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Public Sector Pensions

A REPORT BY GMB

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FOREWORD

Regardless of age or where we work, we all aspire to have a long and healthy retirement free from financial concerns. One of the greatest challenges for today's society is how to pay for our retirement.

A very basic safety net is provided by the state in the form of taxpayers. In addition individuals are expected to save while working in order to provide an adequate income for themselves in later life.

This pamphlet explores the role of occupational pension schemes in providing the British workforce with retirement income. In particular the importance of quality pension provision in the public sector is highlighted – as a lead to the private sector, not in opposition to it.

We do not believe this is an insoluble problem. The achievement of a decent and dignified retirement for all is within our grasp, it is crucial that we step up to the challenge.

The view expressed here reflects the policies of GMB, the UK's third largest trade union representing over 610,000 working people, half of whom are employed in the public sector.

Paul Kenny
GMB General Secretary

"GMB's vision is for a decent and dignified retirement for all, whatever they do, wherever they work."
Naomi Cooke, GMB National Pensions Officer

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EXECUTIVE SUMMARY

The scrutiny of public sector pensions results from a general undermining of confidence in occupational pension schemes combined with the pressure on public finances. However, this is a one-sided perspective that ignores the impact of reducing pension provision. The question none of those criticising public sector schemes have answered is: how does the resulting gap in saving get filled. There is no better way that we know to encourage people to save for their retirement than good quality pension schemes.

For the public sector, it is not enough to simply state that 'pensions are good' or necessary. We need to demonstrate that they are also fair and affordable. Despite the assertions of those whose only intent is to remove the perceived taxation costs of public sector pensions, they are in fact sustainable over the long term. When properly understood, and it is imperative that each scheme is assessed on its own merits, public sector pensions are good value for money, not just for the members of those schemes but for society as a whole.

That is not to say that the schemes should stand still and it is in no one's interest for them to stagnate. There are undoubtedly efficiency improvements that can be made and changes to reflect the changing circumstances. There are new mechanisms being designed for each scheme to make sure that costs are controlled. What will not succeed are random, knee-jerk responses to economic fluctuations or political whim.

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INTRODUCTION

Most people in the UK can expect to spend around a quarter of their lives in retirement. For some this means darting from one Mediterranean island to another on a yacht, for others it means a choice between heating and eating. The press, pensions industry and some politicians have spent the last few years developing public sector pension schemes and their 10 million members as the focal point for pensions loathing. The impression is conveyed not only that public sector workers retire into shameless luxury but that by doing so they are directly responsible for any private sector worker retiring into poverty. To put it mildly, this is exceedingly misleading and factually baseless. Most cynically of all however, it lets private sector employers and the pensions industry off the hook.

Public sector pension schemes in the UK currently contribute to the retirement income of more than 2.5 million pensioners, more than one in five of the pensioner population in the UK, which itself is more than a fifth of the total population. With 20% of the working population employed in the public sector and an ever increasing demand on public services, charging the many public sector workers from fire fighters to forestry managers to save for their retirement is not an exercise to be undertaken lightly. Unfortunately too many participants in the debate have settled for glib sound bites designed to distort public perception and confuse those planning for their retirement. Others use the opportunity to peddle their own insurance or pension products which in reality would only ever be of use to those on above average incomes, a relatively low proportion of the public sector workforce. Most would agree that pension issues require greater clarity and illumination not opportunism and obfuscation intended only to discourage engagement.

This report does not advocate any wide-ranging or scything changes to public sector pensions; in this respect it is a radical departure from some other recent reports (see p.31). It argues that far from being anachronistic and profligate, public sector pensions are sustainable for the long term and vital to the economy and society.

Section I examines first the need for good quality public sector pensions, a need that extends well beyond the public sector alone. Section II outlines the structure of the main schemes covering local government, the NHS, teaching, Civil Service, Armed Forces, Fire and Police Services and the recent reforms all have undergone. Unless explicitly mentioned the MPs' and Judicial Pension Scheme, both 1/40th accrual schemes (although with very different contribution rates) are not covered in this report as they are comparatively small schemes with a homogenous membership. Finally Section III turns to the future of public sector pensions and what could happen over the next few years.

> **"The dumbing down of pension schemes in the private sector is a social disaster for the next generation of pensioners. It must not be allowed to inform policy for public sector pensions – rather the private sector needs to be brought up to the public sector standard."**
>
> **Brian Strutton, GMB National Secretary**

Section I
WHY WE NEED GOOD QUALITY PENSIONS IN THE PUBLIC SECTOR

Not since the development of the old age pension more than a century ago has the need for good quality occupational pensions been more acute. Increasing life expectancy and falling birth rates are changing the demographic look of our country while politicians of all sides try to resist the increase in taxation required to ensure that no one in the fourth biggest economy in the world goes hungry because they have insufficient income in retirement.

Aside from a social desire not to live in a country where people die in poverty after decades of work, there are also key pragmatic reasons for having quality provision for public sector workers. As the population gets older, the country's needs and priorities change and a motivated and committed workforce is essential for the delivery of efficient, high quality public services that politicians and society increasingly require.

This section looks at the underlying need for good pensions in the public sector and also the reality of private sector provision. While public and private sector provision are inherently related, it is in no one's interest for the two to be pitted against each other. The only winners in the battle to reduce pension provision are the insurance industry and those who capitalise on the poverty of others. The losers will be the pensioners and taxpayers of the future.

AGEING POPULATION

In common with almost everywhere in the developed world, the UK has an ageing population. With the retirement of the post war baby boomers over the next decade, the problem for society is set to get more acute. The combination of two main factors lies at the heart of the ageing population problem. Firstly the number of births over the last few generations has been in decline and aside from periodic rises, the birth rate is set to continue to be inadequate to meet a sufficient level for 'replacement' (the rate at which the population can replace itself in the long term assuming zero migration and constant mortality). Secondly, life expectancy has been increasing. Purely down to these two factors there are more pensioners and fewer people of working age. The Pension Commission Reports in 2005 suggested that over the next 50 years while there will be almost no increase in the number of people of working age (20-64 years of age), there will be a 78% increase in the number of people of retirement age, a figure that already stands at over 12 million.

These demographic shifts are resulting in an increase in the dependency ratio, from around one working person for every two pensioners to one worker for every four pensioners. Without a good level of individual savings to cope with the provision of retirement income, pressure on state benefits will dramatically increase with fewer taxpayers available to generate the necessary income. The pension reforms announced and introduced by the government in the Pension Acts 2007 and 2008 are to a significant degree intended to mitigate this problem. The raising of the state pension age for all from 2024 and the introduction of auto-enrolment and Personal Accounts from 2012 is intended to reduce the number of years spent in retirement and increase the number of working people saving for their retirement. It is widely acknowledged that these steps alone will not solve the problem. The level of saving involved in Personal Accounts is far too low and continually raising the state pension age will have a wider impact on employers and the welfare

system than is generally appreciated. The danger of rushing through increases to the state pension age without addressing the nation's health disparities or age discriminatory employment practices will simply prolong the time some spend on working age welfare benefits. A policy that simply moves people from one expenditure column of the public finances to another is not a comprehensive solution to the problems caused by an ageing population and inadequate pension saving.

Increased life expectancy for all has further consequences going beyond the provision of retirement income alone. Improvements in life expectancy have not increased at the same rate universally, with lower earners routinely having lower life expectancies than higher earners. This makes the increase in state pension age particularly harsh and iniquitous, in addition to which, the higher paid routinely retire earlier than state pension age with generous occupational pensions, heavily distorting the average retirement age, reducing tax revenues and exacerbating the regressive effects of higher pension ages. A noteworthy issue is the less appreciated side of life expectancy statistics: the length of time people are, broadly speaking, healthy in retirement. There are two key reasons why these statistics are relevant. Firstly, poor health in retirement is the major reason why an individual's capacity to earn further income is limited. For those that want, or through financial necessity, are forced to work after retirement age, failing health is likely to be the biggest hurdle to them being able to do so. Other factors such as employer reluctance to recruit or retain people beyond retirement age are also significant but as the ageing population phenomenon progresses and age discrimination legislation takes real effect, this employer reticence should eventually start to decline, although much more work in this area is required.

The second, and most direct relevance of the level of health in retirement to public sector pension provision is the cost to public services of providing the necessary health care, social care, housing and transport services to an increasingly aged population. As none of the advocates of reduced public sector pensions is simultaneously suggesting an increase in the public sector workforce or an increase in other areas of remuneration, it seems that key workers in health and local government concerned with providing services to older people are to be required to do more work for less remuneration. As many of these services are already pushed to the limit and recruitment to some of these roles is notoriously difficult, the stress this is likely to put on individuals both providing and receiving these services will be extreme. Where this has occurred in other areas of the public sector, notably child social services and probation, there have been catastrophic consequences. Allowing the same situation to occur in the care of older people, an area where already harrowing reports of neglect are not unheard of, must not go unchallenged.

Health expectancy figures are inherently more subjective but the clear message from those statistics that are available is that the length of time people are spending in retirement in poor health is increasing. While according to the Office for National Statistics, between 1985 and 2005 men's life expectancy at 65 grew by 3.9 years, men's healthy life expectancy grew by only 2.9 years. For women the increase in life expectancy was 2.8 years compared with an increase in healthy life expectancy of 2.6 years. As with life expectancy, the duration of healthy life expectancy is heavily influenced by income. Those in the wealthiest twentieth of the population can expect to have five more years of good health than the worst off twentieth. The Office for National Statistics also suggests that the poorest in society may actually experience a fall in life expectancy between 2021 and 2051 exemplifying the substantial disparity between rich and poor.

The increased time for which many will experience ill health and disability in later years is an issue politicians need to engage with as soon as possible. In the wake of the Pension Commission reports the government instigated an increase in the state pension age. There has not, however, been the same focus on addressing inequality in life expectancy and quality of life expectancy. Aside from the human suffering that may result from this omission, there are very real concerns for the public sector. Increased poverty among the older population resulting from a levelling down of pension provision will lead to greater health and social care demands. As with the cost of providing pensions, an ageing population means that not only will there be fewer people to fund this care through their taxes but the staffing crisis that already exists in these areas will steadily worsen.

INDIVIDUAL RESPONSIBILITY

Exemplified by the Pension Commission's reports, the government, with consensus from all the main political parties, has been trying to move the basis for retirement income away from the state and towards individual, private saving. This necessarily makes individuals heavily dependent on workplace based pension saving vehicles. The reliance on occupational provision is compounded by the pension/insurance industry's disinclination or inability to provide viable saving mechanisms for low to medium income earners.

Empirically the best incentives to save are to have a valuable and sustainable occupational pension scheme, sufficient income with which to make contributions and encouragement to do so. Provision in the public sector typifies this. Public sector employees are more than twice as likely to be in occupational pension schemes as private sector employees with 85% of public sector workers participating in a scheme. Of the 40% of employees in the private sector who are members of occupational schemes, those eligible for good quality defined benefit schemes are significantly more likely to participate than those with lower level defined contribution schemes. The message is clear, even though it isn't being listened to. If workers are going to save for their own retirement and not be forced to rely on the state, they will need quality pension schemes to join. If these are not available, a problem increasingly rife in some areas of the private sector, then individuals will not be willing to save and will not have enough money to fund their retirement, opting for current consumption over saving for the future.

For some individuals, having insufficient provision for their retirement will mean they work longer than they otherwise intended. However, the notion that repeatedly raising retirement ages will automatically solve the problem of inadequate pension provision is completely absurd. Some people, generally lower earners with active or stressful jobs, will simply not be able to continue to work into their 70s. If they don't have decent pension provision, including ill health cover, they will be reliant on the state, potentially for decades. This is the facet of the policy of inexorably increasing the state pension age that routinely gets overlooked. An ageing population and overall increases in life expectancy form a persuasive case for increasing pension ages but not in isolation. The safety net for those who cannot continue must improve and must cover all those who need it. This obviously costs money but it is affordable and it is necessary.

The main barrier to implementing age discrimination legislation in the workplace is the negative perception amongst employers regarding employing or retaining older workers. In addition, employers are not going to appreciate workers they expect to retire at a certain point turning round six months before retirement saying they can't leave because the stock market's fallen or annuity prices have risen and they can't afford to retire at that point. The rules on continued working and forced retirement currently enable employees in this situation to request the right to continue working but do not oblige the employer to grant the request. While employers can discriminate against their employees on the basis of their age, efforts to make individuals work on later in life will be undermined.

The fall-out from the shift to defined contribution schemes in parts of the private sector hasn't even begun to come through yet. The UK is totally unprepared to deal with the issues that will arise as people retire from defined contribution schemes without any defined benefit provision to cushion their retirement. B&Q cannot employ everyone in later life who finds their pension is inadequate; all employers have to adjust their attitude to employing people over 60. There is still a very long way to go before this is achieved. The most obvious first step that needs to be taken is to remove the default retirement age from the statute books. The message that it's acceptable to have different terms and conditions for workers over the age of 65 is neither sensible nor a shining example of joined up government thinking. The early review suggested in the government's 'Building a Sustainable Future' document (July 2009) is welcome. It is to be hoped that the default retirement age and the discrimination that accompanies it will be removed as quickly as possible.

Apart from the fear of living below the poverty line in later life, the main inducement to save comes in the form

of tax relief on pension contributions. Once again though, low and middle earners are disadvantaged in comparison with their highly paid bosses. For every pound a basic rate taxpayer (i.e. those the state really needs to be saving) pays into a pension scheme, tax relief effectively means £1.25 is paid in. However, anyone earning over the higher rate tax band benefits from the equivalent of £1.67 going into their pension pot for every pound paid.

In addition to not benefiting from the current tax relief arrangements, those on lower earnings have particular pension issues, regardless of which sector they are employed in. The means-testing trap: where individuals get no reward for their prudent saving because they are unable to save enough to raise their retirement income above the level of means tested benefits provided by the state (currently a minimal £130 per week) – can apply just as readily to low paid public sector workers as it can to their colleagues in the private sector. However, it is imperative to take into account that the quality of public sector schemes, and the many private sector defined benefit schemes that provide similar or better benefits, take many people above the means-testing level. This saves the state billions of pounds in Pension Credit and allied benefits that are paid to those not saving or in poorer quality schemes that fail to provide a viable retirement income. The funding for these benefits comes directly from the taxpayer, letting millions of private sector employers off the hook.

“Any changes must be made for the long term viability of the scheme, not simply as a knee-jerk reaction to keep the media’s rent-a-quote pension commentators happy.”
John Healey, Minister for Local Government

COMPARISON WITH PRIVATE SECTOR

Much of the discussion, insofar as there has been more than one side of the argument presented in the press, has centred on drawing comparisons between the best arrangements in the public sector (that is, those for the highest paid) and the worst provision in the private sector. Taking a more like for like assessment, public sector schemes constitute fairly average provision. Among defined benefit schemes, the average cost to the employer of benefits in private sector schemes is 15.6% compared with around 14% in the main public sector schemes. It is also not the case that the schemes in the public sector have vastly superior benefits to those in the private sector. With the exception of some company executives’ pension packages and the MPs’ and Judges’ schemes, the standard 1/60th and 1/80th accrual rates remain the majority basis for defined benefit provision along with a normal retirement age of 65, just as in the Local Government Pension Scheme (LGPS) and post reform unfunded public sector schemes. Employee contribution rates too are similar across sectors. While member contribution rates in the public sector hinge around 6.5%, 44% of defined benefit schemes in the private sector also have member contribution rates of between 5% and 7%.

Employers who have moved to defined contribution schemes have in most cases also taken the opportunity to cut the amount they contribute on an ongoing basis. This explains why the average employer contribution to defined contribution schemes is only 7%. The likelihood of this being the basis for a reasonable income in retirement (such as 50% of pre-retirement salary) is reliant on the member contributing at least 8% and starting saving in their early 20s. So at the same time as politicians have sought to move responsibility from the state to private savings (those provided through employers or the pensions industry), many employers have halved their contributions to their employees’ retirement. However, with the average member contribution to a defined contribution scheme being only 4%, the result is likely to

be heavier reliance on the state in future as people realise in retirement that they do not have sufficient savings to fund their basic needs.

It is often said that it's not fair that workers in the private sector have to pay twice, once for their own pension and once for public sector workers' pensions. As with so many inflammatory assertions, this is a long way from the true picture. All workers pay tax so public sector workers pay for their own pensions through their contributions and their national insurance and tax payments. Those in good quality private sector schemes have their schemes paid for partly by their own contributions and partly through their employer's revenue. This revenue is generated largely through the pricing of the product or service sold by that company. The customers, some of whom may well be public sector workers, therefore contribute to the pension savings of private sector workers through their purchases. On top of this, all those who save for their own retirement pay for those who do not, through the public money spent on benefits and local authority and NHS services that would otherwise be funded by the individual. The real difference is between those taxpayers who save enough to be self-sufficient when they retire and those who do not. Given that the take up of good quality pension schemes is much higher than for those of lesser quality, there is a strong argument to say that people in better schemes like the public sector schemes are subsidising members of worse schemes such as the ones held up as 'appropriate provision' by opponents of the public sector.

Comparisons have been drawn between public sector pensions and Personal Accounts, the new national minimum occupational pension due to be introduced in 2012. As is so often the case, this is not a like for like comparison. Personal Accounts, if introduced as currently outlined, will provide a baseline for workplace pensions. No one would sensibly argue that the 8% contribution on earnings over £5,035 (but under £33,500) will provide a sufficient income in retirement not to require any other saving. Public sector pensions are good quality retirement saving vehicles, whereas Personal Accounts represent the minimum acceptable. That is why it is not in anyone's interest for Personal Accounts to become the norm; it would only lead to millions more pensioners in poverty. One of the key problems with Personal Accounts is that as a defined contribution arrangement there are no guarantees, with savers at the mercy of investment returns and annuity prices. For example the DWP estimate that a median male earner (£24,440 per annum) who starts saving in a Personal Account aged 22 can expect to retire 46 years later on around £80 a week. Using the same 2007 figures [Hansard Written Answers for 22nd July 2008] this would double his state pension giving a combined pension of around £160 a week. Many would not regard this as sufficient. For women the outlook is even worse: on the same basic assumptions (using the female median wage of £19,240) a woman could expect £55 a week, bringing her combined pension to £135. If she'd taken five years out of her career, to care for children for example, she would be likely to have saved enough in Personal Accounts for an occupational pension of £47 a week.

If the relentless dumbing down of pension saving continues, this will become the norm, with an increasing number of people unable to meet their basic expenses (the official poverty level in 2009 is estimated to be £165 a week). To date no one has produced a viable new solution to the savings gulf, so if employers are allowed to continually cut their contributions and neither wage levels nor state benefits increase to compensate, the inevitable result is a return to the unedifying spectacle of widespread destitution amongst the elderly. Misguided notions of property investments or ISAs miraculously filling the shortfall should be laid to rest. The reality is that good quality workplace-based pensions are the safest and most sustainable means of providing for retirement.

> **"We should not question whether good quality pensions are affordable – we should instead ask whether the alternative of pensioners in poverty relying on state handouts is the future we want."**
>
> **Brian Strutton, GMB National Secretary**

RECRUITMENT AND RETENTION

A number of public sector employers already report problems with the recruitment and retention of key staff. Low paid staff such as care assistants and frontline NHS workers will come under increased pressure as the effects of an ageing population cumulate. To reduce rather than increase the remuneration package of these workers by cutting their pension provision seems perverse to say the least. According to IDS, the starting wage for these workers is between £5.99 and £6.40 an hour based on national rates (the national minimum wage at the time of the survey was £5.73 an hour). Their pension saving, even if they stay for longer than the average six years (for LGPS members) is likely to result in a pension of no more than a few hundred pounds a year on top of their state pension.

Removing the quality occupational pension provision available to these workers will both reduce their retirement income, directly leading to a greater reliance on state benefits and reduce their commitment to the public sector. Given the hardships experienced by some of these workers: 17.8% of care assistants, for example, report being the victims of violence at work as do nearly a quarter of classroom assistants (starting pay around £7 an hour, most working part time); it is difficult to see how denying these workers security in retirement, or if they are forced to stop work following injury, will assist in attracting quality workers to these understaffed public sector roles.

Several reports over the last year have pointed to the demise of the argument that the pension schemes in the public sector compensate for lower pay. Substantially fewer of these reports, however, mentioned that a key reason for this is the continued prevalence of outsourcing: transferring workers from public to private sector employment while they are still working on a public service contract. The significant majority of jobs outsourced in this way are at the lower end of the public sector pay scales: cleaners, building labourers, school cooks etc., with starting salaries generally below £13,000 per year. Jobs higher up the pay scales: town planners, doctors, teachers and accountants, for example, are far less likely to be outsourced but have generally found that their pay has not kept pace with comparators in the private sector. This distorts the average figures for both sectors. Despite moves by government over the last decade to address the problems of key worker recruitment and retention, it remains the case that many public sector workers rely on the pension provision to make their remuneration package competitive. The average British wage last year was £31,323 while firefighters earned £30,557, social workers £29,569 and nurses £28,241. Despite the furore caused by the salaries and severance packages of some Chief Executives in the public sector, these are dwarfed by those in the private sector. A cautious assessment indicates that the top 10% of earners in the public sector are paid around 12% less than their comparators in the private sector (ASHE 2008). On top of this, the extreme provisions of some Executive contracts in the private sector are almost inconceivable in the public sector. Transparency and accountability, although by no means as good as they should be, generally mean that the sort of 'Fred Goodwin' arrangements made in the private sector cannot be replicated so readily in the mainstream public sector.

Pensions are a major area of focus in their own right and correctly so, however, it is also important to view occupational pension provision, in any sector, as part of the total remuneration package of the employee. Typically, pension provision amounts to around 20% of a public sector workers' total reward package with the services' schemes for police, firefighters and the armed forces accounting for around a third of overall 'pay' for these workers. This includes their own contributions so in reality the main schemes for local government, teachers and the health service effectively add about 14% to a scheme member's pay, provided they also pay in.

Given cost sharing and the spreading mechanisms that exist for funding by employers in both the funded and unfunded schemes, even this 14% (or relevant future cost employer contribution) isn't set in stone. While many local authorities are paying in contributions at twice that rate, most are doing so because in previous years they under-

contributed, i.e. paid in less than was required. In the private sector this is known as a contribution holiday, a phenomenon beloved by many company scheme sponsors a couple of decades ago and widely encouraged by the wholly inappropriate Minimum Funding Requirement rules introduced by the Conservative government in the 1990s. Less talk exists of contribution holidays in the public sector but they have undoubtedly occurred, fairly openly in the Local Government scheme and rather more opaquely in the unfunded schemes.

Changing the system now to provide a defined contribution based public sector pension framework, as advocated by the Conservative leadership (although not all Conservatives) would prove more costly to public sector employers than they currently suggest. The nature of a defined contribution scheme is inherent in its name. The contributions, both employer and employee, are fixed. They cannot be smoothed out over time or election cycles and are incredibly transparent. Moving to defined contribution would effectively put a strait-jacket over the funding of public sector pensions for the future and do absolutely nothing to address the past service liabilities that still need to be paid.

Moving away from identifiable pension provision towards a total reward package would add extra cost to the public purse as the paybill would inevitably increase to cover those not currently participating in their public sector pension scheme (including for example 15% in local government despite auto-enrolment being standard for some years). These workers would be remunerated from the total rewards approach where currently they are not benefiting from the pension scheme.

“My vision over time is to move increasingly towards defined contribution rather than final salary schemes.”

David Cameron, Conservative Party leader

Section II
THE SUSTAINABILITY OF PUBLIC SECTOR PENSIONS

Public sector schemes are long term projects, paid for over the long term and paying out benefits for decades. The idea that there is a sudden panic surrounding these schemes that requires instant, devastating action is simply wrong. In fact the combination of knee-jerk policy-making and reactionary scheme changes is the worst possible approach to any pensions issue yet, it is exactly what has faced millions in the private sector. The solution of course is not to repeat those mistakes in the public sector, but to deal with the underlying problems.

Schemes in the public sector are not identical although almost all have been reformed in the last few years. Millions of current and future public sector workers now have different pension schemes than was the case a few years ago, however, all were made viable and sustainable and appropriate for the workforces they cover. Most commentaries summarise how public pensions are paid for in a throw away line or ridiculous stream of numbers allegedly proving that half the private sector is working solely to provide a pension for one nurse. This section examines in depth how the different schemes are paid for and where the money comes from. The final part outlines the various benefits offered to public sector scheme members. These are good schemes but they are not unparalleled, with the possible exception of the uniformed services' schemes whose provisions reflect the nature of the work their members undertake.

> **“ Public sector pension commitments are skyrocketing. ”**
> **Vince Cable, Liberal Democrat Treasury spokesperson**

SCHEME COVERAGE

Currently there are more than five million active, i.e. contributing, members in the dozen or so public sector pension schemes operating in the UK, over 2.5million already drawing pensions and a similar number with deferred pensions. In total over 10 million people in the UK with retirement income rely on public sector pension schemes. Technically there are over 200 public sector schemes, most of which are very small and are in effect mirror-image schemes of either the Civil Service or Local Government schemes. In addition there are a number of quasi-public schemes such as the Royal Mail, Universities and BBC schemes and those with government guarantees for some or all benefits e.g. the British Coal Pension Scheme and the Remploy Pension Scheme. There is not one public sector pension scheme, instead there is a plethora of distinct and specific schemes designed for, and sustained by, the members and employers who contribute towards them.

As demonstrated by the conclusions of the Pension Commission's reports in 2005, the lack of occupational pension saving by vast swathes of the working population poses very real economic and social threats to the UK. The public sector shows how the trend for non saving can be countered. Around 85% of public sector employees are members of an occupational pension scheme compared with only 40% of private sector employees. The key reason for this disparity is the value of schemes to employees. As is almost inevitably the case, the better a scheme is, the more likely people are to participate. There is no difference between the public and private sectors in this regard: many of the 15% of public sector employees who do not

participate opt out (auto enrolment is already a reality in public sector schemes) due to a lack of financial capacity to contribute. A Unison/IDS survey in 2008 found that while 100% of those surveyed taking home over £3,000 per month were members of the LGPS, only 70.7% of those taking home less than £500 a month were in the scheme. This is despite graduated contributions in the LGPS (and also in the NHS scheme) aimed in part at making the scheme more affordable for the lower paid. The main reason cited for non-participation in the scheme, across income levels, was cost.

RECENT REFORMS

All major public sector schemes have undergone wide-ranging reform over the last few years aimed at ensuring the schemes are sustainable over the long term: valuable to members and viable to the taxpayer. Often overlooked, these reforms alone will save billions of pounds. On top of this, cost sharing arrangements discussed below have been introduced to the three main unfunded schemes (NHS, Teachers' and Civil Service) to limit the volatility to the taxpayer of future benefit costs.

In 2005 an agreement (known as the Public Services Forum agreement) was reached between the government and unions in relation to the normal pension age of existing members of the NHS, Teachers' and Civil Service schemes. As a result, pre-reform members of these schemes retain the right to retire at 60 on an unreduced pension unless they choose otherwise. The NHS scheme is embarking on a 'Choice' exercise where these members can choose whether to remain in the old scheme and retire at 60 or move to the new scheme and retire at 65 with better benefits.

Over the years following 2005, all the main schemes in the public sector, including the LGPS, were reformed resulting in reduced cost to employers and a redesign of benefits and contribution rates for members. The increase in retirement age for new entrants and (in most cases) increased member contributions generated, and will continue to generate, significant savings for schemes for many years to come. Some of these savings were used to retain the lower retirement age, others for improving the accrual rate or other benefits. The future cost of these schemes for active members (before cost sharing) has also reduced as a result of these reforms. On average the schemes for new entrants to the NHS, teaching and the Civil Service are 3% cheaper than the pre-reform schemes and savings have also been made on the old schemes, all of which will be covered by the cost sharing arrangements.

Before reform, both the NHS and Teachers' schemes represented nearly an extra 16% to a member's salary package (excluding their own contributions). After reforms, the schemes for new entrants to those industries are worth about 12.6% (there is a standard contribution rate in the Teachers' schemes but a graduated framework in the NHS). The Civil Service schemes were of greater value than the other main schemes prior to reform, with the pre-reform package worth around 25% of salary, whereas *nuvos*, the scheme for Civil Servants joining the service since 2007, is worth 17.5%.

Outside the Forum agreement were the reforms to the LGPS and the uniformed services' schemes (Fire, Police and Armed Forces). Before and after reform the uniformed schemes' value is higher than most other schemes (aside from MPs and Judges) reflecting the particular demands of those jobs and the likely age of retirement. The pre-2006 scheme for the armed forces was worth an estimated 39% with the new scheme slightly cheaper at 38%, although due to the non-contributory nature of these schemes and the abatement of pay involved, these figures are not easily comparable with the other schemes. Members of the old Police scheme and Firefighters' Pension Scheme have a benefit worth around 24%, however, new entrants now have schemes worth 18.5% and 15.5% of pay respectively.

The LGPS is the only scheme to have retained a broadly similar value before and after reform (aside from an average member contribution increase). There are several reasons for this. Firstly, the scheme reforms have applied to all members, existing as well as new entrants, spreading the detrimental benefit changes, as well as the improvements, among current and future active members, not just new entrants. Secondly, the scheme already had a normal retirement age of 65 so this was not a target for

reform, although the mechanism for retiring with an unreduced pension before that age if a member had 25 or more years' service (known as the Rule of 85) was phased out, with the savings split between benefit improvements and reduced cost to the employer. Thirdly, the pre-reform LGPS was the cheapest public sector pension scheme in terms of value with an employer cost of 14%, this remains the case but the reforms have generally retargeted the scheme's benefits rather than reduced them overall.

The LGPS 2008 (which applies to all 1.7 million active members and new entrants) now costs employers around 13.7% of pay. As with the NHS scheme, the variable member contribution rate affects the exact value to each member, although obviously depending on individual circumstances all schemes can be worth more or less than the headline figure. The new contribution rates are both fairer and generate more income for the schemes, which reduces the amount payable by employers. In the LGPS income to the scheme from employee contributions rose by 15% in the first year of the new scheme. The reforms in all schemes have reduced the costs to employers both in the short term, through lower future service costs, and the long term, through the introduction of cost sharing.

FUNDING BASIS

Almost all public sector schemes are defined benefit schemes. Where members were given the option of a defined contribution alternative, such as the Partnership section of the Civil Service scheme, very few took it up (it currently has only 7,000 active members, 1% of the total active membership of Civil Service pension schemes). Key differences exist between the schemes in the ways in which they are funded. The majority of public sector schemes are 'unfunded' which effectively means that although the schemes are valued and assessed in a way analogous to other pension schemes, they are run more along the lines of 'Pay As You Go' schemes. This has its parallels in the funding of state pension benefits, largely paid from the National Insurance Fund into which contributions are made and used by government while qualifying beneficiaries are simply paid out as and when required.

The main exception to this model of funding is the Local Government Pension Scheme. The largest occupational pension scheme in Europe actually consists of around 100 separate funds all operating within a single set of scheme rules. Collectively the Local Government schemes in England & Wales, Scotland and Northern Ireland have funds worth over £100 billion. This is money that is directly invested in business, public works, government bonds and all the other parts of the economy in which all funded pension schemes invest in order to generate sufficient returns to pay the pensions being built up by contributing members.

The two frameworks are very different and so need to be considered independently.

Unfunded Schemes

The majority of public sector schemes are unfunded: the NHS Scheme, Teachers' Scheme, Armed Forces' Scheme, Civil Service Schemes, Police and Fire Schemes, Judges' Scheme and most others applying to smaller public bodies. These have come under the fiercest criticism as opponents of good quality public sector pension provision seek to maximise press coverage by quoting the biggest numbers possible for these schemes' 'debt'. While it is true that public sector financing in general is less than wholly transparent, some of the calculations being made border on the fanciful.

Unfunded schemes are fundamentally different to all funded pension arrangements whether public or private. Benefit (i.e. pension) payments from unfunded public sector schemes, like those from the National Insurance Fund, form part of government expenditure, so when they fall due they are financed through the income government raises at that time, which in turn depends upon activity in the UK economy. So the long term cost to government of providing a set of benefits from the unfunded public sector schemes is not actually that implied by the marginal cost of borrowing through gilts at any time i.e. the price and the yield they offer investors will be subject to the balance between their availability on the market and demand from those seeking to purchase.

Despite this, detractors have sought to apply accounting methods used for funded pension schemes to the UK's unfunded schemes. Leaving aside the very real problems

that exist with the methods themselves, wherever they are applied, it is fundamentally disingenuous to apply an inappropriate formula which produces staggering numbers and then claim that these schemes are unsustainable. One report claimed that the accumulated liability of unfunded public sector pension schemes is £1.1 trillion or 78% of UK GDP. Another, written by the same author less than three weeks later, said the figure was 85% of GDP. If this was a robust assessment, the size of the numbers is only half the issue: the volatility alone should be causing alarm.

In order to produce the most extreme figures, a number of commentators have sought to present the liabilities (i.e. the pensions workers have already built up) as if they were all payable today (instead of in the future, when these workers retire). This is compounded when asset growth is valued at the most cautious rate. Criticisms of the discount rate (the rate of return on investments assumed by pension schemes to quantify today's cost of pensions due in the future) used in the public sector abound and at times the figures used do look out of sync with the actuarial norm. However, while they may be thought to be at the wrong end of the reasonableness spectrum at times, this is no different from the routine way company scheme sponsors have moved assumptions to suit a particular purpose without stepping out of the boundaries of official guidance.

One key flaw in most attempts to accurately cost unfunded public sector schemes is that no account is taken of the timescale for repayment. If a mortgage is payable immediately the amount owed is overwhelming but because it is spread over many decades, the amount payable is manageable. Pensions, whether funded or unfunded, work in the same way. As live, open schemes (for the most part, effectively pooled when closed as in the Civil Service), with millions of active, contributing members, public sector schemes can plan for the long term. Leaving sensationalism aside, the UK is not insolvent and is not in danger of economic collapse so there is absolutely no need to front load the funding of scheme liabilities. The notional assets (as there is no actual fund) can be increased in line with an equity based return because they are established for the long term. This takes into account that the notional repayment period is very long as befits the strength of the employer covenant.

Those seeking to present unfunded schemes as unaffordable assume a much weaker discount rate than the Treasury. Sometimes this is presented as a prudent assessment based on an imaginary fund invested in bonds rather than equities. Predictably this results in a larger liability figure than official indicators show because equities are assumed to perform better than bonds over the long term. In contrast the return on a bond investment is more secure, leaving some to argue that unfunded schemes' notional investments should err towards caution. The issue this raises is that a live scheme with a steady flow of new members would not sensibly load all its scheme investment into bonds. The action planned by BT to move a substantial proportion of its investments from equities to bonds (from 57% equities in 2007 to a target of 33% announced in June 2009) reflects the needs of a particular type of scheme. The BTPS has been closed to new entrants for many years and so has most of its liabilities known and fixed with limited scope for new money coming in, except for a comparatively small remaining number of active members. BT does not have many decades to meet its scheme obligations so it cannot rely too heavily on the long term return on equities to generate assets. Instead it needs to make a more short term assessment of its scheme liabilities and provide a comparatively predictable mechanism for funding these costs. As a result the company contributions look set to nearly double (from £280 million to £525 million). If a similar process is applied to the notional funds of unfunded public sector pension schemes, it is easy to move from the £800 billion Treasury estimate of liabilities to £1,000 billion (i.e. a trillion) without any public sector worker receiving a penny more in pension.

As unfunded, pay as you go schemes, the relevant assessment is the relationship between contributions (and transfers) coming into schemes and the money going out to pay pensions (and transfer values). For the main unfunded schemes, £19,500 million was received in contributions with £22,562 million going out in benefits. This effectively leaves a deficit for 2008-9 of £3,062 million, albeit a deficit that does not need to be paid up overnight. This is the accurately quantifiable shortfall that follows a number of years of surplus in the past;

everything else involves assumption and speculation. The annual publication of the Long Term Public Finances Report continues to reflect the stability and sustainability of expenditure on these schemes. Predictions consistently indicate that expenditure will remain around 1.5% of GDP for the medium term and then start to fall as a result of the recent reforms.

Funded Schemes

The three main funded public sector and quasi public sector pension schemes are the Local Government Pension Scheme (which, when taken as a whole, is the largest funded pension scheme in Europe); the Universities' Superannuation Scheme, with a fund worth around £30 billion; and the Parliamentary Pension Scheme (the MPs' scheme). While it is more appropriate to assess the costs and assets of these schemes using standard accounting practice, the issue of repayment periods is particularly relevant to these schemes. However the same theory applies as previously mentioned: it is pointless to value a scheme as if all liabilities need to be paid up immediately. The LGPS incorporates three separate national frameworks (England and Wales, Scotland, Northern Ireland) which set out the benefit and administration framework (including investment rules), and 101 individual funds varying in size from the smallest passenger transport authority fund to the largest, Strathclyde, estimated to be worth around £9.5 billion with more than 185,000 members. On their own, four LGPS funds appear in the top twenty UK pension funds by size. The scheme as a whole was valued in 2008 at around £120 billion making it a major feature of the UK economy independent of its role providing retirement income to four million local government workers.

On a year by year cash flow basis, not only is the LGPS not in deficit, it's actually in surplus. The total amount LGPS income exceeded expenditure in Great Britain in 2007-8 was over £6.5 billion. In Scotland the surplus in 2007-8 was £1.4 billion. The surplus in the Northern Ireland LGPS in 2006-7 on this basis was £68 million. In 2008-9 the LGPS in England spent £5.6 billion on benefits but received a total of £10.8 billion in income. Despite the fall in asset value, much of which will already have been recouped because of the improvement in investment returns since 31st March this year, the increase in income from employee contributions (up by 15%) and employer contributions (up by 8%) has led to the income of the funds in England exceeding expenditure by £5.2 billion. There is no reason to assume that this scenario isn't repeated in the Scottish and Northern Irish funds. Similarly although dipping slightly from the previous year, in Wales in 2008-9 pension fund income exceeded expenditure by £264 million. This can not fairly be considered unsustainable.

However, the LGPS does not operate on a cash flow basis and its funds are actuarially assessed on the basis of real assets and liabilities with each individual fund valued every three years like any other funded scheme, and employer contribution rates then being set as appropriate. This reveals a less impressive funding level of 83.5% in 2007, a figure that although up on the 2004 level of 74.9% is likely to have dropped since as a result of the lower value of assets. However, the 100% funding rate target is an artificial construction that has been strategically moved over the years to meet particular political needs. Before the current discussions of ending public sector schemes, a less than 100% funding target and extended repayment period of over 20 years in many cases did not cause any particular problem. If however, the LGPS is to be wound up as some on the right would wish, the shortfall will be very significant.

LGPS funds are also subjected to FRS17 assessments. In a statutory scheme this is particularly absurd. FRS17 has undermined much of the good quality defined benefit provision in the private sector, causing concern among company executives and destabilising company accounts. As a general policy it is in everyone's interest for FRS17 to be abolished and replaced with a more workable and sensible accounting measure, but this is particularly so with open, cash rich, funded statutory schemes like the LGPS.

Despite a desire for intergenerational fairness allegedly underpinning the Conservative policy on public expenditure and debt, there is no acknowledgement of the exploitation that has already occurred. Contribution holidays by LGPS participating employers over many years have contributed to the funding shortfall, local taxpayers of the past have had the benefit of artificially low employer contributions. Now the only option is to demand the shortfall from this and subsequent generations of tax

payers. A genuinely long term approach to intergenerational fairness would not close all good quality pensions to new entrants as advocated by Liberal Democrats and many Conservatives, in fact quite the opposite: it necessitates the promotion of good schemes. Levelling down doesn't remove intergenerational inequality – it exacerbates it.

The funded nature of some public sector schemes rebuts some of the criticisms hurled at them from those on the right. The pension industry too is generally less damning of these schemes, and the LGPS in particular, than those set up on an unfunded basis. This may of course be purely because the industry itself has a major part to play in the LGPS, providing actuarial advice, investment management services and all the other ancillary services relating to occupational pension provision, many of which are not required by the nature of the unfunded schemes. This may also explain the apparent reluctance in many quarters to look at merging funds to reduce administration and other costs. There is limited justification for having 101 funds in the scheme, and as suggested by the Audit Commission in their 2006 report "Efficiency Challenge: Costs of Administering Local Government Pension Funds in London", there may well be cost savings to be made by streamlining the scheme structure.

Having a scheme the size of the LGPS as a funded scheme brings with it some specific issues of concern that neither the recent reforms nor the introduction of cost sharing will solve. The repercussions for local government financing following the Icelandic banks' collapse in 2008 culminated in widespread condemnation of some authorities' lack of scrutiny and led at one stage to the Audit Commission labelling some councils and one LGPS fund 'negligent'.

This has been a wake up call to some funds, many of which blindly delegated the responsibility for investment to one officer with very little accountability. CLG (the government department for Communities and Local Government that regulates the LGPS) and CIPFA issue guidance and some regulation covering the management of funds but practices still remain that are neither efficient nor prudent and certainly not in the best interest of scheme members – as pension funds are supposed to be in line with European legislation. The EU rules covering this area (Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision) clearly oblige member states to ensure that funded pension schemes are run in the best interests of the scheme members. There is very little evidence that the UK complies with this Directive in relation to the Local Government Pension Schemes. While members of private sector schemes were provided for by the Pensions Act 1995 LGPS members still remain outside these provisions.

The performance of fund investments will have an impact on the ongoing viability of the LGPS whether or not they are explicitly incorporated into the cost sharing mechanism. Despite the long term premise on which the LGPS and analogous schemes in the private sector should be based, opportunist headline hunters will always highlight a downturn in funding levels as a reason to dump the scheme and a surplus as a reason to cut Council Tax. In reality surpluses should be rolled into the scheme to cushion deficits, but political intervention has invariably got in the way of this in both the public and private sectors.

One inappropriate activity which hopefully is unique to the LGPS is that of pooling the fund's assets with those of the administering authority's general fund. While not a universal practice, co-mingling as it is known, exploits the pension fund for the benefit of the authority's coffers. This can be lucrative for that authority but comes at the expense of all the other employers in the fund and after the potential introduction of cost sharing, the members as well. Co-mingling works by the administering authority investing money from both the pension and their own general fund and returning the money to the pension fund at the basic LIBOR (London InterBank Offered Rate, the interest rate at which banks lend to each other) rate while channelling the excess profits from the investment into the general fund.

Where this occurs it deprives the pension fund of income that is rightfully owed to it. This exacerbates deficits, puts needless pressure on employer contributions and fuels the wrath of anti-scheme commentators. CLG are looking into closing the loophole that allows this to happen but it is almost impossible to quantify how much income the scheme has lost over the years through this practice.

COST

As indicated above, the ongoing cost of the schemes to the employer is around 14%, with cost sharing occurring in most cases should this figure change. This is not out of step with better employers in the private sector. In the private sector the normal contribution rate of defined benefit schemes (excluding special payments resulting from deficits) was 15.6% in 2007. In terms of local taxation, the cost of pensions funded through local authority expenditure (LGPS and some uniformed services' pension contributions) amounts to less than 6% of Council Tax revenue.

To put government spending on unfunded public sector pensions in context, it is useful to compare the other major item of pay as you go expenditure: the state pension. The state pension is funded from the National Insurance Fund as are other contributory benefits such as incapacity benefit, widows' benefit, maternity allowance and jobseekers' allowance. The fund has for many years had an annual surplus: in 2009-10 this is expected to exceed £2 billion. State pensions (excluding means tested benefits like Pension Credit) account for around 77% of National Insurance Fund expenditure. In 2008-9, £77.4 billion was spent on state pensions with another £10 billion spent on social services for pensioners. In addition an estimated £8 billion is spent on the means tested Pension Credit. Reducing retirement income for millions of public sector workers would increase these figures not just because more money would need to be paid out from the state but also because millions more would be used up in the heightened cost of administering means tested benefits (the cost of delivering one state pension is just £5.40 a year compared with £53.70 for one Pension Credit payment).

In terms of national expenditure, while the unfunded public sector schemes account for less than 1.5% of GDP year on year, spending on state pensions is around 5% and set to rise in spite of the very low level of the state pension (among the lowest in the OECD). Given the number of public sector retirees who would be in receipt of state benefits were it not for their occupational pension, moves to reduce the value of these schemes further will necessarily exacerbate the spending pressures on the state.

CONTRIBUTIONS

Of the major public sector schemes only the Armed Forces' Pension Scheme is non-contributory for members (technically at least, Armed Forces' pay is abated to take into account the pension scheme). Across schemes, employee contributions generally range from 3.5% to 11%. In some schemes the level of contribution relates to earnings. Lower earners in the LGPS and NHS schemes pay a lower rate of contribution than Chief Executives and Consultants, for example.

The contribution rates for the main public sector schemes are set out below (in some schemes variations exist regionally within the UK: for simplicity, where this is the case the England & Wales scheme contribution rates are described below).

LGPS

Contributions are graduated on the basis of whole time pensionable earnings.

Earnings	Rate
< £12,600	5.5%
£12,601 – £14,700	5.8%
£14,701 – £18,900	5.9%
£18,901 – £31,500	6.5%
£31,501 – £42,000	6.8%
£42,001 – £78,700	7.2%
> £78,700	7.5%

A consultation from the Department for Communities and Local Government launched in June 2009 proposed a new graduated contribution table with a higher contribution rate for those earning over £100,001.

NHS

Contributions are again graduated on the basis of full time equivalent annual pensionable pay.

< £20,709	5.0%
£20,710 - £68,392	6.5%
£68,693 - £107,846	7.5%
> £107,847	8.5%

CIVIL SERVICE

A number of schemes exist in the Civil Service. Membership of a specific scheme is largely dependent on the member's date of joining.

nuvos	3.5%
Classic	1.5% (for partner benefits)
Classic plus	3.5%
Premium	3.5%

Partnership – defined contribution scheme, voluntary member contributions.

TEACHERS

Member contributions to the Teachers' Pension Scheme are a standard 6.4%.

FIRE

The new Firefighters' Pension Scheme for joiners since 6th April 2006 has a contribution rate of 8.5% with those remaining in the old scheme paying in 11%.

POLICE

The new Police Pension Scheme operating from 6th April 2006 has a contribution rate of 9.5% with those remaining in the old scheme paying in 11%.

ARMED FORCES

The two relevant Armed Forces' schemes are non-contributory although salaries are abated by 4% to account for the pension schemes.

Generally the employer contribution rate is around 14% for the NHS and Teachers' schemes and 19% for the Civil Service. Employer contributions in the funded public sector schemes are less easy to quantify although for future service the LGPS employer contribution is slightly less than in the NHS and Teachers' schemes (13.7%). There are thousands of employers participating in public sector pension schemes largely as a result of decades of outsourcing, which has added levels of complexity to all levels of public service provision and increased the risks and costs of pension provision.

Over the years political expediency has meant the rules affecting how much employers have been obliged to contribute to their employees' pensions have been changed. In the early 1990's for example, when the Poll Tax was being introduced by the Conservative government, a political decision was made to reduce the LGPS target funding level from 100% to 75%, a move since reversed. This contribution holiday, used by some councils to artificially reduce the unpopular tax, is still being paid for by today's local authorities. The result of the 2007 valuation showed an average funding level of around 84%. A similar adjustment in the funding target today would immediately enable employers to reduce their contributions. However, it might simultaneously make the scheme less viable over the long term. An approach that would be more robust would utilise a more flexible route to achieving solvency. As a cash rich scheme there is no immediate need for 100% funding levels although over time this is a sensible objective.

SCHEME MANAGEMENT

All major public sector pension schemes are established under the Superannuation Act 1972 and as a result have a statutory guarantee. As it is not feasible that the state could go insolvent, public sector schemes are exempt from the Pension Protection Fund (PPF) levy and are not covered by PPF protections. The statutory guarantee should provide certainty for the purposes of member security and funding plans (where there are funds). As there is no need for the rigorous monitoring of the employer covenant and viability of the scheme sponsor, long term funding plans should be at the forefront of public sector schemes' structure.

As the schemes rely in part on public money and in part on member contributions it is vital that the governance of public sector schemes is as transparent and honest as possible. Each scheme in the public sector has a slightly different approach to governance issues. As statutory schemes there is a perception by many that there is less need for the sort of trustee based governance approach that applies in the private sector. The main unfunded schemes (NHS, Civil Service and Teachers') have governance groups consisting of employer and employee representatives alongside representatives from the relevant government department. These have a key role in the cost sharing arrangements as well as providing a forum to address practical and broader policy concerns relating to those schemes. Ultimately however, overall control and responsibility for the schemes lies with government and the relevant Secretaries of State.

The LGPS has more disparate governance arrangements, some of which are slowly undergoing reform. With a greater susceptibility to the fluctuations of the market and substantial 'real' investments, LGPS funds require a different approach. At a whole scheme level, discussion groups of employer and employee representatives, practitioners and other interested parties exist to oversee the three LGPSs in the UK chaired by the relevant department or agency. However, the more rigorous scrutiny of fund management and practice cannot be done at this level (except in Northern Ireland). Each fund therefore has a governance policy, Statement of Investment Principles and funding statement which set out how that fund will operate. Responsibility for the fund lies with the relevant council although most delegate the investment scrutiny and other elements to either a specific committee or an individual council officer.

This leaves LGPS scheme members and many participating employers outside the governance structure. While some funds include representatives of scheme members and non council employers, many do not and very few give them parity with the Councillor members on the committee. This unfairness, compounded by the inadequacy of investment management uncovered recently in some areas, should accelerate the process of reform. LGPS funds need to be as stringently scrutinised as any trust based scheme: the statutory underpin should not be an excuse for inefficient investment management or poor administration. The inadequacy of data emerging from the scheme indicates that there is still much to be done to bring these elements up to an appropriate standard.

COST SHARING

The new and vitally important adjunct to the financing processes of both funded and unfunded public sector schemes is the notion of cost sharing. Already introduced in the NHS, Teachers' and Civil Service schemes, these mechanisms will (if allowed to work as designed), in certain circumstances, limit any increases in employer contribution due at future valuations (mainly where certain changes in assumptions about future performance result in increased costs to the scheme).

Although minor differences exist between the arrangements applying to each of the main unfunded schemes, the basis for cost share is common to all three. Essentially there is a cap on the employer/taxpayer contribution rate meaning that some increases in cost will either be born entirely by the scheme members in terms of increased contribution rates or reduced benefits, or the additional cost will be shared between the employer and member. So if actuaries re-estimate life expectancy in the next year and advise that pension

schemes should assume they will be paying pensions for longer than is currently budgeted for, members of these unfunded public sector schemes will be expected to contribute more or reduce scheme benefits to cover the extra cost.

This is a realistic means to provide far greater predictability of cost for the public purse while maintaining a good quality scheme for members. As unfunded schemes, investment revenue can be deemed a constant, simplifying the process and making for a clear and transparent approach.

With the funded schemes however, particularly those with multiple independent funds and thousands of contributing employers, the process will need to be different. The LGPS has been developing its equivalent of a cost sharing model over the last year. As the fluctuations of investment returns are directly relevant to the LGPS it is important that this variable is taken into account. Unfortunately and doubtless for different reasons, the consensus between government and employers is that these should be excluded from the framework. Much of the positive benefits to all of the cost sharing method will be its long term sustainability. There is, however, a significant danger that cost sharing will be a still-born initiative as the pension industry and it seems the new chair of the LGA, Margaret Eaton, are intent to dismiss the potential of cost sharing before it has been introduced [Local Government Chronicle 30th June 2009].

Currently it appears CLG's intention is that a notional fund, not dissimilar to the unfunded schemes' set up, will be established and a cost sharing arrangement applied to this fund. This, it is envisaged, will meet the challenge of a scheme with a very diverse range of fund and employer experience. The basis for that fund will be a mixture of actuarial assumptions from the Government Actuary's Department (GAD) and the private firms who advise individual LGPS funds and genuine experience data from administering authorities (the element of local government that manages the LGPS funds). It is essential that real experience data is key to the process. While there have always been weaknesses in the data provided by employers it is vital that this improves to facilitate the transparency and effectiveness of the cost sharing process.

Cost sharing in the LGPS was presented as a forward focused approach with the past service deficits, largely brought about by employers' contribution holidays, remaining the responsibility of the employers. While this is still the stated intention of the cost sharing discussions, there are some who do not believe employers today should endure the full cost of actions of employers in the past. They would rather the employees of today bear the brunt of this shortfall instead. In some cases the cost of funding the past service deficit dwarfs the ongoing cost of the scheme leading to a very distorted picture. Some LGPS authorities with a poor contribution history or investment strategy fuel the flames of unsustainability by publicising employer contribution rates of 30% or higher. The picture is presented that this is the ongoing cost of the LGPS despite the truth, which is that the future cost of the scheme (the price of purchasing LGPS benefits going forward) is no more than 13.7%. The rest is the leftover cost of past service deficits, a figure that no amount of cuts to the scheme for the future will reduce. This amount is effectively the deficit recovery payment which in time will reduce to 0% when the deficit is paid off. This is the key reason why the funding approach taken in the LGPS should be set towards the long term. The amount could be spread over a longer period than is currently the case, reducing the pressure on employers and maximising the opportunity for investment returns to recover.

SCHEME DESIGN

Although all the media attention focuses on the highest earners in the public sector and their likely pension entitlements, the truth is these are the exceptions. If the same view was taken of private sector pensions there wouldn't be a savings crisis because Sir Fred Goodwin and others have excellent pension provision. Judging any pension framework by what happens to those on high incomes is pointless. The appropriate measure of a structure is whether it provides for those that need it and therefore encourages private saving for retirement and minimises state reliance. This cannot be gleaned by looking at the pensions of local authority Chief Executives, senior civil servants or high ranking army officers who are hardly likely to be affected by means tested benefits.

Unlike many arrangements in the private sector, senior members of staff in the public sector are in the same pension scheme as the rest of the workforce. This is indicative of the wide range of members these schemes have to satisfy. From midwives to grave diggers through classroom assistants, university cleaners, doctors, town planners, firefighters, social care workers, benefits officers and retirement home wardens; public sector pensions cover workers supporting society at every stage in life. This means that schemes have to cater for a very wide range of working patterns and career experiences. Arguably final salary schemes, which are the majority, are not best suited to a public sector workforce that increasingly consists of female part time workers with inconsistent career histories. In the discussions leading to the scheme reforms recently implemented, career average (CARE) schemes were mooted in most if not all areas. Ultimately however, only the career average accrual rate proposed for the new Civil Service scheme (*nuvos*) was viable.

Although the condemnation of the public sector provision tends to treat all schemes as the same, there are key differences between them. The composition of the workforce covered is one example: very mixed in the LGPS and Civil Service schemes, in comparison with the Teachers' or Firefighters' schemes. Another major variable between the schemes is the average length of service. In some schemes this is comparatively low, 6.3 years in the LGPS for example, for others it's very much longer: 18 years in the NHS scheme and up to 32 years for men in the Teachers' scheme. However, a continual trend running through all schemes is the high degree of reliance the majority of scheme members have on their public sector pension. Most do not have other savings with the capacity to provide security in retirement. Contrary to views expressed by some, these retirement savings are transferable, with particular provisions existing to facilitate transfers between public sector schemes on top of the normal transfer regulations that facilitate pension movement. The issue of transfer flexibility is not an obstacle to saving: what is likely to discourage transfer to private sector provision is the quality of those schemes.

BENEFITS

The benefit packages of public sector schemes are on a par with other good quality pension schemes in the private sector. All new starters in the main public sector schemes and everyone in the LGPS have a normal pension age of 65, all currently have pension options on redundancy and make ill health payments in some circumstances and all will make payments to dependants in the event of the member's death.

The average retirement income members earn from their scheme membership varies from scheme to scheme, largely reflecting the difference in pay levels and normal lengths of service: the average LGPS pension is around £4,000 a year compared with the average fire service pension of over £11,000. However, sterile averages don't tell the full story: while the average Civil Service pension is about £5,500 a year, 25% of retirees receive a pension of less than £2,000 a year.

As is the case throughout the economy, those on high earnings get better pensions than those with low incomes. To some extent the design of most of the defined final salary benefit schemes in the UK exacerbates this inequality. The situation is often further aggravated in the private sector by preferential rules for company executives. A recent survey of executives' pension arrangements found that commonly executives have a thirtieth accrual rate or an employer contribution to a defined contribution scheme of over 30%. This is a long way from the usual private sector scheme or any of the public sector arrangements.

The general pattern of benefits for the main schemes is set out below (some variations exist regionally within the UK, for simplicity the England & Wales scheme benefits are described on the next pages).

“I don't want to see the pay or the pensions of local public servants dragged down by public anger at the excess of a few.”

John Denham, Secretary of State for Communities and Local Government

LGPS

2008 Scheme

Final salary
Accrual – 1/60th
Lump sum – Commutation only
Normal pension age – 65
Survivor's pension – 1/160th
Death in service – 3 times salary

1997 Scheme (subsumed into 2008 scheme)

Final salary
Accrual – 1/80th
Lump sum – 3/80ths
Normal pension age – 65
Survivor's pension – 50%
Death in service – 2 times salary

NHS

2008 Scheme

Final salary
Accrual – 1/60th
Lump sum – Commutation only
Normal pension age – 65
Survivor's pension – 1/160th
Death in service – 2 times salary

1995 Scheme

Final salary
Accrual – 1/80th
Lump sum – 3/80ths
Normal pension age – 60
Survivor's pension – 50%
Death in service – 2 times salary

CIVIL SERVICE

***nuvos* (post 2007 joiners)**

Career average
Accrual – 2.3%
Lump sum – Commutation only
Normal pension age – 65
Survivor's pension – 3/8ths
Death in service – 2 times salary

Premium (2002 member option)

Final salary
Accrual – 1/60th
Lump sum – Commutation only
Normal pension age – 60
Survivor's pension – 1/160th
Death in service – 3 times salary

Classic & Classic plus (pre 2002 joiners)

Final salary
Accrual – 1/80th
Lump sum – 3/80ths
Normal pension age – 60
Survivor's pension – 50%
Death in service – 2 times salary

TEACHERS

2007 Scheme

Final salary
Accrual – 1/60th
Lump sum – Commutation
Normal pension age – 65
Survivor's pension – 1/160th
Death in service – 3 times salary

Pre 1st January 2007 joiners

Final salary
Accrual – 1/60th
Lump sum – Commutation
Normal pension age – 60
Survivor's pension – 1/160th
Death in service – 3 times salary

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FIRE

2006 Scheme

Final salary

Accrual – 1/60th

Lump sum – 3/70ths

Normal pension age – 60

Survivor's pension – 50%

Death in service – 3 times salary

1992 Scheme

Final salary

Accrual – 1/60th for first twenty years, 1/30th thereafter

Lump sum – Commutation only

Normal pension age – 55

Survivor's pension – 50%

Death in service – 2 times salary

POLICE

2006 Scheme

Final salary

Accrual – 1/70th (maximum 35 years)

Lump sum – 4 times pension

Normal pension age – 55

Survivor's pension – 50%

Death in service – 3 times salary

1987 Scheme

Final salary

Accrual – 1/60th for first twenty years, 2/60ths for next ten years

Lump sum – through commutation

Normal pension age – 55 (depending on rank and length of service)

Survivor's pension – 50%

Death in service – 2 times salary

ARMED FORCES

Post 6th April 2006 joiners

Final salary

Accrual – 1/70th

Lump sum – 3/70ths

Normal pension age – 55

Survivor's pension – 62.5%

Death in service – 4 times salary

Pre 6th April 2006 joiners

Final salary

Accrual – 1/69th

Lump sum – 3/69ths

Normal pension age – 55

Survivor's pension – 50%

Death in service – 3 times salary

RETIREMENT AGE

A common, if inexplicable, focus of critical attention is the public sector retirement age. While it is true that a declining number of scheme members have a retirement age of 60, all new starters in the main schemes and existing and new members of the LGPS have a retirement age of 65. Special provisions apply to the emergency services and armed forces that reflect the specific type of work members of these schemes undertake. An argument often presented is that private sector retirement ages are rising while in the public sector they remain low. In fact almost no private sector pension schemes have a retirement age older than 65. According to the ONS Occupational Pension Schemes Survey more than a third still have a retirement age below 65. The survey shows that, like new members of the unfunded public sector schemes and all members of the LGPS, 61% of private sector schemes have a normal retirement age of 65. In a post age discrimination world, retirement ages should become less relevant; even now in the NHS scheme for example, the average age of retirement for those who can retire on an unreduced pension at 60 is 63.

When looking towards the state pension, an individual's state pension age takes no account of whether the person works in the public or private sector. If you were born after April 1978 your state pension age will be 68 regardless whether you work for the Civil Service or Sainsbury's. This is what is erroneously being referred to by a number of politicians with statements such as "At a time when some private sector workers face having to work until 68 before they get their pension, [taxpayers supporting public sector schemes] is neither sustainable nor fair" (Bob Neill, Shadow local government minister, Local Government Chronicle, 25th June 2009). Those private sector workers who have to wait until 68 before receiving a pension are those entirely reliant on the state pension i.e. not in a private sector occupational scheme. They are in exactly the same position as public sector workers who do not save in an occupational pension scheme.

"Everyone needs to save for their retirement and good quality pensions schemes are the best way of ensuring that they do."

Brian Strutton,
GMB National Secretary

GMB
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Section III
THE FUTURE OF PUBLIC SECTOR PENSION PROVISION

This last section focuses on the way forward. The outsourcing of public services, with all the problems that brings in other areas, has a major impact both on public sector pension schemes and the retirement prospects of the workers providing these services. In local government where outsourcing is quite advanced, there has been a significant change in the profile of the LGPS. If the trend spreads further, into the NHS and Civil Service for example, changes will be needed to protect those providing services. Secondly, the criticism directed at public sector pensions is underpinned by a concerted effort by some politicians to fundamentally change pension provision for public sector workers. The consequences of that approach are discussed below.

INTERACTION WITH THE PRIVATE SECTOR

As a result of almost continuous waves of outsourcing and the privatisation of public services, large swathes of the private sector now incorporate both public and private sector pension provision. The LGPS has more than 7,000 participating employers including large nationwide businesses like SERCO and Veolia to small third sector operations providing individual contracts. The transfer of public sector workers to these employers can and should involve the participation of the new employer in the LGPS through an admission agreement that grants the private sector employer 'admitted body status' into the LGPS.

The 'Fair Deal for Staff Pensions' 2000 included an arrangement to protect the pensions of workers transferring from public to private sector employment in order to fill the gap left in TUPE legislation for the protection of occupational pensions in a public to private sector transfer. This was further augmented in the local government sector by the 'Two Tier Code' in 2003 and the 2007 Direction which makes the provision of the LGPS (through admitted body status) or a 'broadly comparable' scheme mandatory for transferring employees. The rationale for this approach is sound, albeit in practice there are a number of flaws. The purpose of contracting out public services should be to achieve better and more efficient service delivery. The ideology behind the drive towards outsourcing is that providers other than the public sector (i.e. both the private and third sectors) can provide high quality public services for less cost thereby potentially saving the taxpayer money. Leaving aside whether this is factually or philosophically realistic, the savings are supposed to be achieved through more innovative service provision or structural efficiencies **not** by reducing employees' terms and conditions to generate savings.

Unions have, for some time now, sought reforms to the way pensions are treated in outsourcing situations. A key area of much needed reform relates to continuing access to public sector schemes for members of schemes other than the LGPS. No equivalent to admission agreements and admitted body status exists for the NHS or Civil Service schemes. While some alternative arrangements do exist, experience suggests that these are much less utilised. Enabling workers transferred from the health service or Civil Service to retain their membership and continue to participate in these schemes would dramatically simplify the process of outsourcing for private sector contractors, maintain continuity in pension saving for the workforce and ensure ongoing contributions into the scheme. The CBI in its June 2009 report, 'A Question of Balance Reforming Pension Practice

in Public Services Contracting', endorses this view.

The CBI is similarly supportive of the replacement of the free choice between providing the LGPS or a 'broadly comparable' scheme by the default provision of the LGPS for transferring employees. This would remove the need for the, often costly, establishment of a whole new scheme with the necessary certification from the Government Actuary's Department. This, the CBI argues would mean there was a level playing field and contractors could all bid for contracts on the same pensions basis. It proposes that to facilitate this, 'pass-through' clauses should be incorporated, sharing some of the risk elements in the scheme between the contractor and the authority. Contractors argue that it is unreasonable for them to be totally at the whim of the administering authority when it comes to the setting of their employer contribution rate. A more reasonable approach is to balance the risks between contractor and authority based on who has most control over the cost in question. Investment strategy for example is totally out of the contractor's hands (although arguably with better governance arrangements this does not have to be the case); however, the number of redundancies is not. Pass-through is a reasonable mechanism for addressing this disparity without putting undue pressure on the pension fund.

Where CBI's proposal in 'A Question of Balance' falls down is that it only intends to provide access to the public sector scheme to transferring workers, not those subsequently employed on the public service contract. This fundamentally undermines the notion of a level playing field. All in-house bidders have to formulate their bids on the basis of allowing open access: new starters would all automatically join the public sector scheme. Allowing private or Third sector contractors to bid on the basis of closed access loads the bidding process in their favour and also undermines the concept of equality and fairness outlined in the Two Tier Code.

The only sustainable solution is to have mandatory admitted body status on an open admission basis for all contractors with pass-through arrangements in place. This would genuinely take pensions out of the outsourcing process, providing certainty to contractors, continuing income for funds and security for employees.

OPTIONS FOR THE FUTURE

The question many of the five million current public sector scheme members, their families and those considering a career in public service are asking is what will happen to these schemes in the future? With a general election looming, pensions could well be a key issue for voters and an area where differences between the parties are stark. Officially the political parties are cagey about their plans but there is enough commentary from Opposition parties to give a clear indication of their trajectory and more than a decade of Labour government experience to draw on.

Labour has successfully implemented a raft of reforms to public sector pensions which have: secured an average increase in member contributions; resulted in savings to employers/taxpayers in the short and long term; and implemented sustainability strategies to ensure the long term viability of the schemes.

By contrast there is a clear indication from those on the right in the Liberal Democrats and Conservatives that their approach is guided more by the perverse belief that the solution to the retirement savings deficit in the UK lies in reducing the savings of public sector workers. At their party conference in October 2009 the Conservatives announced their desire for an independent commission briefed to find savings to examine public sector pensions.

The Liberal Democrats, looking more to their free market roots than their social democratic history, have said they would 'review' public sector pensions and use savings to boost the basic state pension. The obvious conclusion is that when they say review, they mean cut. Either that or they mean there wouldn't be a boost to the state pension. While there may be potential administrative savings available in public sector schemes, these will be nowhere near sufficient to raise the basic state pension by as much as a penny, let alone the £70 per week needed to bring it up to the official poverty level. Reforming the Judges' scheme (as yet the only scheme of note not to have had major reforms) is similarly small fry compared with the changes needed to the state pension. The Liberal Democrats' approach is indiscriminate and inconsistent.

On the one hand they indicate they believe the LGPS is 'robust and affordable', while on the other saying public sector pension costs are 'grossly underestimated'. Given their current party leader, Nick Clegg, thought not too long ago that the state pension was worth £30 a week (actual figure at the time around £85) it is perhaps understandable that they think the basic state pension needs attention. Unions would agree that it does but forcing more people to rely on it by slashing public sector workers' families' income is hardly a sensible way to achieve this.

Moving further to the right, many Conservative spokespeople have argued that one or all public sector pensions are unsustainable and/or should be closed, at least to new entrants: David Cameron, George Osborne, Eric Pickles, Philip Hammond, David Davies and Margaret Eaton (Chair of the Conservative led Local Government Association) to name but a few. While the focus on new entrants may be a ploy to give false comfort to existing members, their strategy comes from the private sector where time and again we have seen these salami-slicing tactics used. Schemes are first closed to new entrants then closed to existing members a few years later. Members and the wider public will not be fooled. This approach would save no money in the short term and store up an inconceivable amount of public spending and poverty in the long run. Closing the LGPS alone would lead to less investment in UK business as funds have to move out of equities and into more secure and predictable bonds. Lack of new contributions from members would lead to the crystallisation of debt that would have to come from the public purse a lot sooner than envisaged. On top of all of this would be the cost of inadequate pension saving, already a time bomb in the private sector but which on current Conservative thinking would be vastly increased by pushing low earning public servants into poverty. It is this that the taxpayers of the future should be concerned about, not the comparatively small amount of current local and national taxation that goes toward public sector pension schemes at the moment.

"Local authority pensions are the model of pension prudence remaining affordable, solvent and fair to taxpayers."

**John Healey,
Minister for Local Government**

CONCLUSION

Public sector schemes are viable and sustainable but they can't and won't stand still. They adapt to changes in demographics and workforce shape and this must continue. There needs to be a better synchronicity between public sector pension arrangements and management practices. Moves to increase pension ages for example, require greater moves from public sector managers to embrace flexible retirement and ensure training is made available to all, regardless of age or job. Changes in member contributions must take on board the need to maintain scheme participation rates, particularly among the lower paid. In past years, and arguably still today for a very select chosen few, public sector management used the pension schemes for their own ends. This was never in the best interests of either the taxpayer or the majority of scheme members. While this approach has largely died out, there is still much to be done to encourage the proper use and governance of public sector pension schemes by participating employers.

The history of public sector pension schemes is one of change, sometimes seismic, more often incremental, adapting to changes in political priorities, workforce needs and employer demands. No one should want schemes to be set in stone, inflexible and inexorably eroding over time. The point the political elite have missed however, is that the public sector should lead, not follow. Perhaps there is a need for a new approach to retirement saving but it's not through a collapse of provision. It shouldn't be necessary to wait for widespread poverty for the system to change. The reduction and dismantling of provision throughout the private sector must be reversed. The downward spiral of employers cutting contributions to workers' retirement must stop, and those contributions should be fairly distributed amongst those workers. Employees must also save for themselves but this must be in a secure and transparent way. All parties need retirement saving to be sustainable and to provide enough in later life for individuals to live free from poverty. Only this way can government move from public spending based on reactively meeting demand to genuinely planned expenditure.

Funding 20 to 30 years of retirement for anyone is not going to be easy or inexpensive. As the majority expect their retirement income to relate to their earnings in work (typically half to two thirds' income), the amount of savings required will be significant. Actuaries estimate that 15% to 25% of earnings over the course of an individual's 40-plus years of working life would be needed for this level of replacement income. Only the very few are able to save this entire amount for themselves; employers must make a fair contribution, or accept pay increases of this magnitude in order to accommodate the necessary saving. Most balance of cost schemes, in both the public and private sectors, were set up on a 2:1 (employer:employee) contribution ratio. Nothing that has happened since that time has justified changing this split but the way it's saved needs reform.

Defined benefit schemes have suited employers in the past, despite a lot of political tinkering with funding requirements that have not served anyone well, the impact of FRS17, for example, being particularly unhelpful. The ability to fund over the long term enables employers, within reasonable limits, to be flexible about how much cash to pay towards the necessary amount at any given time. The move to defined contribution arrangements has inhibited this flexibility, although in most cases the heavy reduction in employer contributions has more than compensated for this inconvenience. If pension reform is to be successful, this reduction has to be reversed. Employer contribution rates of 6-7% are simply not enough. Many employers happy to fund during times of surplus have run at the first sign of trouble, completely undermining the long term structure of these schemes. Governments, past and present, have let them and allowed firms to compound this error by transferring the risk of retirement income entirely on to the individual and the state.

The volatility of employer costs for defined benefit schemes has been a key driver in the decline in private sector provision. As discussed in the first two sections of this report, the durability of the public sector, as with some of the more established employers in the private sector that retain defined benefit schemes, means that funding occupational pension schemes over the long term does not need to be a strain. For other companies, particularly in this economic climate, the demands

of some defined benefit regulatory provisions are too onerous, at least in the short term. This is why a long term perspective is paramount. Both employers and employees need stability. Stability and predictability of cost; security and predictability of benefit.

Accepting that the system of providing income in retirement needs to change and that reducing everyone's provision down to that provided by Personal Accounts is not a viable situation, the UK has a number of options. If government is prepared to ensure employers take their share of responsibility for contributions over the long term and in exchange have some flexibility about what they provide and how it is funded then the current system should be salvageable. What this would require however, is a rethink of the move away from defined benefit schemes and a realistic discussion of a range of hybrid frameworks: those that encompass elements of both defined benefit and defined contribution arrangements. Alternatively, it could be accepted that employers as a whole cannot be relied upon to make the relevant funding commitments for the long term and the existence of occupational provision as such is replaced by a state run pension saving system, embracing the philosophy that underpinned the creation of SERPS and taking the necessary contributions in the form of taxation.

Choice is, politically at least, the spirit of the age. Choice and flexibility could be features of individual saving mechanisms but to make that policy viable the financial education of the workforce must improve inexorably. While not impossible to resolve, the gulf between the majority's understanding of their retirement needs and the reality of the cost and benefit of different elements of pension provision is very wide, certainly not bridgeable in the short to medium term when reform is necessary. Allowing individuals to choose whether to save and for what would in many cases lead to the wrong decisions being taken with the result of poverty, state reliance and a decline of confidence in the process. Choice also leads to complexity and withdrawal. The fact that the overwhelming majority of defined contribution scheme members never deviate from the default options presented to them is indicative of the lack of demand for, or usefulness of, excessive choice.

Instead the priorities of retirement saving need to be drawn out. As discussed above, the degree of predictability of outcome (i.e. a known pension amount at a particular age) is important for government and individuals; it is also relevant for employers who want to be able to actively manage their workforce planning. Continuity of the value of the resultant pension is also an integral element. If pensions once in payment lose value, the pressure falls on the state. The alternative is that individuals, despite saving, get progressively poorer. Some in the pensions industry suggest that indexation of pensions should be conditional on good investment returns, but this is to remove security from arguably the second most important feature of a pension. This is one element already marginalised in many arrangements, both defined benefit and defined contribution, the consequences of which will become increasingly apparent in the next few decades.

If these elements, undoubtedly the most costly, are guaranteed through occupational schemes to **all** employees, then a realistic discussion of a less regulated approach to other elements is possible. Transitional arrangements will be needed. Changing provisions at the last minute, which in pension terms is anything less than ten years before retirement, will quite rightly incur the wrath of savers who have participated in schemes in good faith for many years. Providing the amount of pension and the sustained value of that pension over time are the two primary essentials of a pension arrangement; so long as these are guaranteed, a less rigid approach can be adopted with regard to other benefits. These other features can be more dependent on the needs of the workforce both demographic and industrial. Survivor benefits and low retirement ages are highly prioritised by the uniformed services for example but they may not be as integral to a pension scheme in a different sector. Ill health and death in service benefits may be better provided independently of the occupational pension scheme, separately insured and better matched to individual workforces.

These reforms and flexibilities are possible. Changes to working and retirement patterns over time will both demand reform and facilitate it but no policy will succeed unless it applies to everyone. The greatest feature of the

Personal Accounts plan for 2012 is not the level of contribution or expected pension; these elements are woefully low. Nevertheless the default participation in the process and the universality of application is a major step forward. The challenge of governments to come is to build on that step and develop a structure of pension saving that produces sufficient income in retirement for all pensioners. That will not be achieved if employers in any sector are allowed to continually reduce their commitment to pension saving.

This approach maintains the direct tripartite responsibility for providing retirement income: state, employer and individual. There is an alternative. Instead of expecting employers and individuals to design, maintain and sustain a savings structure, all the responsibility could be passed to the state and directly to the taxpayer. No disparity between sectors; everyone would have a viable income in old age provided by the state. Obviously this would have to be paid for, by taxpayers: individuals and businesses. This approach would reflect that adopted by the unfunded public sector schemes or the basic state pension. Consequently it would not be funded and would not incorporate pension funds invested in UK businesses. The question mark over whether this could succeed however, lies with the political parties. Without a strong and durable consensus between them, the public will not have sufficient confidence in the arrangement and will not accept the tax/contribution burden necessary for it to operate.

For the public sector schemes retention of the contribution levels for the future is paramount, setting a clear marker to the private sector of what is necessary. The design of schemes can change. Some risks associated with core provision may need to be shared but not transferred entirely to the individual. Moving a cost from one part of the public sector balance sheet to another, or from one generation to another, is not the same as making a saving, although many politicians and industry commentators would like to convince the public otherwise. The cost of the benefits that have already accrued will have to be met. This, as in the private sector, is a significant part of today's costs to employers of occupational pension provision.

The public sector can lead the way, pulling the private sector back from the brink of disaster that the dumbing down approach has led it to. Key core benefits across the piece can be secured, well within current expenditure, leaving the flexibility for sections within the public sector to negotiate other provisions. This approach can then be rolled out to the private sector. With the introduction of collective bargaining on pensions as a core feature of union negotiating arrangements, trade unions can and should be at the heart of this process. If they are not, provision will be dictated by the pensions industry that has, on the whole, done nothing to ensure low and medium earners can save securely for their retirement.

The UK is not so far away from this point. Reforms will occur and must be developed through genuine engagement with members, employers and the government; not through press sensationalism and speculation from the pensions/insurance industry who stand to benefit the most from spurious reforms. Only through proper debate can the UK have the pension system it needs: encouraging individual saving, being an asset to recruitment and retention for employers and keeping the dedicated UK workforce out of poverty in old age. This makes economic and social sense, the alternative merely creates anarchy and increased deprivation.

"Pensions and climate change have a lot in common, there are the naysayers, the opportunists and the scaremongers but the fact remains that action needs to be considered and built on a long term consensus."

Naomi Cooke,
GMB National Pensions Officer

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SOURCES

RECENT REPORTS

A number of reports have been published in the last few years contributing to the perception that there is unanimity of opinion that public sector schemes are unsustainable and in need of reform. The list below is not exhaustive but seeks to clarify the real extent of this 'consensus'.

Pension Policy Institute – An Assessment of the Government's Reforms to Public Sector Pensions

A report produced in conjunction with the Nuffield Foundation in October 2008 which, although very strategically quoted from by the media on publication, arguably provides the fairest and best informed analysis of the current state of public sector pensions within the context of reform not closure.

Institute of Directors – The Pensions Apartheid: the Problem, the Cost and the Tough Choices That Need to be Made

As indicated by the title, this report (January 2009) is an attempt to justify a particular policy position rather than an objective and factual report of the public sector pension context.

CBI – Clearing the Pensions Fog

Issued in December 2008, this briefing extols the actions taken by members of the employers' organisation to reduce pension costs and advocates the same levelling down for the public sector.

Policy Exchange – Ponzi Public Sector Pension Schemes: the Second National Debt

Report published on 11th June 2009 by a think tank 'interested in free market and localist solutions to public policy questions' claiming the liabilities of unfunded pension schemes amount to 78% of GDP.

British North American Committee – The Need for Transparency in Public Sector Pensions

A report portrayed as coming from a group of 'leaders from business, labour and academia in Canada, the UK and the US' published on 29th June 2009. Authored in the UK by the same 'expert' as the Policy Exchange document above and the IEA paper below, the press release accompanying the report was headed, "UK public sector pension liabilities now 85% of GDP, hugely exceeding those of US and Canada". It is not explained why this figure differs so significantly from the report published 18 days previously.

Institute of Economic Affairs – Sir Humphrey's Legacy: UK Public Sector Unfunded Occupational Pensions

Produced originally in September 2006 and updated in January 2008, these papers, published by the UK's original free-market think-tank and written by the same person as the two papers listed above, outline particular ideological concerns about the accounting procedures behind the unfunded public sector schemes.

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