therefore pose the most acute problem, for low-to-middle income families. It is clear from the earlier analysis that successive policy changes have done

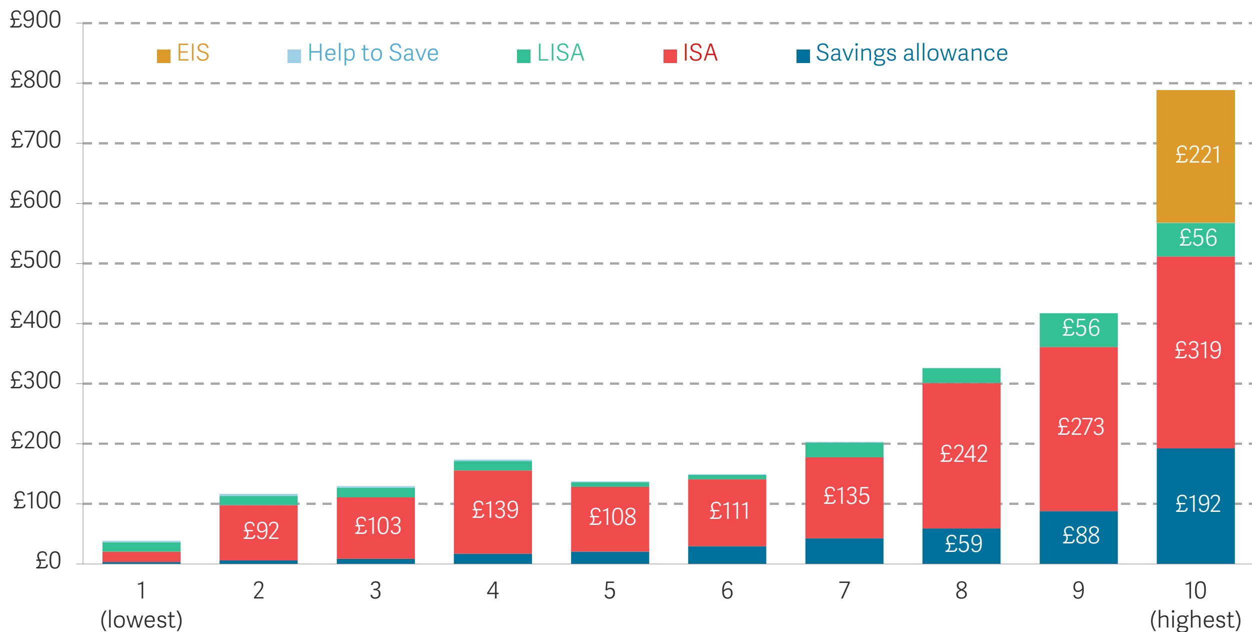
46 G Kelly, The Child Trust Fund comes of age, Resolution Foundation, August 2020.

47 We focus our policy discussions on actions that the central government can take quickly. There are a wider set of policies which could help make families more financially resilient (for example, by embedding financial advice within existing services frequently used by lower income or struggling households; see: RSM, Evaluation of the Savings and Credit Pathfinders Programme – Final Report, The Money and Pensions Service, March 2021).

little to improve either of these problems. For example, when the ISA saving allowance increased in the past (e.g. the increase from £15,240 to £20,000 in 2017-18), there was no increase in saving into ISAs nor an improvement in levels of saving for low-income families.[48] Therefore relying on past solutions is unlikely to be successful.

FIGURE 19: **Most financial support for savings goes to high-income families**

Estimated average fiscal transfer to households from various savings schemes and tax reliefs, by income decile: UK, 2023-24




NOTES: Help-to-save costing is based on the estimated bonuses that would be paid to the total net deposits made in 2021-22. The total cost of EIS is based on HMRC estimates for 2022-23. ISA and LISA costs are shown by household income decile.. Innovative Finance ISAs are excluded from this analysis.
SOURCE: RF analysis of HMRC, Tax Relief Costings; HMRC, Savings Tables; ONS, Wealth and Assets Survey; OBR, Economic and Fiscal Outlook – November 2022.

As Figure 19 shows, the level of effective financial support in the UK for savings is already significant.[49] But the scale of the support is highly skewed towards those with high wealth levels and therefore generally those with high income levels. For example, the average household in the highest tenth of the income distribution receives around £800 per year in tax advantages and direct transfers (the counterfactual here is if all savings income and capital gains in ISAs were taxed in line with other forms of income) compared to around £80 per year for the poorest fifth.[50] This means there is a clear mismatch

48 See Figure 1 and ONS, Wealth and Assets Survey.
49 Of course, treating all savings income as equivalent to other forms of income is at one end of the spectrum on how to tax savings, but it does represent a useful benchmark to understand the scale of the effective financial support for savings.
50 Relying on a counterfactual where all savings returns are taxed at the marginal Income Tax rate is obviously an extreme way of calculating the scale of the savings support. Some would argue, for example, that only 'abnormal' savings returns should be taxed as that prevents an inefficient incentive to save less than would be optimal – see S Adam et al., Tax by design, Mirrlees Review, Institute for Fiscal Studies, September 2011. However, the current system has no mechanism in place to reach this theoretically ideal system, and so calculating the scale of support relative to that ideal is difficult given data constraints and at odds with how the current tax system functions in practice.

between the need for support and where it is being delivered. It is also important to note that current savings support schemes have significant dead weight loss, because much of the support goes to those with already high levels of savings. Policy reforms should, therefore, be focussed on boosting incentives to save for those with less savings and who are lower down the income distribution.

### More support should be given to lower-income families by building on the successes of Help to Save

The most obvious way to encourage savings is to build on the existing policies which work well. As discussed, Help to Save has very high satisfaction with its users and, given that it is currently set to end for new applicants in 2023, it would be a positive step to continue the scheme. Furthermore, limiting the scheme to four years when someone might still be claiming benefits at the end of the period is unnecessarily restrictive. Therefore, allowing people to keep their Help to Save account for an additional two-year period, assuming that they are still eligible, would again be a sensible way to expand the positive impact. Another way to expand the scheme would be to raise the monthly saving limit, which has been set at £50 since its announcement in 2016; indeed, this was the most popular way to reforming the scheme among participants.[51] The recent rapid rise in prices means that the saving limit has effectively been cut to below £40 today in 2016 prices. In addition, 92 per cent of monthly deposits are at the £50 level, which clearly implies it is a constraint to additional saving. The monthly limit also reduces the incentive for someone who is on UC but receives a temporary income boost one month to take advantage of saving that money. Thus, raising the monthly limit to £100 could be a way to increase incentives to use the scheme and boost the level of savings for low-income people.[52] It would also be sensible to remove Help to Save account values from the UC assets test to ensure that someone building up savings doesn't find themselves losing benefit entitlement as a result. All of these reforms, in isolation, are unlikely to have a significant fiscal cost, given the current low level of take-up.

The biggest barrier to Help to Save being more effective is the low take-up rates. Clearly, the low incomes of those on benefits will prevent many families from being able to save money; indeed, it might be inappropriate for struggling families to worsen their living standards by putting some money aside.[53] The only way to reduce that constraint would be to raise benefit payments. However, the relatively low share of open accounts which have not had deposits (around 50,000 out of 350,000 total accounts) and the fact that

51 HMRC, Help to Save Customer Experience Research: Quantitative and qualitative findings from research with Help to Save customers, Research Report 623, August 2021.

52 We do not propose removing the limit, as that increases the chance that the scheme can be used in a way which does not help people build up a habit of monthly/regular saving.

53 There has been a rise in the proportion of people coming to Citizens Advice for help with debt problems who have a 'negative budget' where their incomes do not cover their requirements: up from 37 per cent in 2019 to 48 per cent by mid-2022 (Citizens Advice, Cost of Living Dashboard, accessed January 2023).

92 per cent of deposits are at the £50 limit, suggest that low incomes are not the only barrier. Indeed, the Government's analysis suggests that one barrier is that people are unaware that the scheme exists.[54] Therefore, we propose that all new claimants of UC that are eligible for Help to Save are automatically given a Help to Save account. UC recipients can then be given frequent communication, with a focus on ensuring that they understand the benefits of using the account to save money.[55] In addition, it would encourage take-up for the scheme it there were to be an initial bonus (for example, £50) placed into the account immediately on being opened. To magnify the effect of people developing the habit of using the account, this bonus should have some restrictions on withdrawal – we propose that someone would have to make deposits in three months (not necessarily consecutive) before withdrawal is possible.

Together, these two changes could significantly increase use of the scheme. Again, the cost of these changes is hard to estimate given there is no data upon which to base the behavioural effects. But if we assume that an upper limit is the existing cost of the scheme but scaled up so that all eligible people are using it, then that would still represent an annual cost of only around £400 million (compared to the current cost of below £43 million per year) – far lower than the 'cost' of ISAs.

Not all low-to-middle income families are eligible for UC, and so it might be fruitful to broaden Help to Save to capture low-income individuals not in receipt of UC. Eligibility could be modelled on a previous government initiative aimed at encouraging saving among lower-income households and promoting engagement with mainstream financial services – the Saving Gateway pilot.[56] Much like Help to Save, each pound placed into a Saving Gateway account was matched by the government at a certain rate up to a monthly contribution limit. However, the eligibility criteria were somewhat wider. In addition to those in receipt of an out-of-work benefit, individuals aged 16-64 with individual earnings up to £25,000 and family earnings below £50,000 were also eligible for a Saving Gateway account.[57] A more radical approach could be to build on the success of pension auto-enrolment and automatically open accounts for anyone meeting a low-earnings threshold based on PAYE data (although it is not possible with current data to have a family income condition as part of this process, which could make the scheme less well targeted than it currently is).

54 HMRC, Help to Save Customer Experience Research: Quantitative and qualitative findings from research with Help to Save customers, Research Report 623, August 2021.
55 This follows the wide literature that shows that 'nudge'-type policy changes can support better individual decisions on personal finances. For example: J Cribb & C Emmerson, What happens when employers are obliged to nudge? Automatic enrolment and pension saving in the UK, Institute for Fiscal Studies, November 2016.
56 The Saving Gateway was closed after the second pilot and was effectively replaced by Help to Save, which built on many of the findings from the earlier pilots.
57 Ipsos MORI & Institute for Fiscal Studies, Final Evaluation of the Saving Gateway 2 Pilot: Main Report, May 2007.

## Boosting savings support for lower-income families can be funded by reducing the significant support currently going to the already-wealthy

As outlined above, 44 per cent of those with an income above £150,000 have savings in ISAs which exceed £50,000, while this group also chooses to substantially diversify financial wealth holdings into other asset types like direct holdings of stocks and shares and other investments. Therefore, it seems unlikely that ISAs provide a significant boost to the incentive to save, given that many families are choosing to put the marginal pound of saving into other assets. At the same time, the tax-advantage of ISAs represents a significant and growing cost to the Treasury, with the expected cost set to hit close to £4.3 billion per year by 2024.

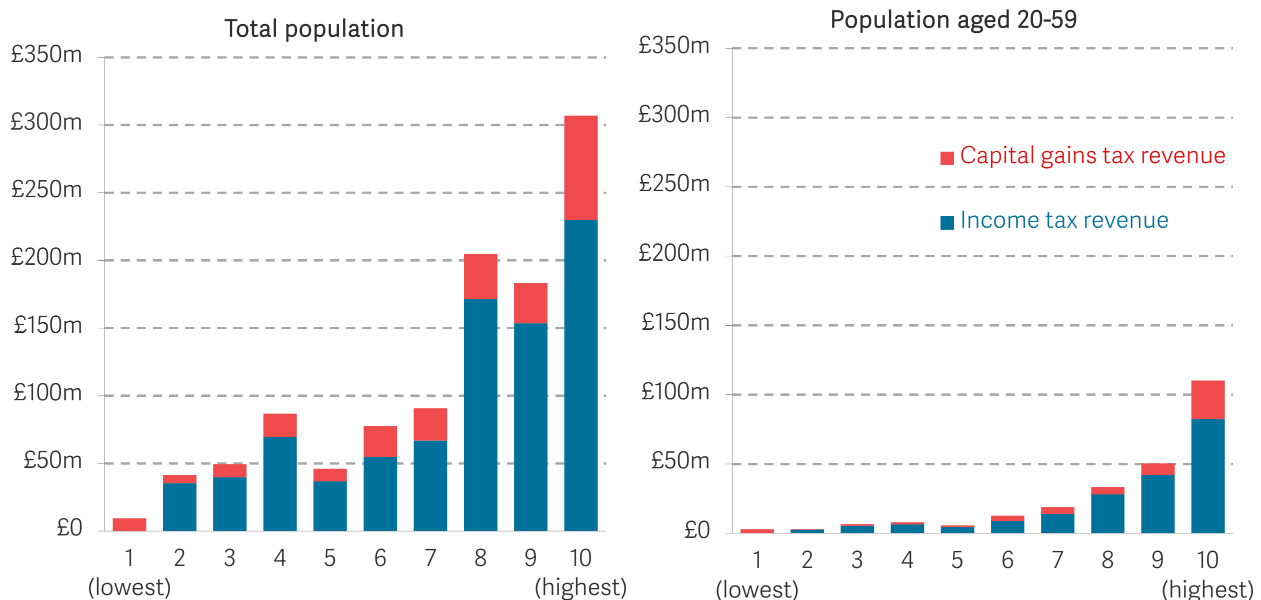
Nevertheless, ISAs clearly provide a useful mechanism, in addition to tax-free savings thresholds, to incentivise saving financially and to reduce administrative costs of families who would otherwise need to fill in tax returns.

Therefore, the sensible approach would be to cap ISA amounts, which could be done in a variety of ways. It is already the case that there is an annual cap on the amount that can be added to an ISA in any given tax year (currently £20,000). But there is no cap on the total value allowed to be held in ISA accounts, nor is there a cap on the income from the value within ISA accounts. It would be administratively difficult to cap returns or income because returns from stocks and shares ISAs can vary widely and over time. A simpler approach would be to cap the total value an individual is allowed to hold across any ISAs – and when this cap is hit, either as a result of active saving into an ISA or as a result of savings income or capital gains, then an individual would no longer be able to add money to any ISA account.[58] Setting this cap at a relatively high level, say £100,000 (£200,000 for couples), would ensure that incentives to save for those with lower savings levels were not reduced at the same time as generating additional revenue which could be used to fund an increase in generosity of the Help to Save scheme. Figure 20 provides estimates of the revenue raised by capping existing individuals' ISA holdings at £100,000, based on taxing returns on cash ISAs as income and taxing the returns on stocks and shares ISAs as capital gains. This shows that there would be significant revenue captured even with a cap set at a very high level, and that this would exceed any plausible estimate of the cost of expanding the generosity of Help to Save. But what is also evident from Figure 20 is that taxing returns on ISAs above £100,000 would largely impact those aged 60 and above: 1.5 million people had ISA holdings above £100,000 in 2018-20, of which 1.1 million (72 per cent) were aged 60 and above.

58 Applying this retroactively creates a challenge for those with more than one ISA account. One approach, and the one we assume for the following policy costing, is that individuals would need to choose what accounts to withdraw in order to meet the overall £100,000 limit. It would be needed to phase this requirement in over time given some ISA products have contractual restrictions on withdrawing finances immediately. There could also be legal challenges with a retroactive approach but that is beyond the scope of this paper and there are many examples of previous retrospective changes (e.g. cutting the lifetime pensions cap).

FIGURE 20: **Capping ISA values at £100,000 could raise around £1 billion a year by 2023-24**

Estimated fiscal revenue from capping total ISA values at £100,000, by tax treatment of savings returns above this threshold and household income decile: UK, 2023 Q4




NOTES: Chart shows the estimated tax revenue assuming savings above £100,000 are saved in the same products as existing ISA splits, returns on cash ISAs will be 4.8 per cent and the returns on stocks and shares ISAs will be 1.5 per cent in Q4 2023, and that returns on cash ISAs are taxed at the marginal Income Tax rate for the typical person in each decile and the returns on stocks and shares ISAs are taxed at 20 per cent capital gains tax. These estimates do not account for behavioural changes (e.g. raising consumption expenditure). We assumed those with ISA values over £100,000 would not be entitled to tax free allowances under the 'starting rate for savings' and the Personal Savings Allowance because those with ISA values over £100,000 had around £80,000 in other savings (such as current and savings accounts) on average. Analysis includes Innovative Finance ISAs.
SOURCE: RF analysis of HMRC, Annual savings statistics 2022; OBR, Economic and Fiscal Outlook – November 2023; Bank of England, Bankstats; ONS, Wealth and Assets Survey.

In addition to capping ISA values, there is a strong case to reassess the various schemes discussed above which can be used to reduce taxes on capital gains and investment returns. Previous research has shown that these types of returns are highly skewed to high-wealth and income individuals,[59] and that previous similar tax schemes like Entrepreneurs' Relief (now reformed into Business Asset Disposal Relief) are not effective in incentivising investment and are extremely costly.[60] Analysis should be undertaken to understand the efficacy of these schemes and, if not delivering value for money, then reduced in scope or scrapped.[61]

59 A Corlett, A Advani & A Summers, Who gains? The importance of accounting for capital gains, Resolution Foundation, May 2020.
60 G Bangham et al., Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.
61 A Corlett, Five bad ways to hand out £4 billion a year, Resolution Foundation, January 2023.

## Conclusion

The current cost of living crisis is highlighting why the endemic and long-standing issue of too many families having too little in savings is such a problem for the UK. Policy makers have tended to focus too much on raising aggregate saving levels – a worthy goal, even if success has been limited to date – and too little on ensuring that more families have a decent level of savings.

Much of the economic issues in the UK at present result from over a decade of slow income growth for most UK families combined with the legacy of rising inequality after the 1980s.[62] Low incomes for many families pose a significant barrier to saving more and create its own issue of widespread financial insecurity. Policy makers now need to recognise this new, economic reality and refocus savings policy towards providing more support for a broader range of families to build up savings. More effective support could easily be funded by reducing the ineffective tax advantages that the very wealthy enjoy.

62 The Economy 2030 Inquiry, Stagnation nation: Navigating a route to a fairer and more prosperous Britain, Resolution Foundation, July 2022.

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