

## Tackling the intergenerational crisis requires fundamen...

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Intergenerational justice is in the news this morning, and rightly so. As [the Observer notes](#), The Resolution Foundation has a report coming soon on the issue. Their research has found that the number of households headed by a 25 to 34 year old that own their own home (even with the help of a mortgage) has more than halved in some areas over the last 35 years. The hint is that they are going to suggest tax reform to address this issue.

Let me be clear: I have no problems with having wealth taxes, land value taxes, and higher rates of income tax on rental income to tackle the fact that this income source is not subject to NIC. In fact, I would welcome them all, most especially if used to reduce taxes that are an impediment to stable and fair employment prospects. But, they are not the solution to this problem. The intergenerational problem is about the failure of society to create a model for pensions that reflects both the sheer number of baby boomers and the fact that there is a fundamental pension contract that our whole model of private sector based pension provision simply fails to recognise.

I explained the essence of this in a short publication I wrote in 2010 called '[Making Pensions Work](#)'. A lot of what I wrote then does, I think, remain completely relevant today. At the heart of my concern was the failure of what I called the '**fundamental pension contract**':

*This is that one generation, the older one, will through its own efforts create capital assets and infrastructure in both the state and private sectors which the following younger generation can use in the course of their work. In exchange for their subsequent use of these assets for their own benefit that succeeding younger generation will, in effect, meet the income needs of the older generation when they are in retirement. Unless this fundamental compact that underpins all pensions is honoured any pension system will fail.*

As I then argued of private pensions:

*This compact is ignored in the existing pension system that does not even recognise that it exists. Our state subsidised saving for pensions makes no link between that*

*activity and the necessary investment in new capital goods, infrastructure, job creation and skills that we need as a country. As a result state subsidy is being given with no return to the state appearing to arise as a consequence, precisely because this is a subsidy for saving which does not generate any new wealth. This is the fundamental economic problem and malaise in our current pension arrangement.*

If anything matters are now worse than I envisaged at the time. George Osborne's pension reforms are turning what was meant to be a pension system into a tax subsidised short-term savings arrangement for those already well off. As [the Telegraph has reported this weekend:](#)

*The number of people making use of the "pension freedoms" soared to record levels in the first few months of 2018, according to figures released today.*

*A total of 222,000 pensioners made half a million withdrawals from their pots in the first three months of the year — 20,000 more than the previous quarter. The total amount withdrawn in the 2017-18 financial year was £6.7bn, the highest figure since the reforms were introduced in 2015.*

And remember, this is a "freedom" that comes at a considerable price. This is the [latest estimated data on the cost of pension tax relief from HMRC:](#)

**In 2016/17 the income tax cost was £38.6 billion and the NIC cost £16.2 billion, or £54.8 billion in all. In 2016/17 total government spending was about £770 billion. And let me be clear, the taxes on past pensions would have been received in that year in almost exactly the amount noted above if no new tax relief had been given. So, the net effect was that a subsidy was given to the pension sector equivalent to 7.2% of all public spending. To put this in context, defence spending in the year was £46 billion, housing and environment spending was £34 billion and public order and safety also cost £34 billion. We are spending more on subsidising pensions than we are many things most people would think a lot more important.**

**The latest reliable data I can find on the allocation of these sums comes, somewhat surprisingly, from the ONS in [Pension Trends — Chapter 9: Pension Scheme Funding and Investment, 2013 Edition](#). They report that the mix of assets invested in the largest category of pension funds is as follows:**

**There was a flattening in corporate exposure post 2009, and this figure includes bonds and equity with overseas holdings growing significantly over**

**time:**

**This is a trend seemingly associated with a growing use of mutual fund investment:**

**Now I stress that I know that this is not the whole picture on pension fund investment, but what seems to be fairly obvious is that the trends that are occurring are broadly towards increasing financialisation, less direct engagement with UK corporates and an increasing international diversification to the point that the obvious question has to be asked, which is what is in this for the UK government and what now justifies its massive spending on pension subsidies? More [recent data](#) for the pension and insurance sectors as a whole confirms that the value of much of this tax relief leaks from the UK, although I stress that this chart is for more than pension assets:**

**In essence, however looked at, the question has to be asked as to why are we willing to spend £54 billion a year subsidising the financial services sector in the UK and abroad when doing so is not resulting in funds being used to, in almost any way, fulfil that fundamental pension contract that I outline above because the majority of funds are being used to invest in financial assets and not those tangible assets that might induce the next generation to forego their income to look after us in old age. Whilst we're at it we might also ask why we are also tolerating the use of those funds to a) support the increasing financialisation of our society b) support activity largely based in the south-east of England c) increase wealth divides in society, which is what this process, inevitably, does?**

**If the answer was 'because it works' it may just be worth putting up with this situation. But what we also know is it does not. The return on pensions is paltry, and not just because of low-interest rates and other low investment yields: the UKL pensions system makes half the rate of return of the Dutch system because it eats away returns with massive charges. And pensioners now know that. And that's why they are buying property. It's rational to do so as far as they are concerned. But as Keynes long ago pointed out, what is rational for an individual can, when aggregated, result in wholly irrational behaviour for society as a whole, and that is what is happening with pensions.**

**Let me name the basic problem. It is exactly the same one that plagues our macroeconomic management as a whole. We think about pensions in the macro sense as if we are a household, but as a nation we're not. Because this is what we do we think we can save our way as a nation into pension prosperity. And that is as wrong as thinking cuts could balance the government's budget. Only spending could balance the government's budget. And it's only investment, and not saving, that can solve the pension problem. And for the sake of the record (and getting back to the theme of national income accounting that has bugged my blogging this weekend)  $S \neq I$ , which means savings do not equal investment in any shape or form.**

**The fact is that as a result of the failure of governments to, yet again, understand the difference between micro and macroeconomics a massive game of deception has been played on millions of people and the consequences are becoming clear: the pretence that we were providing for anything with our savings was just that, a pretence. And it all happened to ensure that the financial services sector got rich in real time.**

**It was for this reason that I suggested [People's Pensions](#) along with Colin Hines and Alan Simpson (then an MP) in 2003. The idea was simple. The government would create a pension fund, or funds, in which people could invest. This fund would then fund the creation of the assets that the nation needs to ensure that the fundamental pension contract was fulfilled. So, it would finance the building of hospitals, schools, broadband for rural locations, insulated properties and invest in small business and high tech and so much more. The fund would attract tax reliefs: an ISA wrapper may work for investments in it. Alternatively, capital gains and income received from it, to a limit, could be considered tax free. And the fund would then work in partnership with (let's call it) a National Investment Bank, whose bonds it would buy and who would actually deliver the projects. The same National Investment Bank would also issue those bonds into the broader market for those who wanted to buy them: they would also be available for the purposes of People's Quantitative Easing when the government, via the Bank of England, believed it needed to stimulate the economy by increasing investment in these assets.**

**How would returns be paid? Three ways. First, by way of interest payment: that's hardly surprising. The government is used to paying interest on its borrowing.**

**Second, there would be a real current return on the investment: I think it would be entirely appropriate to designate local funds or sector funds so people could see that the money they were investing was linked to a real economic output. Nothing could make investment more comprehensible than that.**

**Third, there is, of course, in the long term a return to be paid as a state-backed pension based on contributions. The mechanisms would need refinement, but given that government bonds have for decades underpinned the annuities used by private pension funds such an arrangement is completely normal. The important point to make though is that this pension could be economically justified precisely because the assets underpinning it would still be in use: this is a pension contract that reflects the inter-generational agreement that must underpin such arrangements with real assets.**

**How much could be spent a year on new investments? Well, let's start with most of that £54 billion, shall we?**

**The gains are obvious. The fundamental pension contract would be recognised and be the basis for pension provision, for maybe the first time ever. And the savings mechanism would be readily comprehensible, have low risk and be secure. Whilst at the same time a mechanism for increasing the flow of funds into the productive economy and away from the financial services sector - an essential part of rebalancing the economy - would have been created.**

**What's not to like? Ask the City. But for the rest of us this is all gain.**

**First this is a programme to deliver real investment.**

**Second, it redirects pension subsidy to public gain.**

**Third, it rebalances the economy.**

**Fourth it creates jobs in every constituency in the UK.**

**Fifth it creates an understandable savings mechanism.**

**Sixth, that mechanism reflects the fundamental pension contract that must exist in the macro economy.**

**Seventh, this provides a mechanism for enduring quantitative easing (call it PQE or otherwise; [as I have now shown they're really the same thing](#)) when it is needed.**

**Eighth, this is clear economic narrative that is straightforward to explain both as to the reason for its creation and as to its long term benefit.**

**This is how to tackle the inter-generational crisis. On this occasion tax plays second fiddle.**