Isle of Man Government

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Intergenerational Fairness

Economic Affairs

Cabinet Office

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Contents

Foreword

In May last year the UK Intergenerational Commission published its final report, "A New Generational Contract", and in this document such a contract is defined as "*the principle that different generations provide support to each other across the different stages of their lives*".

In his foreword to that report Lord David Willetts stressed the "*danger of breaking these ties because younger generations were having a hard time when it came to their pay, housing and pensions",* and emphasized that the report was attempting *"to promote generational thinking"* rather than *"to incite generational warfare".*

This white paper is aimed to encourage transfer of this generational thinking into our own public policy decisions in the Isle of Man. Decisions might have been made, or might be made, which might weaken our own generational contract without us being aware of what is happening. This white paper provides some local evidence to complement the more general evidence provided in the UK Intergenerational Commission report.

This local evidence suggests that generational progress has indeed stalled here as it has done in the UK; and that we do face significant challenges in providing the career, housing and pension opportunities that previous generations came to expect.

Earnings progress has stalled for young adults. Millennial families are less likely to own their home and more likely to rent privately. Private sector membership of 'defined benefit' pensions has fallen, and thus future pensioners are exposed to retirement income risks from which many current retirees are largely protected. Young adults spent the same as those approaching retirement at the turn of the century, but they are now spending less. Household wealth has grown rapidly throughout the 21st century, but this wealth is owned by older cohorts.

But this white paper needed to do more than just present the intergenerational challenges we face, it also needs to outline some policies that could be used to tackle them. As Lord Willetts concluded:

> *"We can deliver the health and care older generations deserve without simply asking younger workers to bear all the costs.*
>
> *We can do more to promote education and skills, especially for those who are not on the university route. We can and should provide more security for young people, from the jobs they do to the homes they increasingly rent.*
>
> *And we can promote asset ownership for younger generations so that owning a home and access to a decent pension are realities not a distant prospect in 21st century Britain. The ideas we set out are not easy or comfortable……..but we have to tackle substantial long-term problems – they will not fix themselves."*

This white paper can help us secure the consensus we will need about the intergenerational challenges we face and about how to respond to them, with policy changes affecting people across the generations.

My thanks to Economic Affairs for producing the data and analysis in this white paper and I commend its perusal to Tynwald and the wider public. The next stage following this white paper is to look into the policy options from elsewhere and consider them for action in the Programme for Government.

Hon Chris Thomas MHK,

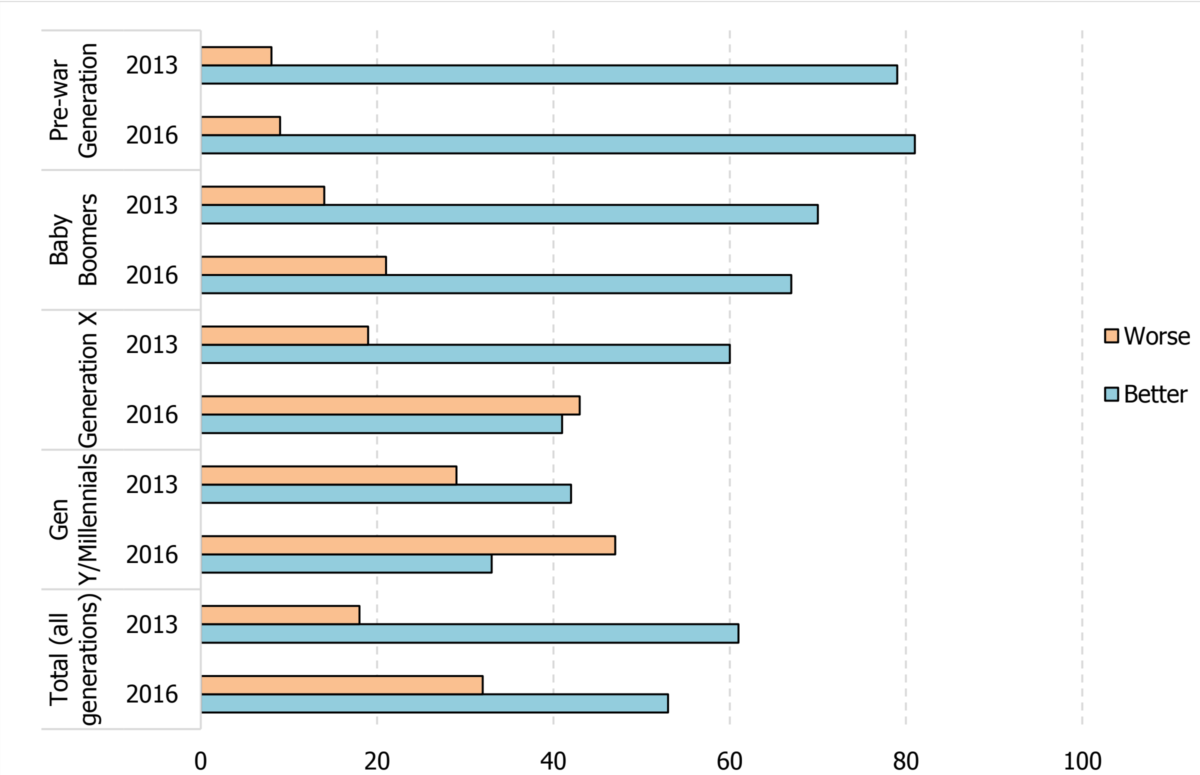
Minister of Policy and Reform

Introduction

Many of the benefits and services provided to older people currently - such as pensions, care and nursing home provision - are funded in whole or part by public revenue levies on those currently working. This is accepted in part because of an expectation that each of us will in turn receive similar benefits later, rolling forward through each generation.

Recently this intergenerational contract, supported by the fact that each generation has been progressively better off than the previous, has come under strain. This shift is most commonly identified as having begun after the 2007/2008 financial crisis, which has resulted in generations no longer having better, or even the same, prospects as their parents. Surveys in the UK have shown an increasing shift in attitudes towards the prospect of a better life than their parents.

Figure 1 Attitudes towards the prospect of a better life (UK)



Source: 2013 results from Intergenerational Justice Research Report, Ipsos MORI/Joseph Rowntree Reform Trust Jun 2013 -Base: 985 British adults aged 15+, 5–25 Apr 2013; 2016 results from Fragmented Times –Generational Strains, Ipsos MORI Base: 1,001 British adults 18+, 13th –16th Feb 2016

This shift in attitudes is also reflected in older generations who also believe that today's children are likely to have a worse life than their parents[1].

[1] Ipsos MORI, Fragmented Times – Generational Strains, 2016: https://www.ipsos.com/ipsos-mori/en-uk/only-third-generation-y-think-their-generation-will-have-better-quality-life-their-parents

The strain, as highlighted by attitudes towards their prospects, is being driven by the fact that Baby Boomers, who are approaching, or recently have reached retirement, are likely to enjoy a much greater provision of welfare support relative to their tax contribution compared to younger generations.

Such factors as increasing retirement ages for the young and longer life expectancy (particularly for those aged 65) meaning they are being supported for longer and the increasingly unhealthy lives that people are living are all putting pressure upon the intergenerational contract.

Defining the Generations

Pre-War Generation: born before 1945.

Baby Boomers: Born between 1945 and 1965.

Generation X: Born between 1966 and 1979.

Generation Y/Millennials: Born between 1980 and 2000.

These issues have been further compounded by younger generations finding it increasingly difficult to buy a home or save for retirement, which then has the potential to exacerbate the issues in future as those generations move into retirement and may not have the resources available to them to support themselves.

It is important to note that younger generations do not wish to take benefits or services away from older ones. Older generations also do not wish to see future ones disadvantaged, but that does not mean no action should be taken to reinforce and enhance fairness where possible.

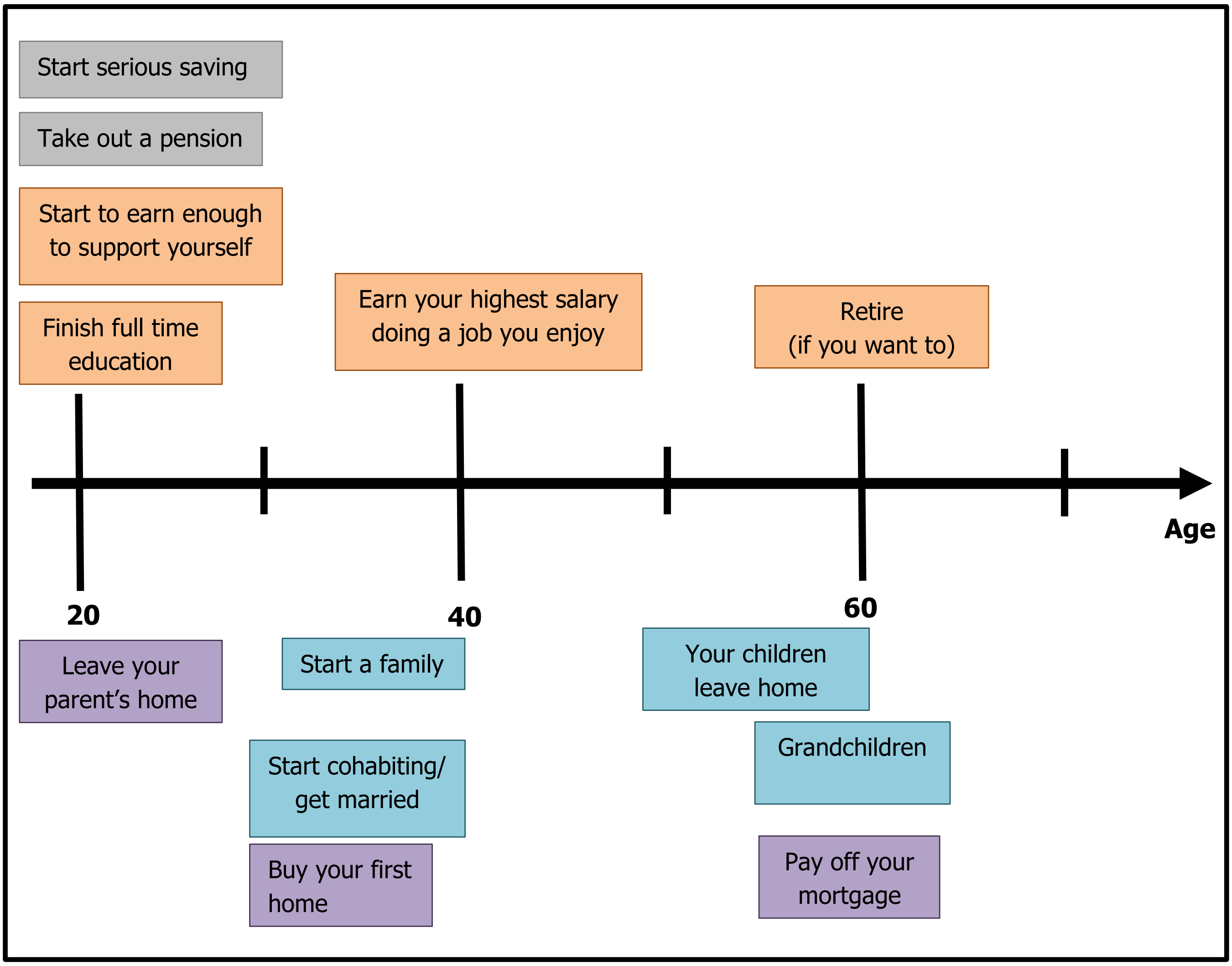
This paper looks into some of the evidence regarding changes in how different generations are living may affect intergenerational fairness, what impacts these changes might have on these generations and Government, and considers some measures which have been proposed in other jurisdictions that might be applicable to the Island.

Ideal Life Journey Timeline

A useful starting point for the discussion around intergenerational fairness is to consider when people think they should achieve certain milestones in their life. PwC, alongside BritainThinks, commissioned a Citizens' Jury[2] to look into the issues around intergenerational fairness, including representatives from the Baby Boomers, Generation X and Generation Y age groups.

As part of their process, the Citizens' Jury created an ideal life journey timeline, created by each generation separately, which was notably similar in many respects, with the ideal timing of key milestones such as leaving home, buying a house, or retiring being around the same time for each generation.

Figure 2 Ideal Life Journey Timeline



[2] Intergenerational Fairness: A Citizens' View, PwC and Britain Thinks, February 2016: https://www.pwc.co.uk/assets/pdf/Intergenerational-fairness-report-with-britain-thinks.pdf

The white paper notes that when each generation reviewed the timeline, whilst all agreeing on the ideal timings, both the Baby Boomers and Generation X participants felt that in general their experience had matched fairly closely to the timeline.

Generation X did however consider that their experiences had changed in the later years, with the prospect of retiring being pushed back, both due to changes in state retirement ages and as a result of financial commitments. They did notably mention that they had benefited from the best of both worlds compared with the generation before and after them in regards to things like university, as there was both greater availability for them to attend, but they also did not have to pay any fees.

Whereas, whilst the Generation Y participants agreed with the ideal timeline, they felt that each milestone would probably actually happen at least five to ten years later. Buying their first house was mentioned as being potentially unattainable for them. It was noted by the wider group of participants that some of these changes had been forced upon later generations, such as university degrees becoming almost compulsory for younger generations, with jobs that never used to require a degree, now requiring one.

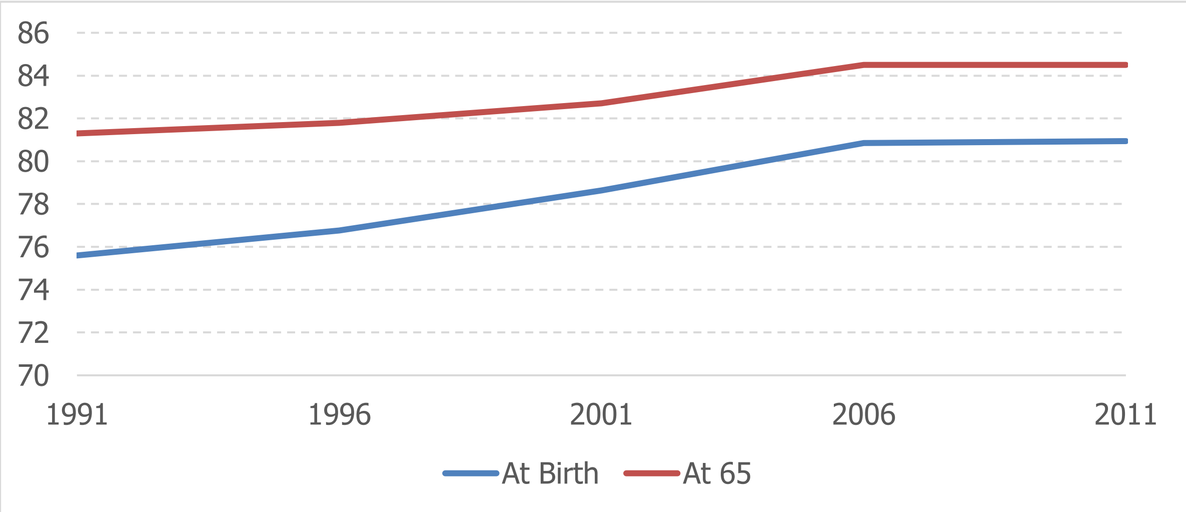
Demography

Life Expectancy

A key driver of the strain on the social contract is that of changing demographics, most notably that average life expectancy is longer than in previous generations. Whist this success is a great achievement, it also has brought additional strains and pressures that need to be addressed.

Intergenerational fairness is impacted by two key changes in the demographics of the Island, which are seen around many Western societies. Firstly, individuals have a much greater life expectancy than they did 20 years ago, both when considering life expectancy from birth and also life expectancy at 65.

Figure 3 Life Expectancy, at birth and at 65 (Isle of Man)

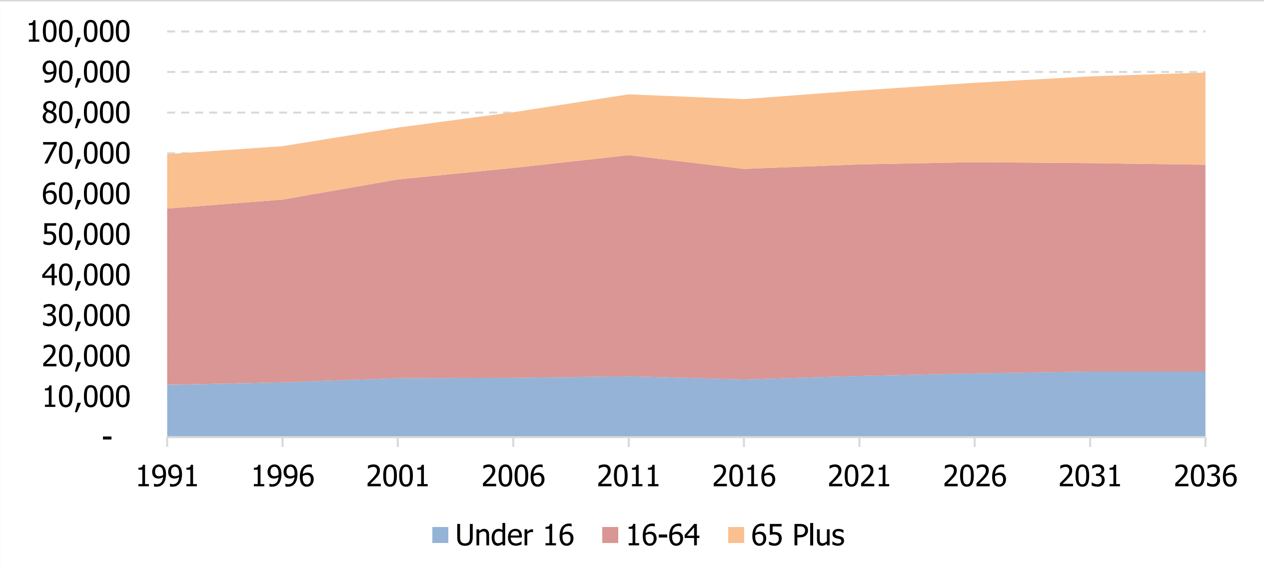


This increase in life expectancy is even more pertinent as the number of individuals that are benefiting from this increase is much larger than previous generations. For example the cohort of Baby Boomers (those born between 1946 to 1965) and Generation X (1966-1980) are much larger than subsequent generations, therefore not only are individuals living longer than before, there are more of them doing so.

Due to this increase in life expectancy, which it should be noted that future generations are also likely to benefit from[3], the proportion of the Island's population that is made up of those aged 65 and over is expected to rise from 13,442 people (19.3%) in 1991 to 22,715 (25.3%) in 2036.

[3] UK projections suggest that boys born in 2015 are four times more likely as those born in 1955 to live to 100.

Figure 4 Over 65 Population



Note: 1991 to 2016 is based upon census records. Data after 2016 is based upon population forecasts (500 net migration)

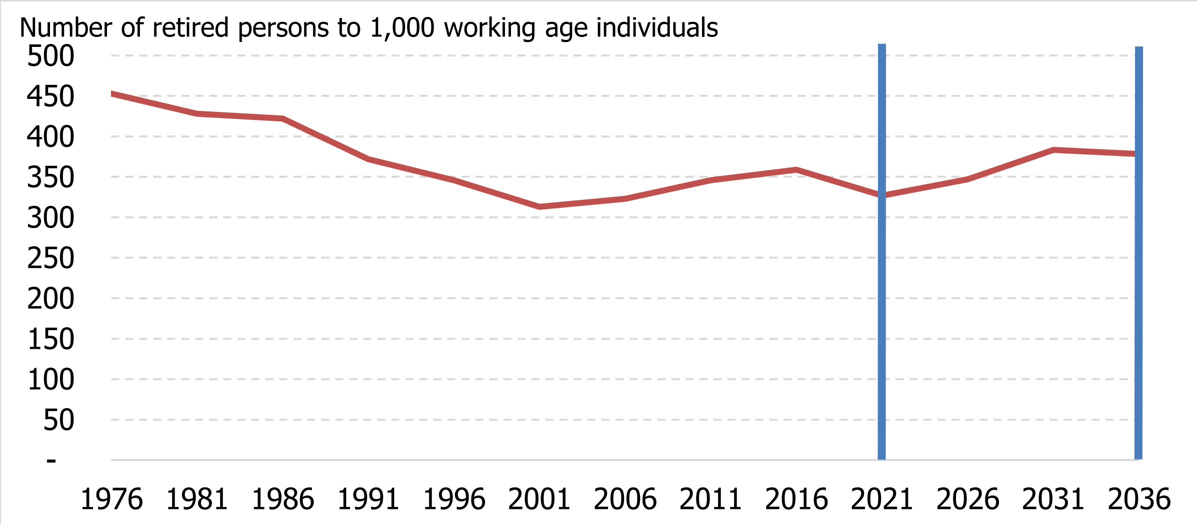
This is a particular driver of the shifting intergenerational imbalance, as it means the current older generations such as the Baby Boomers and Generation X are likely to require a bigger financial contribution from later generations than they provided to the generations before them.

Aged dependency ratio

A measure of the additional strain that this places upon the social contract is the aged dependency ratio, which measures the number of retired individuals against the working age population. Unlike the UK however, the Island's Aged Dependency ratio improved over the period of 1976 to 2006, although this was caused by an unusually high aged dependency ratio in 1976 and 1981 as a result of Government policies to attract retired people to the Island. Since 2006 however the ratio has begun to climb again, and is expected the return to the same level in 2036 as seen in 1991.

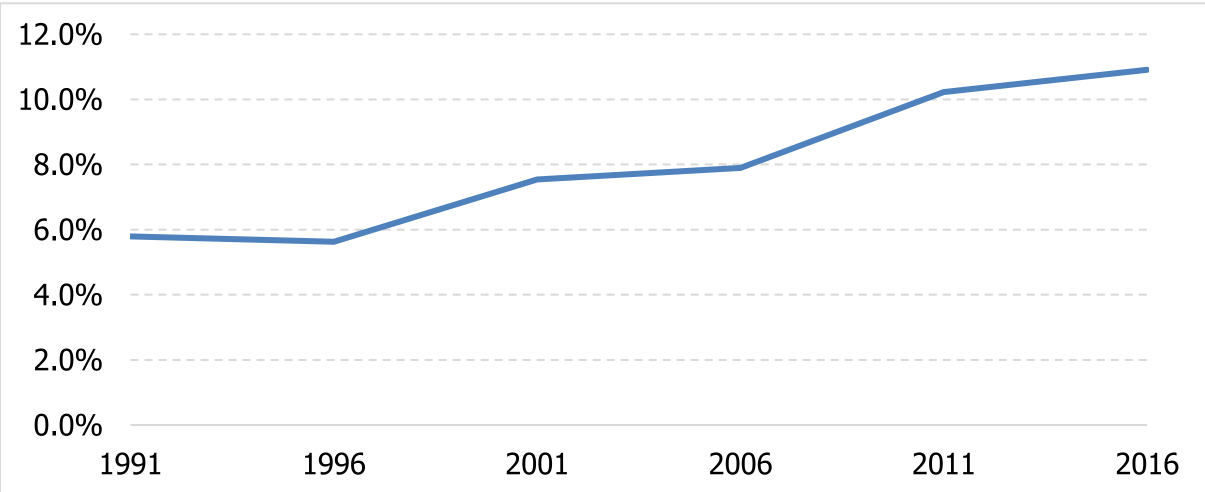
The rate of increase does step back in 2021 and 2028 due to increases in the state pension age to 66 and 67, and will likely do so in 2046 when it shifts to 68. However during the period between each rise, the ratio continues to rise, with the ratio worsening by 6% between 2021 and 2026 and by 10% between 2026 and 2031.

Figure 5 Aged Dependency Ratio 1976 to 2036 (Isle of Man)



However the aged dependency ratio does ignore the issue that some individuals over retirement age continue to work, which reduces the extent to which they are dependent upon financial transfers from younger generations, although they may still be in receipt of their state pension unless they have chosen to delay receipt. This trend towards longer working lives is expected to continue, in part from the state pension changes but also by choice. Since 2001, those aged over 65 have increased their economic activity from 6.8% to 11.1%

Figure 6 Proportion of 65 plus population who are economically active (Isle of Man)



The vast majority of those still working over 65 belong to the 65-69 age cohort and then there is significant drop after this point, which may either be due to individuals not feeling they need to continue working, or because they no longer can even if they wish to do so. The increases in state pension age are likely to further increase the size of the economically active over 65 population, which may help to support the cost of an ageing society.

However, research from the UK Government Office for Science has highlighted that healthy life expectancy and disability free life expectancy at 65 has not kept pace with overall increases in life expectancy from that age. So whilst society maybe living longer, it is not necessarily living healthier lives, which may bring into question whether or not proportions of the population may be unable to continue to work passed 65 and may have to fall back on other benefits until they are entitled to their state pension.

The gap that is emerging between life expectancy and healthy life expectancy presents further issues with the ageing population as costs in relation to nursing and care homes continue to rise, for example in the UK, at age 85, whilst life expectancy has increased by 0.5 years, healthy life years decreased by 0.1 over the same 5 year period. There is also increasing evidence that future, older generations, will be less healthy than current generations, with rising rates of obesity and lower levels of activity than has been seen before.

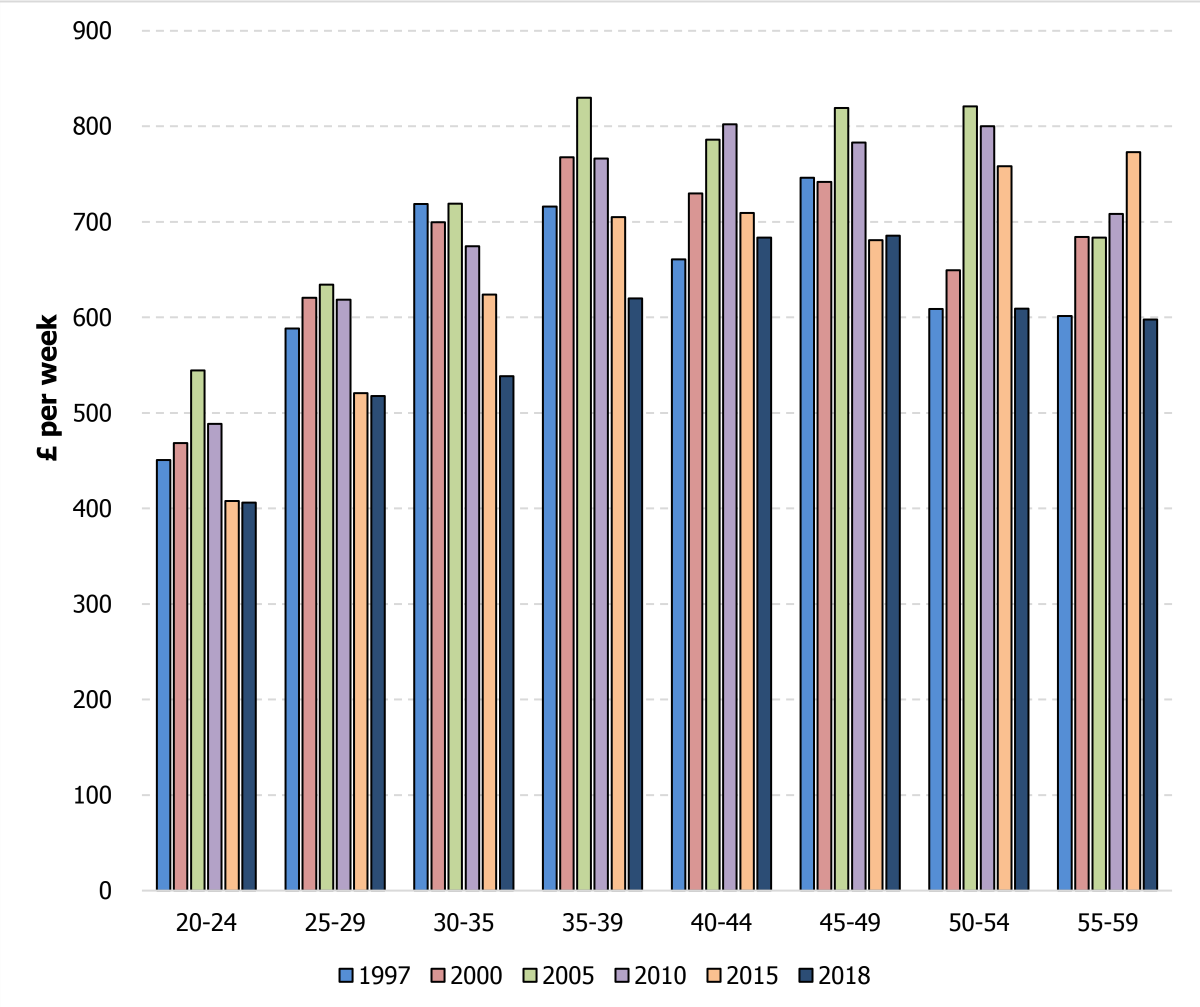
Income and Wealth

Earnings

One of the key underpinnings of the intergenerational contract has been that successive generations would, generally, be better off than the last. However, in recent years, particularly after the 2007/08 financial crisis, which has been marked out as a period of low productivity growth, and therefore lower wage growth, this assumption may no longer prove to be true.

When adjusted for inflation, median earnings for full time workers for 5 out of the 6 age cohorts is currently lower than it was in 1997. Only those in the 50-54 age group have experienced a real terms increase in earnings over this period, although whilst higher than 1997, they have fallen since 2010.

Figure 7 Median Weekly Earnings, for full time employees, by age group (Isle of Man)



The impact of lower wages throughout each generation is likely to compound some of the issues that are detailed further in this paper, such as the ability for individuals to become home owners or save for a pension in the future.

Home Ownership

There are many positive aspects to home ownership, such as the provision of a stable basis to bring up a family, the possibility of living payment free in retirement (either from rent or mortgage), the benefit that rising house prices provide to consumer confidence and for many recent generations, the ability to pass something onto the next generation.

However there are a number of changes that are happening throughout society which are starting to alter this status quo, and there is clear evidence that this has changed significantly over the past 20 years, as shown by Figure 7.

Figure 8 Home ownership rates by age (Isle of Man)

As can be seen, there has been a significant reduction in home ownership rates for those under 30, dropping from 44% in 1991 down to 33% in 2011. Rates of ownership have also dropped slightly in the 30-49 age group, although they still own property (either outright or mortgaged) at nearly twice the rate of the under 30 group. The over 70 group, as expected, also overwhelming own their properties outright, with only 4% of home owners still have a mortgage on the property.

Whilst ultimately the housing stock will have to pass onto younger generations, the current increase in house prices and stagnant or falling wages may mean that this increasingly happens through inheritance rather than purchasing, which then has the potential to create wider wealth divisions within generations, between those who stand to inherit property from their parents, and those that do not.

As the 2017 Housing Market report[4] showed, the affordability of housing is a considerable issue, both generally, and in particular for younger people, who for the purposes of that report was defined as those aged 25 and under. The ratio of median earnings to the median house

[4] Isle of Man Housing Market Review 2017, https://www.gov.im/media/1361664/2018-02-08-2017-housing-market-report.pdf

price has risen from 5.55 in 1991 up to 8.59 in 2017, although it has reduced in the last two years. For younger people however, the lowest quartile house price, was 9.65, which whilst this has improved since 2011 (12.83), still presents a sizeable obstacle to house ownership for younger people, particularly as many banks have tightened their lending requirements and require a higher initial deposit than they previously did. The Bank of England has introduced a number of new affordability requirements that prospective borrowers have to satisfy before a bank can lend to them, many around outgoing costs that were not previously included. This is compounded by the fact that many individuals will have to live in rented property, which increases the difficulty of saving towards such a deposit.

Local Authority Housing

Alongside the ability to purchase a house, there are also issues around local authority housing. The issue arises from the introduction of the 5 year tenancy agreements which will impact upon new tenants (as well as those moving out for refurbishments) who are likely to be younger. However many existing tenants will not be transferred onto this newer tenancies.

Whilst there will be a movement over time towards all local authority housing being on 5 year agreements as existing tenants vacant properties, there will be a significant period of overlap. This will result in a situation where the same change in circumstances could have different results for different tenants, as one may end up being required to leave or pay a higher rent, whilst the other tenant would be unaffected.

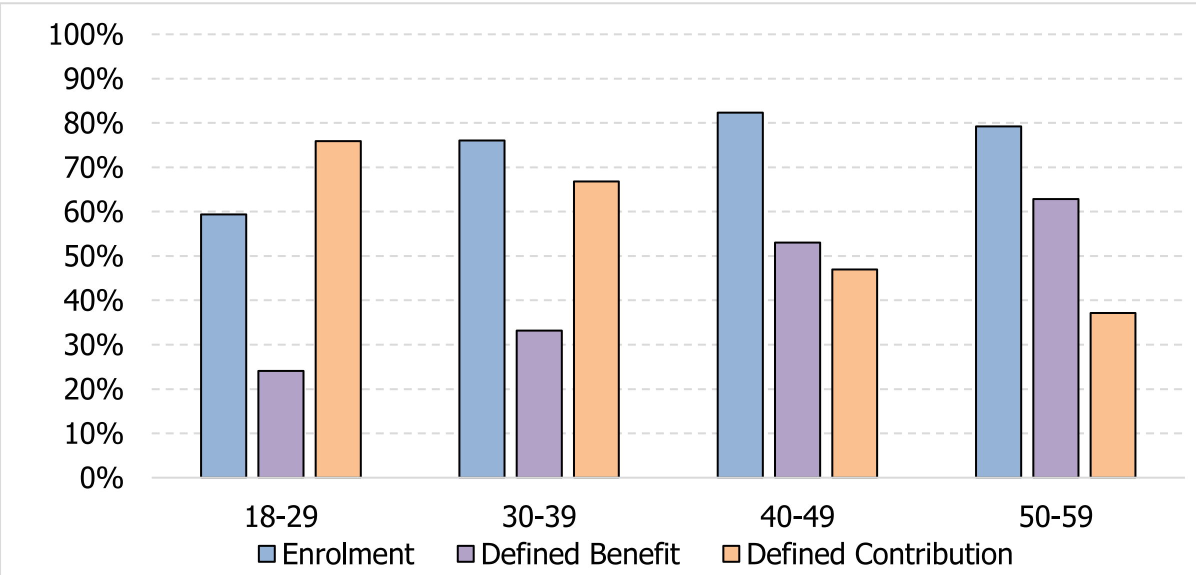
Pension Arrangements

Another area that impacts upon intergenerational fairness is the extent to which different generations are likely to benefit from pension arrangements outside of the state pension. The pension arrangements are likely to differ in two aspects between generations, firstly the likelihood of an individual being in any kind of employer pension scheme at all, and if they are, the type of scheme they belong to and the benefits that these will provide later in life.

The rate of enrolment into an employer pension scheme dramatically increases between the lower age cohorts, with enrolment rates of 59% for those aged 18-29, which jumps to 76% for those aged 30-39 and continues to remain this high for older age groups. The reasons for this lack of uptake a likely to be varied, from the type of employment that they are in, which has become increasingly more transient than before (such as the 'gig' economy) where employers tend not to offer pension schemes. The Island also does not currently require automatic enrolment into a workplace pension (like the UK). Finally, many younger people may not be thinking about planning for retirement.

This lack of enrolment in a pension scheme is compounded by the changing nature of what pension schemes are available to younger generations. As defined contribution pensions depend upon the level of life time contributions, alongside other market forces, to determine what size of pension an individual is going to receive, the fact that 40% of 18-29 year olds are not contributing means that they are likely to have smaller pension pots than they otherwise would. This is amplified by the lower earnings that they are experiencing compared with earlier generations.

Figure 9 Pension scheme enrolment and type of enrolment (Isle of Man)



Source: Isle of Man Social Attitudes Survey 2017

Alongside this lower rate of enrolment in pension schemes, of those that are enrolled, the type of pension has significantly changed which will affect the income of individuals as they retire.

As Figure 9 shows, of those who are enrolled in an employer provided pension scheme, 76% of 18-29 year olds are part of a Defined Contribution (DC) scheme, which will pay out considerably less than that of a Defined Benefit (DB) scheme. DB schemes were common place for many individuals who have recently retired, and still are for those in the 50-59 age group, with 63% of those enrolled in a pension scheme belonging to this type.

There are two significant impacts of different pension arrangements that are likely to place a strain on the intergenerational contract. The first consequence of this change is that those who are part of a DB scheme are likely to be significantly better off in retirement than those in receipt of a DC scheme. The latter makes no promises as to the value of the pension pot upon retirement and the average employer contribution in the UK is only 2.5% compared with 16.2% for DB schemes. So it is likely that future generations of retirees will retire poorer than their predecessors, possibly with higher costs, if they continue to rent or have an outstanding mortgage later in life.

The second impact of these differing pension arrangements is that the cost of servicing the current DB schemes is rapidly increasing as many schemes are not fully funded, and therefore companies and organisations have to direct significant funding towards these schemes to pay for ongoing scheme member benefits, rather than using them for investment. For example in the UK, the ONS found that in 2015 companies had to make £11 billion of additional contributions to cover this funding gap, on top of £20 billion of ordinary contributions for DB schemes. This creates a situation where companies are potentially being limited in expansion but also where younger workers could be supporting these schemes whilst not being able to accrue the same kind of benefit later in life.

Existing actions and actions for consideration

As highlighted at the start of this white paper, the purpose of looking at intergenerational fairness is not to try and place fault or blame at a particular generation because they happened to enjoy certain changes in the economy due to when they were born. However going forward, policy development needs to be more mindful of how what is being promised now might be afforded in the future and which proportion each generation will pay. At the same time, every effort must be taken to ensure younger generations are given new opportunities which may help to offset those which they can no longer access.

Within the Programme for Government there is a wide range of policies, whilst not expressly shown as linked to intergenerational fairness, will address some of the issues that have been raised in the previous sections. This includes:

- The Locate Strategy – there are actions to develop skills more widely through the use of internships, graduate apprenticeships and accelerator programmes.
- An all Island housing strategy with a five year action plan, which should give consideration for how first time or younger buyers can be more effectively supported.
- Development of a lifelong learning strategy which should help people change and improve their skills throughout their life to improve their opportunities and earnings potential.
- Develop a rent protection mechanism and tenancy arbitration process, together with other necessary landlord and tenancy arrangements which should help those who are in living in rented accommodation, which is becoming increasingly common for younger generations.
- Consult on work based pension schemes so that people are able to make suitable private provision for their retirement.
- Implementing the recommendations from the Independent Health and Social Care review and the establishing a funding model for nursing and residential care.

Additional Actions

There are however some additional policy areas that could be considered which are not included within the actions above, and are worthy of further investigation:

- Improve housing options for older people, which should form part of the all Island housing strategy, but more specifically consideration could be given to a 'help to move' scheme that makes it easier to downsize.
- Conduct focus groups with younger generations to investigate what their aspirations are and what challenges they face. The debate often focuses on missed or foregone opportunities which younger generations can no longer access. However the debate should be about what opportunities and aspirations do younger people have and how can Government and society more widely promote or remove barriers to these opportunities.

Conclusion

The Isle of Man is not alone in facing many of the challenges relating to an ageing population; much of Western Europe is encountering similar challenges. Most of the rapid population growth took place during the post war period. This has resulted in a wave of people entering into retirement for longer than has been experienced ever before. This wave has distorted the traditional balance between those in work paying tax to support Government services and those who are retired.

As others who have investigated this area have found, housing is a central issue for intergenerational fairness. Home ownership helps to concentrate wealth in the hands of those who can afford it, and those that may inherit it (which worsens inequality within generations). High private sector rents limit the ability of younger generations to save for a deposit for a house which is amplified by the fall in wages that they are also experiencing.

The other central pillar of intergenerational fairness is the ability of each generation to earn more than their parents. Historically this has allowed younger generations to shoulder the additional responsibilities of looking after those that have come before them. This appears to no longer be the case. Earnings for almost every age group are now lower than they were 20 years ago. This means fewer people are able to save for retirement and are paying less tax. This directly affects Government revenues.

These issues are not insurmountable. Some progress has already been made. The Government has already addressed, through the new Manx State Pension, the key issues raised by the UK Work and Pensions Committee about the issues with the triple lock on pensions. Some fundamental challenges remain though. For instance how to make housing affordable for younger people, keeping people healthier for longer and sustainable funding for nursing and residential care. Some policy ideas have been raised in this white paper to help encourage a national discussion on how to ensure intergenerational fairness.

Finally it is important to restate that we should not see this issue through a lens of blame and recrimination. Those in previous generations have not taken advantage or used more than their fair share. They simply participated within a system which is no longer sustainable. It is the role of this and future generations to identify innovative and long term solutions to this challenge.

Isle of Man Government

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