The Real Indicator of Economic Health: The Rewards for Savings. The U.K. example

Kees De Koning

30. July 2012
The Real Indicator of Economic Health: the Rewards for Savings. The U.K. example

Drs Kees de Koning 30th July 2012

GDP output growth is generally used for measuring economic health. This indicator is a result indicator; the result of how a society combines its savings with the available manpower in order to produce output. Changes in unemployment levels are measured to indicate whether the savings-manpower combination results in higher or lower unemployment levels. What is surprising is that in economic theory and in practice so little attention is paid to the rewards for savings. For instance the defined benefit schemes in the U.K. made a loss of £250 billion in the year to June 2012 according to figures by the Pension Regulator. The losses accumulated in the DC schemes for individual savers are not even measured on a monthly basis; however, they are likely to show a similar drop of around 30% in the values of the combined portfolios in the year up till June 2012, probably with a loss of some £150 billion. On top of this savers will also have lost on individual holdings of assets -property, shares and government bonds-, just like through their pension pots. With U.K. GDP output running at around £1.5 trillion, a loss of around £400 billion in values represents a 27% loss for the U.K. population on all output produced. Not the sign of a healthy economy. The Pension Regulator assumes that a healthy pension sector needs to earn 3.5% over inflation rate in order to afford the U.K.‘s long term pensions. What a pity that the Pension Regulator does not seem to speak to the Bank of England. The latter managed to keep the 10 year gilt yield at around, on average, 1.8% below inflation rate over the year to June 2012. Perhaps the time has come for some joint up thinking and collective risk management methods.

Just like one measures government debt levels to GDP, one can also measure changes in households’ net worth to GDP. A sound running economy does not only show economic growth, but also an increase in net worth of individual households. However savers can move savings around not only based on yield, but also with the intention to protect the principal sum of their savings. Overcoming the savings paradox is essential in understanding what needs to be done and what can be done. It is explained in an article which can be found on website: http://mpra.ub.uni-muenchen.de/40146/

What can be done is summarised here: Firstly economic growth: Keynes concept was to use future taxpayers’ incomes to create additional government expenditure -over current tax income- in a current year. This concept worked well when governments had low debt levels. However government debt levels, including in the U.K., have breached the 60% of GDP mark, which some economists regard as the turning point. As government debt is like a consumer debt type -once used for consumption it does no longer add to output-, its debt servicing depends on income levels of the British population. The latter incomes are closely linked with economic growth. My proposed solution is to use part of future taxpayers’ incomes not to service additional government expenditure, but to pay back money borrowed from long term savers: collectively represented by pension funds and life insurance companies. The latter savings organisations can pay out a “pension dividend” to all pension savers and those drawing a private pension - a demand pull cash injection. The “dividend” is preferably tax free and preferably on an equal amount basis, so that those who still have to save the longest period with the highest investment risks, will get an equal amount to those who have accumulated savings over a long period of time. Dividend beneficiaries should be encouraged to spend the money rather than save it.

The size of the dividend could be around £ 30 billion a year, probably best paid out in quarterly instalments. If pension funds would not have enough cash on hand, the Bank of England could advance such amounts, till dividends, pension contributions and bond interest incomes make up the pay-outs.

Secondly the question of the savers remuneration level for the pension dividend. The “taxpayers’ bonds” will need to reward the collective of long term savers a percentage over inflation levels. My suggestion is a 2% real reward over inflation level, currently a combined total of 4.4% per annum. The taxpayers bonds should be gradually repaid as and when economic growth levels are restored. The Pension Regulator and the pension funds etc. could collectively decide how much and when such funds are due for repayment.
Thirdly the gap between the Pension Regulator recommendations and the Bank of England’s actions in quantitative easing should be closed, through Parliamentary discussions. My suggestion is that Parliament establishes that savings - for the benefit of all- should receive a positive yield over inflation. Parliament can decree this principle for its own government debt, not for other users of savings. It does not need to, as other borrowers would not get funds, unless there is a proper chance of reward. My suggestion is also that Parliament decides about the proper range for 10 year gilts, for instance 2% over inflation.

Finally what happens in the U.K. is also influenced by what happens around Europe and in the U.S. Savings move around the world. No country is an island in economic terms. The main element the Eurozone countries could arrange is to have 10 year government bond yields maintained at around 2% over each country’s inflation level. This can be achieved by the 7 countries which have bond yields less than 2% over inflation, take savings out of the markets and placing them as deposits with the ECB. Subsequently the ECB buys up the bonds of the 10 nations till their 10 year yield is also at 2% over inflation. Real savings are used to create stability in the Eurozone’s government bond markets. Such financial intervention does not constitute a burden to the taxpayers in the 7 countries as the taxpayers in the 10 nations pay for the increased yield. The taxpayers in the 10 countries are also better off as their yields come down to reasonable levels. Private savings flows to higher yielding bonds will be restored. Fiscal prudence can and need to be maintained.

For countries which have large accumulated private pension savings wealth, like the U.S., Canada and the Netherlands, they could use the example of the U.K.’s pension dividend scheme. For others, especially in the Eurozone, the European Financial Stability Fund could be used. The latter Fund is big enough to help create economic growth, by arranging cash injections -working just like the pension dividend- to the countries which are struggling to create growth. The repayments come from taxpayers bonds in the receiving countries.

Reward savers and use savings to stimulate economic growth as and when needed, are the two elements which help avoid the losses in net worth of individual households to the benefit of all.

Drs Kees de Koning
30th July 2012