Average household incomes for UK pensioners are reducing each year due to harmful government reforms and the Bank of England's monetary policies

Ros Altmann *argues for supporting pensioners who have been negatively impacted by monetary and fiscal policy since 2008. She highlights the distributional inequities of the Bank of England's policies in dealing with the economy and calls for more consideration for pensioners who are seeing their savings dwindle.*

Conventional thinking is that pensioners have escaped unscathed from government measures to reduce the fiscal deficit, but this is a myth. The combined impact of government changes to pensions and benefits alongside the Bank of England's monetary policy measures, are reducing average household incomes for UK pensioners significantly each year. It is important to consider the distributional consequences of policy more carefully, since policymakers seem unaware of the impacts had on older generations.

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The government says it has protected pensioners but research from the Centre for Economics and Business Research (Cebr) shows this is not the case.

A briefing note by the Institute for Fiscal Studies (IFS) in March 2012 misleadingly suggested that pensioners actually benefit from tax and benefit reforms. This has lured politicians into a false sense of security but they ignore this impact at their peril. Pensioners may not demonstrate on the streets but they do vote.

To be fair, until 2011, fiscal policy had been relatively benign for pensioners. From 2011 onwards, however, in addition to the effects of monetary policy, pensioners will suffer further as fiscal policies start to bite, including freezing or abolishing age-related allowances, cutting the winter fuel payment and reducing the savings credit element of Pension Credit. Even government's "triple lock" pledge to increase state pensions by the highest of the Consumer Price Index (CPI), earnings growth or 2.5 per cent will leave pensioners worse off that under than the previous formula based on the Retail Price Index (RPI).

In addition, since 2008, monetary policy has had a negative impact on older generations. This has led them to reduce spending as they fear for their financial futures in the face of falling interest rates, lower pensions and savings income, plus high inflation.

The findings of two research papers were recently presented at a Saga Thought Leadership event. The papers analyse how the over 50s in general and pensioners in particular have been negatively impacted by the Bank of England's monetary policies since 2008 and fiscal changes since 2011.

Record low interest rates, falling annuity rates and rising inflation have significantly reduced nominal and real savings income and eaten away at the fixed incomes of annuitants. Even the state pension has failed to keep up with rises in pensioners' cost of living, as official measures of pensioner inflation since Northern Rock failed show prices for the average household rising by 16 per cent, while pensioner inflation has been 26 per cent cumulative. As pensioners spend more of their money on food and energy, they have less to spend on going out or travel and entertainment, which has a wider economic impact on jobs for younger people. This is another source of downward pressure on the economy as a result of

QE.

According to calculations by the Bank of England, its policies have taken away £70 billion from savers since 2008. The majority of savers are older generations, who have paid off their debts and need to live off their life savings in retirement. However, with an ageing population, just as record numbers are coming up to retirement, policy has reduced their income. The Bank of England's policy of quantitative easing (QE) has diminished pensioner income, both by pushing up inflation and slashing annuity rates, which determine the pension income for life when purchased at retirement.

QE was designed as an emergency measure to fight deflation, expand the economy and boost spending. However, by lowering older people's income, whether savings income, annuity rates or income drawdown, it has actually taken spending power out of the economy.

Monetary policy is acting like a tax increase by lowering income. This leads pensioners, savers and those approaching retirement to cut their consumption. 21 million over-50s make up more than half of UK households and nearly half of all private consumption spending. If their incomes are being reduced, they will cut their spending.

The Bank of England says borrowers have benefitted by £100 billion, which should stimulate the economy. However, if borrowers do not increase their spending and banks do not increase lending, the £100 billion will not necessarily boost growth.

There are several reasons why monetary policy may not be working as economic theory would predict and why a policy that would normally be considered expansionary is actually having the opposite effect:

- Borrowers are so hugely over-indebted that falling borrowing costs do not lead to higher spending. Instead they repay more quickly to bring themselves back to a more sustainable financial position;
- Banks are impaired by their own bad debts, and are using extra deposits from QE gilt-buying to boost their balance sheets rather than lend;
- Weakened banks have become ultra-cautious about who they lend to whilst charging huge fees and imposing draconian terms. Indeed credit card and lending rates are now higher than in 2008;
- In an ageing population, cutting savings and pensions income does not lead them to stop saving as the Bank would have predicted. Worried about their future as they approach or find themselves in retirement, those of pensioner age actually cut spending as high inflation adds to the pressure of falling incomes;
- The UK pension system is underpinned by gilt yields, so QE has reduced pensions and aggravated pension deficits. Companies have to divert money to their deficits and find it harder to obtain finance.

Pensioners with savings and the most recently retired are "the biggest losers" according to this Cebr research. The record number of pensioners reaching 65 will be poorer permanently as they lock in to the current low annuity rates and face fiscal pressures from the abolition of age-related allowances. Many pensioners do not have time to wait, and will not benefit from any future upturns in the economic cycle which may see interest rates rise later. Once they have bought their annuity, it can never change.

Even pensioners who chose to avoid annuities and opt for income drawdown have been trapped by low annuity rates limiting the income they can withdraw.

I hope that the Bank will take this analysis seriously rather than dismissing as "nonsense" the idea that a policy which boosts inflation can damage growth. After three years of 0.5 per cent base rate and three rounds of Quantitative Easing the UK economy is still in recession. At the same time inflation is still above target. It is therefore important to question whether current policy may be having unintended side-effects that are undermining its efficacy.

Closer examination of the distributional effects of policy may help explain why policy is not working as expected. It is a debate that needs to be had.

Note: This article gives the views of the authors, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

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