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Implementing Stakeholder Grants: the British case

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Britain is the first country actually to begin the process of implementing the idea of stakeholder grants. The government of Tony Blair has introduced what it calls a Child Trust Fund. This is a universal grant, topped up by a means-tested addition, given to every baby at birth, invested in a fund and available for use when the child reaches 18. It raises a number of issues, both theoretical and practical, that are of more general interest and form the focus of this short chapter.

THE PRECURSORS

As Ackerman and Alstott have noted, the pioneer in this area was Tom Paine, who suggested that every 21-year-old man and woman should receive an endowment of £15, financed from an inheritance tax. "The subtraction will be made at the time that best admits it, which is, at the moment that property is passing by the death of one person to the possession of another ... The monopoly of natural inheritance to which there never was a right, begins to cease."[1]

In more modern times in the UK a similar idea was put forward by the economist Cedric Sandford in the early 1970s and discussed by A. B. Atkinson in his pioneering work on wealth inequality.[2] Both explored the idea of a capital grant, although not one necessarily connected with the inheritance tax and not necessarily provided at the age of majority: Atkinson, for instance, discusses the possibility of including a capital element in the state pension.

Unaware of these predecessors, over ten years ago I published a proposal for a grant to everyone on reaching the age of majority

financed out of a reformed inheritance tax, terming the idea a "poll grant."[3] More recently, influenced by developments in the US, especially the work of Michael Sherradon and Bruce Ackerman with Anne Alstott, similar ideas have acquired momentum in British policy circles.[4] In 1999, a capital grant at the age of majority was discussed in several contributions to the *New Statesman* magazine.[5] In 2000 Gavin Kelly and Rachel Lissauer of the influential centre-left think-tank the Institute of Public Policy Research (IPPR) reviewed schemes designed to promote asset ownership and proposed a "baby bond": A grant of £1,000 made at birth.[6] And in the same year, the Fabian Society produced a pamphlet by myself and David Nissan advocating a capital grant of £10,000 to every 18-year-old.[7]

This momentum has carried through to government. Just before the election of June 2001, in a star-studded event at No. 10 Downing Street, Prime Minister Blair, the Chancellor of the Exchequer, Gordon Brown, and the Secretaries of State for Education and Social Security, David Blunkett and Alistair Darling, launched proposals for a "child trust fund." This has now been implemented.

THE POLICY

The government has set up a Child Trust Fund for each child born on or after 1 September 2002. The government starts the fund off with a £250 voucher, and will make a further contribution when the child is seven (the exact amount has yet to be decided). Children born to parents below a threshold income will receive a furhter £250. Parents can pay into the fund, which will be invested in a wide range of vehicles including equities. Neither parents nor children will have access to the Fund until the child reaches 18; there will then be no restrictions as to use. Financial education would be provided to both parents and children.

Issues

The government's proposals, together with the other contributions to the US and British debates, raise a number of issues, especially with respect to the Child Trust Fund, that need resolution before the idea can become practical policy. They include timing, finance, universality and possible restrictions on use. Some comments on each follow.

Timing

Should the grant be given at birth in the form of a "baby bond," as the government and the IPPR have proposed, or at the age of majority, as Paine, Ackerman and Alstott and I have argued? There are arguments on both sides. In favour of a grant at birth, since the money is to be invested for eighteen years, less can be given up-front. This would make the grant allocation easier politically, because it apparently saves the government money (in reality, of course there is no saving, since the government is simply losing the income that it could have earned by investing the grant itself). Another advantage is that the fund can be seen to accumulate by both parent and child, thus serving a useful financial educational purpose. On the negative side, this very visibility may make the fund unpopular with parents, especially poor ones, who will see money accumulating that they might feel they could have put to good use, but which they are unable to touch. Also, depending on how each of the funds is invested, children may end up with different amounts on reaching the age of majority – an outcome that could be regarded as unfair.

This last point raises questions as to the appropriate investment strategy for a "baby bond," and the related issue as to who would manage the investment. Should the funds be invested in savings accounts, equities or government bonds? Should government or private sector financial institutions manage the fund? What should be the role of the parents in managing the investment – or indeed of the children?

In the British case, the government preferred the private sector to manage the funds. The private sector, although interested for long-term reasons, was worried about the small size of the amounts involved and the difficulty of covering their fixed costs. This was resolved by confining fund management to a few finance institutions, from whose offerings parents would choose.

Finance

Where would the money to finance the stakeholding grant come from? The British government does not specify this in its proposals. Ackerman and Alstott finance their much more generous scheme from an annual wealth tax. Kelly and Lissauer finance their baby bond through reducing tax reliefs for pensions.

I have argued that the best way to finance this potentially popular spending proposal is by linking it to reforms to a hitherto unpopular and inefficient tax – inheritance tax.[8] Hypothecating, or earmarking, inheritance tax revenues to capital grants could provide the means for rehabilitating a much despised tax. It also has an obvious popular appeal: The wealth of one generation is visibly spread around so as to fertilise the growth of the next.

Inheritance tax is a misnomer in the UK. What we have is a tax on estates that bears no relation to the amount any individual inherits, either from the estate in question, or over a lifetime. And the tax is largely voluntary. The Inland Revenue estimated that in 1995 total marketable personal wealth stood at £2,013bn. This measure excludes wealth that cannot be realized, such as accrued pension rights. In contrast, the yield from inheritance tax is pitiful, just £1.7bn in 1997–98. Wealth passes almost untaxed between generations through lifetime gifts, through exempt items such as agricultural land and forestry, and through devices such as discretionary trusts which can defer tax liabilities for decades.

It is against this scale of wealth transfer that suggestions such as capital grants should be measured. There are approximately 650,000 18-year-olds in Britain, so it would cost £6.5 billion to give them each £10,000. The current yield of £1.7bn would pay for about £2,500 per recipient.

Yields, and hence the grant, could be increased in subsequent years by reforms that have long been on economists' agendas, but that have lacked political support. These include shifting the basis for the tax from the donor to the recipient, and extending it to include lifetime inheritances and gifts. This would encourage the wealthy to pass on their wealth to those who have not already been substantial beneficiaries, as by so doing they could reduce the taxman's take. The system would require that everybody had a lifetime gift and inheritance allowance, say of £50,000, which could be received free of tax. Thereafter tax could be levied at progressive rates to maintain incentives for wealth to be spread around. A review of exempt items and Trust law should also be undertaken to broaden the base of the tax.

In theory receipts could collapse with such a tax if bequests were directed only to those who had not used up their inheritance tax allowance. However, if that occurred a fairer distribution of inherited wealth would have been achieved, and there would be less need of an additional system of grants. More likely, however, is that wider bequests would happen mainly at the margins, as people would continue to want to help their own children first. As they did so they would be taxed to pay for grants for those less fortunate.

It would not be necessary to impose penal rates of inheritance tax to finance a substantial reallocation of capital. Indeed an ideal system would have rates that most regarded as reasonable, to minimize incentives for avoidance or evasion.

What might such rates be? The inadequacies of the existing inheritance tax mean we have very limited information indeed about the extent of wealth bequeathed or given on a year by year basis. But a crude estimate by Le Grand and Nissan suggested that a reformed inheritance tax would need to be levied at an average rate of around 15 percent to finance £10,000 per young adult. If higher education subsidies were reduced *pari passu* (as they should be if equity is to be maintained), the savings from this could also be used to finance the grant and the inheritance tax rate could be lowered yet further. Since the participation rate of the relevant age group in higher education is now running at around one third, this means that the inheritance tax rate could be lowered to 10 percent. Alternatively, the rate could be kept at 15 percent and the savings in higher education spending could be used elsewhere within the education budget or for other public services. In short, there is every opportunity here to levy a modest tax on gifts and bequests, and still make sure every young person has the capital needed to get off to a good start.

The insignificant contribution of inheritance tax to financing public spending, and the sense of the state as inherently wasteful, have meant that avoiding such tax has never attracted much moral opprobrium. The ease of avoidance of inheritance tax reflects the lack of public support for it. But if the proceeds of the tax were visibly distributed through stakeholding grants, perhaps that perception could change.

Universality

Should the grant be universal or means-tested? The British government's proposals involve both a universal and a means-tested element, where the relevant "means" are parental income.

The case for a universal grant is part of the more general case for universal benefits over ones targeted on the poor. Universal benefits contribute to the sense of national community, whereas targeted ones can be socially divisive. Also targeted benefits require a cumbersome apparatus for determining eligibility: One that is expensive to administer and can be demeaning to the recipient. In contrast universal benefits require only the information necessary to determine that the individuals concerned fall into the relevant category: In this case, simply their age.

But there is an additional, more fundamental reason for a universal grant. Everyone born into a developed country benefits from a share in a common inheritance: A set of capital assets, including buildings and other physical infrastructure, transport links, capital equipment and agricultural land. The vast majority of these are the results of the labors and efforts of previous generations, the members of which have struggled together to produce what is in effect a gift of wealth to the next. It is largely because of this inheritance that the current inhabitants of any developed country are as wealthy as they are; without that enormous accumulation of capital over the centuries, no amount of efforts by the current generation could generate the levels of current production that maintain our standards of living.

This idea, that the wealth of one generation is a common asset to the next, is important for it cuts across the argument that individuals who have created wealth should be free to give it all to their children. Ownership gives personal command of resources, but it is not easy to justify this persisting beyond the grave, especially when, as we have seen, the life chances for many are reduced by lack of access to start-up capital. How can one argue that people have as great a right to inherited wealth as to, for instance, the income or profits that result from their own efforts? It would seem fairer if the right to our national patrimony was more equally distributed – as would happen if our proposal for a universal capital grant were implemented.

A standard argument used against any universal benefit is what we might call the "Prince William" objection: should the benefit be paid to the better off who are unlikely really to need it, such as Prince William, as well as to the really needy? The answer is, in general, yes: for this is a price that has to be paid if the other advantages of universality are to be obtained and the problems of means-tested targeting avoided. Moreover, if the grant is financed through inheritance tax then, as parents pay the tax, a significant portion of their wealth will now be going to pay for the start-up costs for thousands of other children, as well as their own. In the prince's case, an exception may be made as long as his family, uniquely, are exempt from inheritance tax.

It is also worth noting that the children of the better off already receive a form of grant through subsidies to higher education. Although with the recent introduction of tuition fees and student loans these subsidies are being reduced, they remain considerable. Most students come from middle-class backgrounds. Hence the

proposal can be viewed as simply a means of extending an already existing subsidy to the better off to those less fortunate. It also has the implication that higher education subsidies can be further reduced without making anyone worse off, since one potential use for the grant could be to pay for tuition and living expenses while acquiring further education.

Restrictions on use and eligibility

Political support for the scheme would depend not only on its method of finance but also on what happens at the other end: what the recipients of the grant did with the money. The intention of these schemes is to encourage investment and hence the accumulation of capital (financial, physical or human). Hence it would be desirable for grants to be spent on investment opportunities. There would be no surer way to lose popular and political support for a system of capital grants than a few well-publicized cases of young people blowing their grants on cocaine or wild holidays.

The size of the grant may in itself be of importance here. While it may be tempting to launch such a scheme with a small grant to introduce the idea, as the British government is doing, there is a danger then that it is seen to be insignificant by the recipient, who might then feel quite justified in blowing it for a bit of fun. The sum needs to be seen as significant, providing a one-off opportunity that justifies careful consideration. Instinct says that a grant of a thousand or two may fall between stools, being insufficient for most worthwhile investments. Hence my and David Nissan's suggestion of a £10,000 grant.

It would be possible to make a respectable case for this level of grant to be given unconditionally on the grounds that ultimately adults do have to take responsibility for their own lives, and that young adults have to learn to do so. As it is, there would be plenty of social pressure on 18-year-olds not to blow their grants; to add to that pressure by confining the grants to only certain kinds of spending might be seen as unacceptable state paternalism.

Indeed, this is the argument put forward by Ackerman and Alstott, who do not put any restrictions on how their grant is to be used. However, they do restrict the recipients to those with a high school diploma and without a criminal record. Interestingly, the possibility of these kinds of restrictions has not been raised in the British case. This is perhaps because it is felt that they would exclude precisely those who would most benefit from the scheme.

Currently the British Government is proposing no restrictions on

the use of its child trust fund. This is largely because of the impossibility of policing the restrictions. So it is important for those who advocate restricting use to spell out how the restriction process might work. Nissan and I have suggested that the grants could be paid into a special account held in the individual recipient's name either in a local commercial bank or in a local branch of a network of publicly owned savings institutions set up by the government specifically for this purpose. The account would have a special name: since its purpose is for the (A)ccumulation of (C)apital and (E)ducation, this suggests the simple acronym ACE. ACE accounts would be handled by a set of trustees, whose purpose would be to approve the spending plans of individuals before releasing any capital; hence individuals would only be able to draw money from the account to spend on approved purposes, as defined by the trustees.

Having quality ACE trustees would clearly be important to this aspect of the scheme. For they would not only have to vet the spending plans, but also ensure that the money was spent in the way proposed. They could be specially employed by the local institution to vet the spending plans of all the grants being given out by that branch; alternatively they could be drawn from panels of local business people and other community leaders, on a voluntary basis, perhaps through the Business in Community scheme.

What sort of investment purposes should they approve? One obvious possibility is higher and further education: a way of accumulating human capital and hence of increasing an individual's value to the labor market. The grant could be used to contribute to the fees and maintenance costs for a university education, or to the costs of more vocational forms of training. To ensure compliance, it could be paid through the educational institution concerned, in much the same way as the present student grant and loan scheme.

Another use for the grant might be for the down payment on a house or flat purchase. Unpublished research by Gavin Smart suggests that for many poor people, the down payment is the biggest obstacle to homeownership; once the down payment is made, people have a commitment to their homes and usually manage to keep up the mortgage payments regardless of any income or employment problems they encounter. Again to ensure compliance the payment could be made directly to the vendor.

The grant could also form part of the start-up costs of a small business. The development of a business plan and its approval by the trustees would be essential – which makes it the more desirable to include local business people among the trustees.

What should happen if no worthwhile uses are proposed for an individual's ACE account? One option would be for the grant to be put towards a personal or stakeholder pension. The pension schemes could be drawn from an approved list, and payment made directly from the ACE account to the scheme.

Such arrangements could not prevent all abuse, and it would be pointless to pretend otherwise. Assets bought through trustee-approved distributions must at some future date be saleable, and use of the proceeds could not easily be monitored. It is not unheard-of for the offspring of the wealthy to fritter away their fortunes; and it will always be in the nature of some of the recipients of our capital grant to do so. What counts is for everyone to get his or her opportunity. Thereafter, as in many other aspects of life, it should be up to them.

Conclusion

Stakeholding grants are an idea whose time has come – at least in Britain. It is to be hoped that some at least of the British discussions will be of use to other countries that may be considering going down this road.

NOTES

1 Quoted in Ackerman and Alstott (1999), p. 182.
2 Sandford (1971), pp. 250–254; Atkinson (1972) pp. 233–236.
3 Le Grand (1989), p. 210.
4 Sherradon (1991), Ackerman and Alstott (1991).
5 These included an article by the ex-US Secretary of Labor Robert Reich (14 June), an editorial endorsing the idea (13 September) and articles by the present author and David Nissan (26 July, 4 October).
6 Kelly and Lissauer (2000).
7 Nissan and Le Grand (2000).
8 Le Grand (1989); Nissan and Le Grand (2000).

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