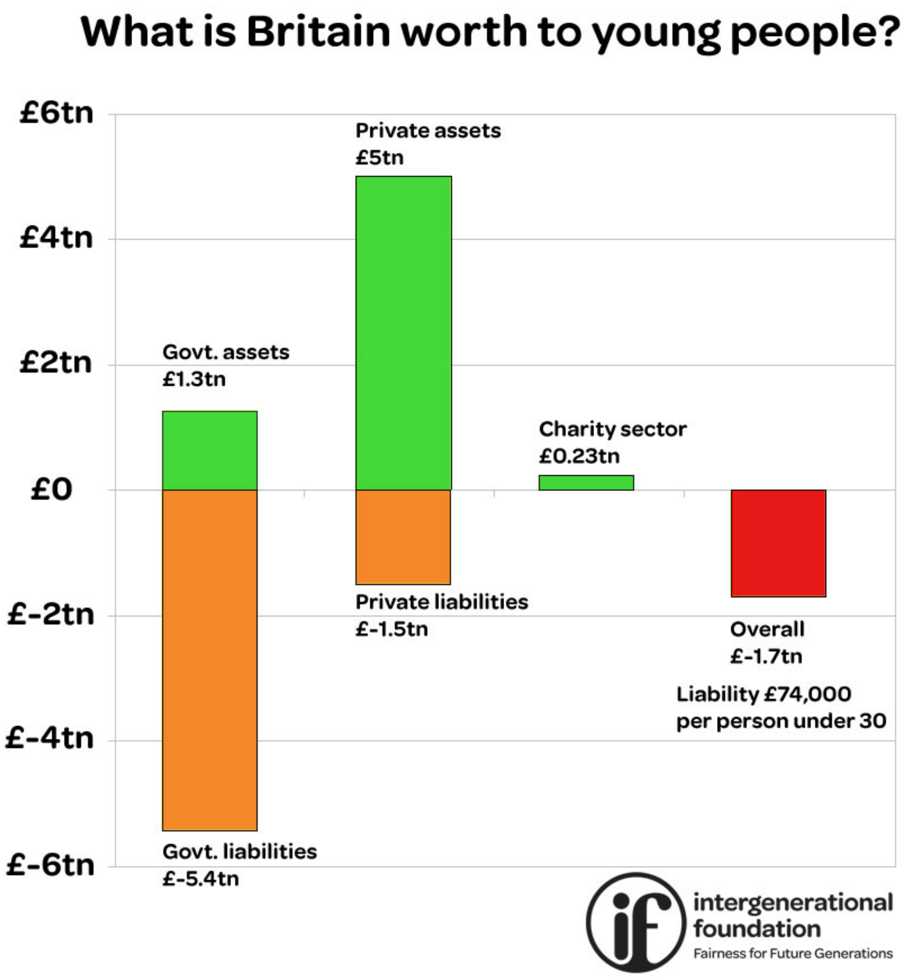
What are we leaving to our children?

Britain's value from a young person’s viewpoint



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The Intergenerational Foundation:

The Intergenerational Foundation (www.if.org.uk) is an independent, non-party-political charity that exists to protect the rights of younger and future generations in British policy-making. Whilst increasing longevity is to be welcomed, our changing national demographic and expectations of entitlement are placing increasingly heavy burdens on younger and future generations. From housing, health and education to employment, taxation, pensions, voting, spending, transport and environmental degradation, younger generations are under increasing pressure to maintain the intergenerational compact whilst losing out disproportionately to older, wealthier cohorts. IF questions this status quo, calling instead for sustainable long-term policies that ensure younger and future generations are better protected by policy-makers.

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Executive summary

- This is the first serious attempt to work out the value of all Britain's assets from the viewpoint of young people.
- By adding up the value of Britain's assets (e.g. housing, transport infrastructure) and subtracting its liabilities (e.g. pension commitments, other debt), we can see that the younger generation faces a net liability of about £1.7 trillion
- Expressing this as an individual liability, each young person is inheriting a "debt" of about £74,000
- The government now has net liabilities of £5.4 trillion, taking account of all its assets and its various liabilities including the state pension
- Although the private sector has positive net assets, these have now reduced to only £3.5 trillion, based on their value to the next generation
- For the first time ever, ONS figures show that the UK has fewer assets overseas than foreigners own in the UK, so the country cannot expect to be bailed out by its overseas reserves
- Without the government's unfunded pension liabilities (public service and State Pension) the UK would have about £5 trillion less in obligations and overall a significant positive asset position — which illustrates that pensions are at the core of Britain's economic decline.

"The principle of spending money to be paid by posterity, under the name of funding, is but swindling futurity on a large scale." **Thomas Jefferson**

"Blessed are the young, for they shall inherit the national debt." **Herbert Hoover**

"Mmm, my father left it to me. Along with his debts." **Wendolene, Wallace and Gromit, "A Close Shave"**

Foreword

This report is a pioneering piece of work. It makes a very compelling case for why we all need to be concerned about the debt that our generation is set to pass on to future generations and it gives us a way into a difficult issue.

Government is constantly building up debt and the burden of this debt falls on our current and future citizens. This report uses government data to look at the future from a young person's perspective and its findings make for very thought-provoking reading. Pension liabilities will be a particularly heavy, perhaps unsustainable, burden.

I believe that we need a much more strategic national — and cross-party — approach if we are to improve the outlook for future generations. So I am delighted that the Intergenerational Foundation is publishing its report on the same day that another initiative I support, the Common Sense Collective, discusses future demographic challenges. I hope that both will help to lay the foundations for a better legacy for our children and grandchildren.

Dr Phillip Lee, MP

Introduction and background

Britain as a whole has been building up its liabilities for many years whilst running down its assets, but do we still have meaningful reserves to hand on to the next generation? This report shows emphatically that our obligations now outweigh our assets and that Britain is only viable on the basis of taking into account the hoped-for earnings of the younger generation. In short, we are in hock to our children, and saddling them with ever more liabilities year by year.

Fortunately over the last few years the government has been improving its accounting and we now have annual “Whole of Government Accounts” (WGA) which gives a snapshot of the government’s indebtedness. In addition, the Office for National Statistics (ONS) produces a regular Wealth and Assets survey which gives a good picture of assets held by the private sector. Even though both sources are always a couple of years out of date, these figures, along with other official data, allow us to assess Britain’s public and private finances from the point of view of a young person.

In this report we have looked principally at two pairs of figures — first, the government’s assets and liabilities, and secondly, the private sector’s assets and debts — in order to get a view of the finances of the UK as a whole. We also include the assets of the charity sector (or “third sector”) to complete the picture. We then add up all these figures to see whether the young are being handed a position of net assets or one of net liabilities. It turns out that the young are inheriting liabilities which very significantly outweigh the assets they will inherit so we then work out what the liability is, on average, on a per household basis and for each person under 30 years of age.[1]

This assessment is explicitly not done on a “going concern” basis but from the perspective of a young person. Therefore we treat the government’s pension promises as a liability because the money has to be found by the working population, but we don’t treat existing entitlements to a government pension as an asset – because the older generation will need those pensions to live on. In this sense **we are very much reflecting the perspective of an 18 year old who wants to know the net amount of assets/liabilities that are being passed to his or her generation.**

Similarly we do not take account of the value of pension assets in the private sector as these will be needed by the older generation to live on. For housing, we want to know the replacement cost of the housing stock rather than a current market value because market value is really only a function of the scarcity of planning permissions to build: what matters to the next generation is what the housing stock would cost to replace.

The first sections of the report look at the public position (assets and then liabilities). We then briefly review the net assets of the “third sector”, and the next two sections look at the private position (assets followed by liabilities). The final section brings together all these figures to show how things stand overall. We do not treat the government’s tax-raising power as a measurable asset, though it is partly because of this power that it is relevant to look at private finances in the same context as public finances. This tax-raising power, referred to explicitly in the Whole of Government Accounts, is essentially a statement about the government’s ability to make future generations pay the obligations that the government has taken on.

[1] ONS, 2011 Census, 16 July 2012, http://www.ons.gov.uk/ons/dcp171778_270487.pdf

Within the figures there are plenty of "eyebrow raisers", such as the clinical negligence liability which the government has built up, which now amounts to almost £1,000 of liabilities per household.[2] There is also the £36 billion "asset" which is technically money owed by young people for student loans but is arguably a statement of intent to tax future graduates more highly in future than the rest of the population.

[2] HM TReasury, Whole of Government Accounts, year ended 31 March 2013, House of Commons, 10 June 2014. Clinical negligence — pages 109 and 110. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/318657/whole_of_government_accounts_2012-13.pdf

The Public Sector position

Government assets

The government owns, by its own reckoning, about **£1,263 billion of assets** .[3]
This is made up of these main elements (non current):

- Property, plant equipment **£747 billion**
  (including infrastructure £272 billion, and £211 billion of buildings)
- Investments in banks **£45 billion**
- Other financial assets **£127 billion** (including £36 bn of student loans and £55 bn of deposits with banks)
- Trade and receivables **£121 billion** (mostly tax owed)
- Other financial assets **£116 billion** (mostly deposits with banks)

The accounting for these is set out in the Whole of Government Accounts 2012/13 which is the latest available, with the balance sheet on page 51 and detail covered in the notes to the accounts.[4]

Government liabilities

The government acknowledges **£2,893** billion of liabilities (ref 4), which sum is made up of these main elements:

- Government borrowing **£996 billion**
- Private Finance Initiative liabilities of **£152 billion**
- Financial liabilities **£409 billion** (almost all money owed to banks and about £50 billion of banknotes)
- Provision for liabilities **£118 billion**
  (incl £70 billion for nuclear decommissioning and £24 billion for clinical negligence)
- Public service pension liabilities **£1,171 billion**

These figures are on pages 50 and 51 of the Whole of Government Accounts 2012/3 and the detail is found in the notes.

The public service pension liability is almost certainly understated because the future liabilities are discounted at an unrealistically high discount rate and arguably should be as much as £600 billion higher. This is set out in a paper by the Intergenerational Foundation.[5]

[3] HM Treasury, Whole of Government Accounts, year ended 31 March 2013, House of Commons, 10 June 2014. Assets — page 51.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/318657/whole_of_government_accounts_2012-13.pdf
[4] ibid.
[5]Record, N. The £600 billion question, Intergenerational Foundation, May 2014, http://www.if.org.uk/wp-content/uploads/2014/05/The-£600-billion-Question.pdf

But in this present report we are using the official figure despite a widespread view that government figures understate the true liability.

The Whole of Government Accounts excludes the state pension liability, which is estimated by the ONS at £**3,800 billion** and, again, would be significantly higher if a lower discount rate were used to calculate it.[6] It is also understated in that the most recent rises in life expectancies significantly increases the liability. Sarah Levy of the ONS, working with the Government Actuary's Department, has shown that an increase in future life expectancies of three years would increase the pension liability very significantly, probably by about 10%.[7] Although we have used the official figure for the State Pension liability, it is clear that if one uses a lower discount rate and assumes a continuation of the increases in average life expectancy there is a strong case that the liability could already be as much as £1 trillion higher.

It is argued by some that this isn't a liability at all on the basis that government can choose not to pay any state pensions and they are not contractually bound to pay them. The Whole of Government Accounts recognises this omission from its figures: "future state pension benefits are not recognised as a liability as the obligation for government arises in the year of payment."

However, we have included this pension liability on the basis that it is widely seen by the public as a binding obligation, and from a young person's point of view, it represents a government commitment for which they will surely have to pay. Both the state pension and almost all the public service pensions are unfunded, meaning this money has to be found from general taxation or future deductions from salaries – these pensions are promises and are not matched by a real fund.

Net position of government

The financial position of the government is therefore as below:

Official assets £1,263 billion
Official liabilities (£2,893 billion)
State Pension debt (£3,800 billion)

Total government liability £5,430 billion (= £5.4 trillion)

[6]Hobbs, D. A broader picture of the public sector balance sheet" State pension and other pension obligations — An update at April 2012, ONS, 27th April 2012. Summary, page 4
http://www.ons.gov.uk/ons/dcp171766_263808.pdf
[7]Levy,S.Pensions in the National Accounts, ONS, April 2012. Sensitivity analyses on page 22.
http://www.ons.gov.uk/ons/rel/pensions/pensions-in-the-national-accounts/compiling-a-complete-picture-of-uk-pensions-including-unfunded-pensions-for-public-sector-employees--methodology-article-2011-/index.html

The Charity Sector ("third sector") position

This has been regularly studied by the National Council of Voluntary Organisations (NCVO) and has been looked at by several other organisations. According to the NCVO, general charities account for £105 billion and housing associations £76 billion, with the next biggest categories being universities and faith groups (each with £26 billion).

In aggregate the NCVO calculates the net assets of this sector were £228 billion in 2012.[8] There will have been some increase since then and the value of some assets is probably understated, such as the value of artworks. However, property assets are likely to be valued at market value rather than rebuilding cost which, for residential properties, will generally be lower, so we have adopted the NCVO figure.

We therefore assume total net assets of the charitable sector are about £228 billion.

[8] NCVO, Civil Society Almanac, NCVO 2014 http://data.ncvo.org.uk/a/almanac14/what-assets-do-civil-society-organisations-hold/

The Private Sector position

Private assets are set out in the ONS's Wealth and Assets Survey[9], but we have made two major adjustments: (a) we have taken housing assets at rebuilding cost rather than market value, and (b) we have taken off the value of pensions as these are needed to support the older generation in retirement and will not usually be available to hand on. The effect of these adjustments is to eliminate values that, from a younger persons' point of view, are illusory —, pension assets that will needed by older people and housing valuations that reflect scarcity value.

Assessing the value of the UK housing stock based on replacement cost

Taylor Wimpey recently stated that their average cost of building is about £102 per square foot. A report from Cambridge University puts the average floor area of dwellings across the UK at 916 square feet, which is confirmed by other studies.[10] Therefore the average cost of building a UK house is about £93,000. According to the latest ONS estimates there are 27,767,000 residential dwellings in the UK, so their theoretical rebuilding cost would be about **£2,600 billion.** So, from a young person's point of view, this is the legacy value of the UK housing stock. This is a little over half of the market value as estimated by the ONS, suggesting that about 55% of the value of UK housing is the building cost and about 45% is the premium created by the market. One can argue that the value is more because some of the stock could be sold at significantly higher prices to foreigners, or that it is worth less because so much is built in the "wrong place" — but we have adopted the £2,600 billion building cost.

Other private wealth

The Wealth and Assets survey estimates non-housing wealth as follows:
Physical wealth (mainly cars and other "things") **£1,100 billion**
Financial wealth **£1,300 billion**

This gives total private assets of **<u>£5,000 billion</u>**

Interestingly, while there are many assets held abroad the Office for National Statistics says that the position has changed over the last 10 years. Whereas historically the UK has always owned more assets abroad than foreigners have owned in the UK, this has been recently reversed, according to Michael Hardie of the ONS.[11] Also, as the ONS shows, the UK's earnings on its overseas assets have been dropping over the last few years while earnings by foreigners on UK assets have not dropped, so they have converged at a return of about 2% per annum. The effect of this is that, on balance, the UK now gets no help in its net earnings position from its assets held abroad in contrast to the situation in the past. In other words the UK will not be bailed out by its overseas assets.

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[9] Chamberlain, E. Wealth in Great Britain Wave 3, 2010-2012, ONS, 15 May 2014.
http://www.ons.gov.uk/ons/rel/was/wealth-in-great-britain-wave-3/2010-2012/index.html
[10] Morgan & Cruikshank, Quantifying the extent of space shortage: English dwellings, Centre for Sustainable Development, Cambridge. http://www.tandfonline.com/doi/full/10.1080/09613218.2014.922271#abstract
[11] Hardie,M. Statistical Bulletin: Foreign Direct Investment Involving UK Companies, 2013, ONS 20 January 2015.
http://www.ons.gov.uk/ons/rel/fdi/foreign-direct-investment/2013/stb-fdi-2013.html?format=print

Private sector debts
The private mortgage debt is about **£1,300 billion**
Other private debt is about **£200 billion**
Total private debt is therefore about **£1,500 billion**

Net position of the private sector, adding up these figures:
Private assets (excluding pensions) £5,000 billion
Private liabilities (£1,500 billion)

Total private assets less liabilities £3,500 billion

The overall financial position of the UK

adding up public liabilities, charity assets and private assets

So we now have estimates for the totals of all five categories — public assets and public liabilities, charity assets, private assets and private liabilities. Adding these together we can see the net position, from a younger person's perspective:

Public assets £1,263 billion
Public liabilities (£6,693 billion)
Charity/third sector assets £228 billion
Private assets (excluding pensions) £5,000 billion
Private liabilities (£1,500 billion)

Total liability of public and private sector combined £1,702 billion

which amounts to:

about £63,000 of liability for each UK household,[12]

or

about £74,000 of liability for each person under 30[13]

[12] ONS, 2011 Census: Population and Household Estimates for the United Kingdom, March 2011. We have taken the number of households as 27 million and number of under 30s at 23 million. http://www.ons.gov.uk/ons/rel/census/2011-census/population-estimates-by-five-year-age-bands--and-household-estimates--for-local-authorities-in-the-united-kingdom/stb-population-and-household-estimates-for-the-united-kingdom-march-2011.html
[13] ibid.

Conclusions

Although these figures are estimates, they are based on official data and represent the first attempt to look at the full picture from the point of view of the younger generation. As this short report has shown, these estimates of liabilities are, if anything, significant understatements of the true position because the official numbers are about two years out of date and in that time the UK's financial asset position has deteriorated due to these factors:

(a) over the last two years the annual budget deficit of around £100 billion per year will have added liabilities of more than £200 billion (ONS says £102 billion in 2013/4 and £126 billion in 2012/3 — the current year deficit is projected to be about £90 billion)

(b) the unfunded pension liabilities (state pension and government employee pensions) will have gone up by at least 5% which would be by about £250 billion — as a result of the steady process of accrual and increased life expectancies.

So we have an outlook that is particularly bleak for younger people, but more importantly it is getting progressively worse each year. Whilst the media tend to concentrate on the annual budget deficit, which is certainly important, the increasing burden on the younger generation relating to increases in the unfunded pensions liability receives very little attention.

Whilst it is widely believed that many current government policies are unfair on younger generations there is a further problem that older generations will also suffer from the recent dissipation of British assets: older people currently feel safe in their pension entitlements but, as it becomes apparent that these are unaffordable, their pensions will probably have to be cut and very likely to levels that create real hardship for many older people. The lobby groups for older cohorts are actively campaigning for higher pension promises, but they might better serve the interests of older people if they pushed for the longer-term sustainability of the public finances as a whole.

Many reasons have been put forward for the squandering of Britain's assets, including short-term policies, the power of the grey vote, poor leadership, an economy increasingly owned by foreign corporations and a policy of running large government budget deficits. These all seem important contributors, but the figures in this paper show the significance of the unfunded pension promises (including the State pension and public service pensions) in combination with much longer life expectancies. The slowness to adjust to both rising life expectancies and the ageing population have generated, as this paper shows, an almost intolerable burden for the younger generation.

Market research shows that the younger generation are extremely caring towards the older generation and respectful of them: this paper illustrates that — whatever else these attitudes may be based on — they cannot be based on gratitude for what the older generation as a whole is leaving to them.