Decent pensions for all

Why public sector pensions are affordable and the real challenge is the collapse of private sector pensions

Executive summary

- There is a sustained attack on public sector pensions from business organisations, right-wing pressure groups and opposition political parties. They say that public sector pensions are unaffordable, unreformed and gold-plated.
- Public sector pension critics are right to say that public sector staff now get better pensions than private sector staff, but this is because of the collapse of pension provision in the private sector. The challenge is to provide decent pensions for all by levelling up private sector pensions, not cutting those in the public sector.
- In 1967 there were more than 8 million pension scheme members in the private sector and 4 million in the public sector. In 2006 the number of public sector scheme members had risen to more than five million (largely because of the inclusion of many part-timers), but the number of private sector members of pension schemes had fallen to 3.6 million.
- In just three years between 2004 and 2007 there was a 25 per cent fall in the number of private sector members of DB schemes. More than half of DB scheme members in the private sector today are members of schemes that are closed to new members. This means that while they can carry on building up a pension, new staff can only join the replacement DC scheme.
- DC schemes have not filled the pensions savings gap. The big picture remains a retreat by employers from providing pensions. Between 2005 and 2008 there was a 5.1 per cent drop in the proportion of the working population in the private sector in membership of a DB pension (18.6 per cent to 13.5 per cent). But there was a much smaller increase in the membership of DC schemes with an employer contribution of just 1.9 per cent (19.9 per cent to 21.8 per cent).
- The biggest pension gap is between top directors who have genuinely gold-plated pensions and everyone else. Members of the FTSE100 pay an average of 70 per cent of pay into final salary pension schemes.
- Most public sector schemes, including the major schemes for teachers, civil servants, police, NHS staff and the armed forces, are unfunded pay-as-you-go schemes, though the Local Government Pension Scheme (the biggest) and some others are funded.
- Unfunded schemes have strict rules with employee and employer contributions made as if the scheme was funded. They are valued using the same FRS17 approach as private sector schemes.
- Unfunded schemes can only be run where there is a guarantee of state continuity that can ensure that pensions promises can be met into the future, but are common in other countries. It makes more sense to see spending on public sector pensions as the repayment of previous contributions lent to the state.
- Pensions schemes are very long term. Expressing the cost of future pensions promises in unfunded schemes as if they all had to be paid today is a favourite device of public sector pension scheme critics as it produces frighteningly large numbers, but makes as much sense of expressing the cost of the next century of the NHS as a bill that has to be paid all at once.
- A better way is to look at the cost of public sector pensions is as a future proportion of GDP. Treasury estimates show a modest increase from 1.5 per cent

of GDP to 2 per cent by 2027 and then remaining stable.

- Another way of looking at the cost of unfunded public sector pensions is the net annual cost – the difference between pensions in payment and the income from contributions. This is an affordable £4.1 billion or about 0.3 per cent of GDP for the current year.
- This figure can vary sharply from year as it is the difference between two much bigger numbers. While over time pensions (linked to prices) and contributions (linked to public sector wages) will go up together, they can vary from year for example if there is a blip in price inflation or a wage settlement that is less than inflation. This doesn't mean that pensions are out of control.
- The cost of providing tax relief on pension contributions each year is much greater than the net cost of public sector pensions. In 2007/8 tax relief cost £37.6 billion – almost ten times the net cost of unfunded public sector pensions. This tax relief is heavily skewed towards the well off. 60 per cent goes to higher rate tax payers and a quarter of tax relief – nearly £10 billion a year – goes to the one per cent of the population who earn more than £150,000.
- Turning unfunded public sector DB schemes into DC schemes would result in a big bill for tax payers as they would have to pay the full cost of current pensions in payment. Employee and employer contributions, currently used to help pay pensions, would go instead into a fund to pay future pensions.
- The mean average public sector pension is £7,000 but the majority of public sector pensioners have pensions under £5,000, with women on even less. The average local government pension in payment to women is £1,600.
- There are comparatively few large pensions in payment in the public sector, and even top public sector pensions are much less than 'fat-cat' director pensions. Unlike in much of the private sector, top public servants are in the same pensions schemes as their staff.
- Public sector pensions have been renegotiated. New joiners in most schemes have a standard pension age of 65 – which has always been the case in the Local Government scheme. In many schemes a novel cost sharing element has been included that means the cost of unexpected increases in longevity will be shared by employee and employer.
- A good pension helps compensate better paid public servants for earning a lower salary than they would in the private sector. Highly skilled workers in the public sector earn 5.5 per cent less than they do in the private sector.
- But low paid public servants largely do better than their equivalents in the private sector as they earn above the minimum wage and have access to a pension. Unskilled workers in the public sector earn 7.2 per cent more than they do in the private sector. Only one in five private sector employees earning between £100 and £200 has an employer sponsored pension, compared to 70 per cent in the public sector.
- The average pay of public sector staff is higher than that of the private sector, but this is not new and was true under the last government. It is a consequence of taking large numbers of low paid jobs out of the public sector through privatisation and contracting out, and putting them in the private sector.

Introduction

Public sector pensions are under attack. Headlines in the press shout that the country cannot afford them, that they are unreformed and that they give retired public servants fat cat pensions.

None of these are true. But this well organised campaign has had its effect. Decent pensions for public servants are in danger.

In this pamphlet we show that public sector pensions are affordable and far from gold-plated. What has happened is a collapse of pensions in the private sector. The real challenge is the retirement poverty facing millions of private sector workers with no employer backed pension. We need to level-up – not level down.

Employer organisations have led the attack on public sector pensions, with the Institute of Directors particularly vocal.

The IoD have got it in for public services as a whole. At their 2009 convention they both attacked the recent Budget's 50 per cent tax rate for earnings over £150,000 and called for a freeze on the pay of every public servant, including the low paid.

They name their attack on public sector pensions, *Pensions Apartheid*.[1] It is sad to see the experience of black South Africans under the apartheid regime used as a debating point in an argument about pensions.

But the most sustained attack on public sector pensions has come from the vocal - but secretive - Tax Payers' Alliance (TPA).

They like to focus on the relatively few public sector staff with substantial pensions such as senior judges. This is of course an attempt to tap into public concern about inequality in the wake of the revulsion at the city bonuses and bank boardroom excess that helped trigger the recession. But it is cynical. The TPA – and many other critics of public sector pensions – have nothing to say about private sector inequality. Even the best paid public servant's pension pot is dwarfed by the size of top directors' retirement funds. The TPA say:

> "There is a pressing need for major and immediate reforms to cut the shameful and unsustainable costs of public sector schemes, often supported by taxpayers who have watched their own schemes disappear or decline."[2]

They like to attack the pensions of the best paid public servants, but they campaign to cut them all. A few retired public servants do receive generous pensions. But they are still far less than the pensions taken for granted by top directors such as Sir Fred Goodwin, and unlike many boardrooms, even the most senior public servants are in the same pension scheme with the same rules as other staff in their part of the public sector.

And of course the only way of making big savings in public spending is by slashing the pensions of millions of low and moderately paid public servants. The majority of pensions in payment are less than £5,000 a year. Just cutting the top pensions in the public sector would raise very little cash.

Politicians have joined the bandwagon. The Conservative leader David Cameron spoke to a business audience in Manchester in November 2008, apparently under the impression that it was a private meeting:

> "My vision over time is to move increasingly towards defined contribution rather than final salary schemes. This is something (sic) where the government has been remarkably feeble partly because they are in hock to the public sector unions."[3]

Perhaps realising that this was a big potential vote loser among five million public servants, the Conservatives tried to row back. Their then Shadow Work and Pensions Secretary said of moving to defined contribution schemes:

> "That is not a decision we have taken. That is not a decision we have even discussed. There is no hidden plan to make radical changes in one particular direction or another.
>
> "It is an issue that no future government will be able to ignore but we're just not willing to get involved in a detailed discussion about the future of public sector pensions from a position of substantial ignorance in opposition."[4]

But this does not say that public sector pensions are safe. As there are no great secrets about public sector pensions only available to government all we can say is that the Conservatives will want to make cuts, but have not told us what they will be.

The Liberal Democrats say similar things. Their formal policy is to call for a policy commission to look at the future of public sector pensions. Vince Cable has said that the cost of public sector pensions is "completely out of control"[4] and that "The big test of political courage is public-sector pensions, which are in danger of running out of control."[5] Lord (Matthew) Oakeshott, their pensions spokesperson in the House of Lords, accused David Cameron of being:

> "caught with his petticoat showing, promising friendly businessmen he'll sort out public sector pensions but lacking the guts to say it in public."[4]

Party leader Nick Clegg says:

> "let's look again at public sector pensions - not breaking commitments already made, but looking for ways to keep the cost of future obligations, particularly to the higher paid, under much tighter control."[6]

Public servants should be very afraid.

Level up or level down?

Many arguments used to attack public sector pensions are flawed. But the starting point often used by their enemies is true. Today's typical employee in the public sector does have a better pension scheme than the typical worker in the private sector.

This is because private sector employees have been fast losing decent pensions. There are two main reasons for this.

First, growing numbers of private sector employees work for companies that provide no pension at all. This is not a recent trend, pensions coverage has been declining since the 1960s.

Secondly, employers have closed many decent salary related pension schemes. Sometimes the scheme carries on for existing staff, but new staff can only join a much less generous replacement scheme.

But there is now a growing trend to close schemes completely, with existing staff also transferred to a new scheme for future service. Such replacement schemes are worse for members in two ways. First they are simply less generous. Employers nearly always make a big cut in the contributions that they make. But they are also riskier for members – the value of the pension a member eventually gets paid will depend on ups and downs in stock market and other investments – the employer is no longer bearing the risk of such fluctuations.

The question is whether the right response to this gap is to level down public sector pensions or to make private sector pensions better. Some seem to think that every cut in a private sector pension should also be imposed on public servants. But this leads to a race to the bottom until no-one has a decent pension.

Oddly it is often trade unions and other campaigners for a fairer society that are accused of the politics of envy and wanting to level things down.

But when it comes to public sector pensions, this is precisely what their critics – normally entirely relaxed about inequality – seem to be doing.

Unions want to see everyone at work – whether they work in the public or private sector – with a decent pension. It is unfair that private sector workers have poor pensions, but the answer is to improve their pensions not cut those of public sector staff.

Many of those attacking public sector pensions have a not-so-hidden agenda of hostility to public services, state provision and effective trade unionism in a throwback to the attitudes of Mrs Thatcher's government.

Having a decent pension in either the public or private sectors is one of the most obvious benefits of working in a unionised workplace. Union members get better pay, better holidays, more entitlement to flexible working and are less likely to be injured or made ill by their workplace. But the huge gap in pension provisions between unionised and non-union workplaces is now one of the biggest differences. In unionised workplaces in both public and private sectors, changes to pension schemes have been negotiated to ensure they are sustainable and meet the needs of a changing workforce. In non-union workplaces there probably isn't a pension to start with, and even if there is the employer is free to cut or close it.

Who are the Taxpayers' Alliance?

Most press attacks on public sector pensions can be traced back to the Taxpayers' Alliance. This is how Polly Toynbee in the Guardian describes them.

"The TPA is a rightwing lobby whose finances are opaque, but which was founded, and is staffed, by former Conservative party councillors and researchers. Its advisory council consists of luminaries of the free-market right: Ruth Lea, who was head of policy at the Institute of Directors; Madsen Pirie, of the Adam Smith Institute; and Professors Minogue and Minford, leading lights in Margaret Thatcher's economic firmament. With a full-time staff of 10, it digs and delves to produce "facts" and "figures" designed to undermine trust in everything in the public sector.

It is a phenomenally successful lobby, of the greatest use to the Conservatives. David Cameron can disown any particular connection, so while he sweet-talks the value of community, health visitors, teachers and the like, these rottweilers rubbish everything on his behalf, softening up the electorate to believe that what the public sector really needs is pruning, squeezing and cutting."[7]

The Other Taxpayers' Alliance is a website set up to expose the TPA at http://www.taxpayersalliance.org/ This is some of what they say:

"For an organisation so concerned with transparency, the TaxPayers' Alliance is surprisingly opaque about its own finances. No list of donors is available. It states only that all donations are from private sources and that no single donation accounts for more that 5% of income. But 5% of what? The Alliance's 2006 accounts record an income of £130,000 – up from £68,000 in 2005 – but that seems hardly enough to sustain 10 full-time staff and offices in London and Birmingham … In 2007 the Alliance published "abbreviated" accounts, which meant income and expenditure were withheld."

2 Pensions – public and private

Many people have only a hazy idea about how their own pension works, let alone know about all the different types of pension that others get. In this section we look at how pensions work, how public sector pensions differ from others, and what has been happening in recent years.

Private sector pensions

There are basically two types of private sector pension, (although some employer-run schemes combine bits of both in what are called hybrid schemes.)

We get quickly into jargon when describing pensions, but the basic principles are not that complicated.

Pensions with a promise

The first type of pension is known as a defined benefit (DB) scheme. Only employers can run this type of pension. With a DB scheme, the pension that you get when you retire is based on your pay and how long you worked for the employer who provides the scheme.

A typical scheme might pay one sixtieth or eightieth of the salary you earn when you retire for each year of employment. DB schemes make a pensions promise based on your pay, your length of service and what is called the accrual rate – the amount of pension you build up each year (one sixtieth or eightieth in the typical schemes above).

Of course it gets more complicated in real life. There needs to be ways of working out your pension when you stop working for an employer before you retire. Some schemes work out your pension based on your average salary, rather than your last pay cheque before you retire or move on to another employer.

But the basic principle is simple. You can work out what your pension will be. This is because it is based on things like your length of service and your salary. There is a pension promise. It is backed by a pension fund built up from employer and employee contributions. The employer provides the guarantee that the fund will have enough cash to meet its obligations. The size of your pension is not dependent on the performance of the investments held by the scheme.

Pensions with a pot

The second type of pension is known as a defined contribution (DC) pension – or sometimes a money purchase scheme. Employers can provide this type of pension. But individuals can also build up their own. It is the only type available to someone who wants to save for their own pension, such as a self-employed person or someone who works for a company that provides no pension.

A DC scheme is simply a kind of savings account. You, and your employer in an employer backed scheme, pay in regular contributions (on which you get tax relief). They are then invested on your behalf. Its value will depend on how much is paid in, and how well the investments perform. You – not your employer - bear the risk. If investments do badly your pension will be smaller. There is no pensions promise. The size of your pension will depend on what your savings are worth. This is often called your pension pot.

When you retire you need to turn your pension pot into a pension. You can take some of your pension as a lump sum, but normally you turn the rest into a regular pension by buying what is called an annuity from a pensions company. (This is why they are called money-purchase pensions). An annuity pays you a regular pension until you die (and possibly one for any surviving dependents, if you buy this option). Annuity prices are the other major area of risk with DC provision. Just as investments go up and down, so do annuity rates. The pension you can buy for every £10,000 in your pension pot can vary significantly even from month to month as annuity rates change.

What has happened to pensions?

There has never been a law requiring employers to contribute to the pensions of their staff. But in the past most large employers and many medium sized ones provided a good DB pension, often thanks to good union organisation. Coverage peaked in the 1960s. This means that in recent years many people have retired with a decent employer backed pension. The average income of pensioners has increased as a result.

But here – as in any discussion of pay or pensions – you need to be careful about averages. Just because the average has gone up, it does not mean that everyone has benefitted. Many of today's pensioners face real hardship because they do not have significant employer backed or personal pensions. Instead they have to rely on means-tested benefits and credits. European Union statistics show that nearly one in three UK pensioners lived in poverty in 2007, and that the UK has the fourth highest level of pensioner poverty in the UK, behind only Cyprus, Latvia and Estonia.

Fewer and fewer pensioners will retire with decent employer backed pensions in the future, leaving many more dependent on the UK's comparatively poor state provision.

There are three main reasons for the decline in employer support:

- newer and small employers very rarely provide any kind of pension, let alone a quality DB pension.
- many employers who once offered a DB scheme to all their staff are replacing it with a DC scheme - usually with much reduced contributions.
- the long-established big employers who once provided decent pensions now employ fewer people. Automation has shrunk what were once labour-intensive sectors. Some sectors are in long term decline as production shifts overseas or demand for their products shrinks. And few companies now employ a full range of staff from cleaners and canteen staff to top managers. Jobs – particularly

lower paid ones – have been outsourced. The companies that provide these services often have little or no pension provision.

There are undeniably pressures on pensions. People are living longer. Investment returns have been extremely variable with periodic stock market crashes even before the current recession. Too many employers took long contributions holidays when investments were doing well leaving their schemes ill-prepared for harder times.

Schemes have also had to modernise to reflect changes in society and the need to treat people equally. So schemes have been opened to part-time workers following union legal action in Europe. Unmarried and same-sex relationships have been recognised for survivors' benefits.

Pension schemes can change to meet new challenges. Too much debate suggests that employers only have the simple choice of keeping a scheme going unchanged or closing it down. Good employers, however, have worked with staff through unions to reform quality DB pensions, where there have been genuine pressures. They have dealt with real issues by negotiating change. Decent pensions have been kept and even improved, even if members have had to accept some less generous terms such as an end to early retirement schemes, new pension ages, higher contributions and lower accrual rates. This has happened in both the public and private sectors. Indeed there are some particularly ground-breaking arrangements to share the costs between employer and members in the public sector if people live longer than expected.

But too many private sector employers have used the recession as an excuse to make deep cuts in pension provision. This has been done simply to save money. It is no more than a wage cut that employers have been able to get away with. Companies that plan for the long term see pensions as a good way to build staff loyalty, keep their best employees and part of their role as a good corporate citizen. But today's company owners, whether shareholders or new owners such as private equity funds, now put on pressure to maximise short-term returns, with pensions often in the firing line.

The result has been a big fall in the number of private sector pension scheme members. In 1967 there were more than 8 million pension scheme members in the private sector and 4 million in the public sector. In 2006 the number of public sector scheme members had risen to more than five million (largely because of the inclusion of many part-timers), but the number of private sector members of pension schemes had fallen to 3.6 million.

In just three years between 2004 and 2007 there was a 25 per cent fall in the number of private sector members of DB schemes. More than half of DB scheme members in the private sector today are members of schemes that are closed to new members. This means that while they can carry on building up a pension, new staff can only join the replacement DC scheme.

But while some DB schemes have been replaced by DC schemes, DC schemes have not filled the pensions savings gap. The big picture remains a retreat by employers from providing pensions. Between 2005 and 2008 there was a 5.1 per cent drop in the proportion of the working population in the private sector in membership of a

DB pension (18.6 per cent to 13.5 per cent). But there was a much smaller increase in DC membership (with an employer contribution) of just 1.9 per cent (19.9 per cent to 21.8 per cent).[8]

The net result is a continuing and sharp decline in pension provision in the private sector. In 2000 55 per cent of private sector workers were not members of an employer backed pension scheme. This rose to 63 per cent by 2008 – almost two-thirds.[9]

This rapid and sharp decline in private sector pensions has led to a big difference in pension coverage between public and private sectors. The vast majority of public sector staff have access to a decent pension, while now only a minority of private sector staff can join one.

But public sector schemes are comparable to good private sector schemes. The gap has grown not because public sector schemes are gold-plated or haven't changed as people live longer, but because the private sector has cut back.

Those attacking public sector pensions argue that they should now be levelled down. But that would not give a single private sector worker facing poverty in retirement any extra pension. The challenge is rather to level pensions up so that private sector workers too can get access to a decent pension.

This has been the approach of this government since they adopted the main recommendations of the Pensions Commission set up partly as a response to the employer retreat from pension provision. As a result from 2012 every employer will be required to make pension contributions for their staff unless the employee opts out.

Public sector pensions

Almost all public sector pensions are defined benefit schemes. Some such as the Local Government Pension Scheme have structures similar to private sector defined benefit schemes, known as ‘funded’ pension schemes.

But most public sector schemes, including the major schemes for teachers, civil servants, police, NHS staff and the armed forces, are what is known as unfunded schemes. Just like funded schemes, members and employers both make contributions, and the scheme makes a pensions promise to members. But pensions are paid directly out of current government income rather than from investments held in a pension fund. Similarly employee and employer pension contributions go directly into current government resources rather than into a pension fund. They are therefore sometimes known as pay-as-you-go schemes.

There are strict rules for unfunded schemes. Public sector employers who offer an unfunded public sector pension scheme for some of their employees pay contributions to a sponsoring government department as if the scheme were funded. Under this system, known as SCAPE (Superannuation Contributions Adjusted for Past Experience), employer contributions form part of the employer’s annual budget. Just as in the private sector, public sector employers have to take the cost of pensions contributions into account in their planning. They are valued using the same FRS17 approach used by private sector DB schemes and publish annual accounts open to all.

'Unfunded' is therefore a potentially misleading term. It means that the pension is not provided by a specific fund. But it can give the impression that no-one is making any contributions and no-one is assessing what contributions need to be made to ensure future benefits can be paid. The SCAPE process means though that the fund that backs the pension is not separately held with its own investments but contained within the generality of public funds. However we use the term ‘unfunded’ here as this is how most people refer to these kind of pensions.

There are seven main public sector schemes with about 5 million active members between them.[10] Six are unfunded, though the funded local government scheme has the most active members, with 1.6 million staff paying contributions. The next biggest are the NHS scheme with 1.3 million active members and the teachers’ and civil service schemes, both with 600,000 active members.

Unfunded pensions

Unfunded arrangements seem to cause particular outrage to the critics of public sector schemes, but many governments run at least some public sector schemes this way. There are fewer differences between funded and unfunded schemes than the critics say, but for some parts of the public sector there are some advantages for governments.

Clearly a private sector employer could not run an unfunded scheme. A twenty year old employee could still be alive in eighty years time. There can be no guarantee that the employer would still exist or, even if they did, have the means to pay the pension. This is why employers are required to build up a pension fund with sufficient resources to guarantee these future payments.

But the state will exist into the future. It will always be in a position to honour its pensions promises. There is no need therefore to build up a pension fund with all the costs and risks of investments. This is why most countries have unfunded pay-as-you-go schemes for public servants. There is nothing special about the UK having unfunded public sector pensions, they also exist in Europe and the US.

It is also not that surprising that some parts of the fund management industry would rather like to run funded pension schemes as that would give them the opportunity to do so for a profit. Tax payers would have to not only pay the contributions needed to fund the payment of future pensions, but also the costs of running the funds, including the fees and profits of the fund managers.

Any sensible pension fund – particularly a giant public sector scheme – would have a considerable slice of its investments in government bonds. It does not make much sense for the government to pay investment managers to take contributions, then lend back to government, thereby requiring the government to pay interest.

If fund managers could guarantee to produce spectacular returns from their investments, this might be worth considering. But they can't. Public sector pension funds would soon be huge, and the idea that smart investment would produce gains bigger than the general growth of the economy year in, year out is unrealistic. Indeed it is more likely that the opposite is the case.

The tax income available to government is closely linked to growth in the economy, rather than good or bad investment choices. Governments throughout the world have therefore concluded that unfunded schemes are an efficient way of running pensions for state employees where it is possible to make the permanent guarantee to honour pensions commitments.

Nor should the costs of running an investment fund be underestimated. This will be an additional cost to government.

Even though unfunded pensions do not have their own pot of investments, it does not mean that they are not carefully managed. Contributions are calculated and paid in unfunded schemes in much the same way as in funded schemes. Deficits are identified at scheme valuations in both funded and unfunded schemes and should be addressed in the same way by adjustment of employer contributions, or by negotiating an adjustment to employee contributions or benefits with the appropriate union.

Unfunded schemes in effect lend their contributions directly to the government and receive a designated rate of interest in return while funded schemes invest them in a wider range of assets.

Public sector pension critics describe pensions payments as straightforward public spending, but it is more appropriate to think of it as repayment by the government of the contributions made by members over the years and lent to government.

Don't forget that when the unfunded schemes were first set up the government was for many years receiving far more in contributions than they were paying out in benefits as at first there were no pensioners. The cost of pensions in payment would have built up very slowly as the first few people to retire would only have built up very small pensions. The big surplus build up in those early years provided a one off boost to public sector assets.

As well as the big funded local government scheme, there are also other quasi-public sector schemes that are funded such as the universities, Royal Mail and BBC schemes. These are run much as any private sector DB scheme, and have funds under investment that are used to pay pensions, and many have been treated as private sector schemes in official statistics since 2000.

Just as in other countries it is those parts of the public sector that are closest to central government and not likely to significantly change that tend to have unfunded schemes. In those bits of the public sector that are more distant and autonomous from central government – and possibly subject to change, such as through local government reorganisation – it makes more sense to have funded schemes.

Funded schemes

One issue with funded public sector schemes is that there is a temptation to take employer contribution holidays – just as private sector employers did when the stock market was booming. It is somewhat hypocritical for the Conservative Party to complain about deficits in funded public sector schemes when a significant part of the underfunding goes back to contribution holidays taken in the 1990s. For example when the Poll Tax was introduced, the then government took the political decision to reduce the target funding level in the Local Government Pension Scheme from 100 per cent to 75 per cent. Similarly, there was a 13 year contributions holiday in the Royal Mail pension scheme.

But over time there is not that much difference between funded and unfunded schemes. Both need to raise sufficient contributions from employers and employees to cover their benefits – and have any shortfall made up by the sponsoring employer. All pension schemes are long term, yet subject to a degree of volatility from year to year, and periods where the balance between current active members making contributions and pensioners receiving benefits may change. In funded schemes those changes are smoothed over time within the scheme. In unfunded schemes these changes takes place within overall public spending and are thus reported in each year's national accounts.

The real pensions divide

The Institute of Directors are some of the biggest critics of public sector pensions. They talk of pensions apartheid. But top directors are the real pensions winners, and pay themselves much better pensions then their staff.

A recent report from actuarial consultants Lane Clark and Peacock[11] found that Britain's biggest companies (members of the FTSE 100) pay an average of 70 per cent of pay into final salary schemes of top officials. ''An executive could have a pension earning him one thirtieth of his salary for every year of service'' Mark Jackson, one of the authors of the study told the FT[12]. Ordinary workers in DB schemes only get to build up a much smaller eightieth or sixtieth of salary in their pensions each year.

The TUC conducts a regular PensionsWatch survey of directors of a slightly different sample of top companies. The average transfer value in the 102 companies surveyed for the 2008 PensionsWatch for a director's DB pension is £3 million. (The transfer value is an estimate of the cost of providing the pension that has been built up.) For those directors with the greatest entitlements at each company, the average transfer value is £5.2 million.

The average accrued pension was £201,655 a year – £333,664 a year for the highest paid director in each company.

The majority of directors in the 102 companies with DB schemes were able to retire on a full pension at age 60.

3 Can we afford public sector pensions?

Those who favour cutting public sector pensions compete to find the biggest possible number for their future cost. This always results in a frighteningly large number, but this is hardly surprising when you look at what is being calculated.

Pension liabilities are one of the very few bits of public spending that carries firm promises into the future. So while we know that the National Health Service will continue to cost a significant amount of money this year, next year and into the future, precisely how much will be spent on the NHS in future years will be up to tomorrow's politicians. This is why some enemies of public sector pensions dislike them so much. They may dream of shrinking the state through cuts and privatisation, but they cannot avoid honouring the pensions promises already made to staff.

Pension payments can go a long way into the future. A good example is an early pension scheme for those who fought in the US Civil War (1861-1865). The last veteran to receive a civil war pension died in 1956 when he was receiving a pension of $135 a month. But a handful of widows – who married elderly veterans when young - lived into this century and continued to receive pensions until they died.

Every government should monitor the level of future pensions commitments, but the figures have to be treated very carefully. It does not mean very much to express liabilities that will go more than a century into the future as if they were a final reminder bill in red ink that has to be paid within 28 days. But this is what public sector pension critics do when they cite huge numbers for the costs of future pension commitments.

In any case pensions liabilities already built up cannot be avoided without breaking the pensions promise made to scheme members that are almost certainly legally enforceable.

To be fair, both Conservatives and Liberal Democrats have said that they won't attack these accrued benefits (pensions jargon for pensions promises already built up) – although it is unclear whether this applies to the pension age.

But if they honour accrued benefits then they cannot achieve immediate savings. Even if the pension that public servants build up in future is cut back severely, it will take many years before this feeds through into pensions in payment. It is particularly dishonest to suggest that a significant boost to the state retirement pension could be achieved by changes to public sector pensions in the short or medium term.

Public sector pension critics cannot describe meeting these pension promises as unaffordable one minute and promise to pay them the next.

Even if it makes sense to work out the cost of paying more than a century's pensions payouts as if they were a single bill that has to be paid this year, it is very hard to do. Economists use a measure called the discount rate to express the cost of future bills in today's money – it is a special kind of interest rate.

Discount rates are a helpful way of thinking about the costs of projects that will take a few years to complete or comparing alternative projects with different time-scales. But even tiny changes in the discount rate will make a big difference to bills due to be paid many years in the future.

There is considerable disagreement about which discount rate to use for public sector pensions. Those who dislike public sector pensions naturally choose the one that supplies the biggest cost, but eminent economists support much more modest estimates.[13]

Of course it would be irresponsible for policy makers to ignore future pensions promises or not think about whether they are affordable. Yet there is a much better way of asking this, without generating scarily big numbers that don't actually mean very much.

This is to look at the cost of public sector pensions as a likely share of the nation's resources each year into the future.

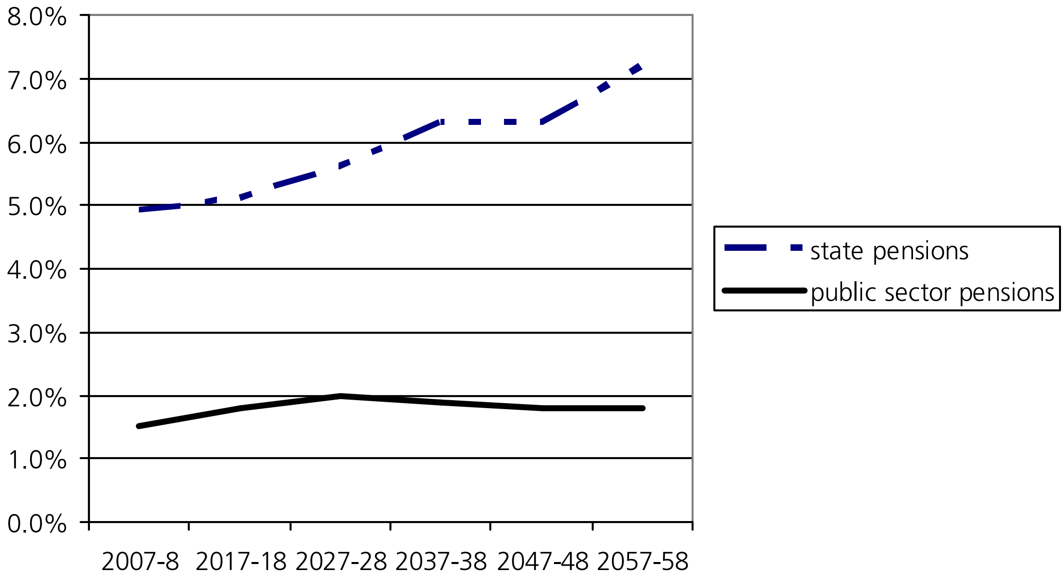
The Treasury regularly do this. "*The long term public finance report: an analysis of fiscal sustainability*[14]" looks at whether the government can afford its future commitments.

This is what it says about public sector pensions:

> "Expenditure on public service pensions is projected to increase from 1.5 per cent of GDP to 2 per cent by 2027-28, remaining just under 2 per cent thereafter."

This is undoubtedly an increase. But as people live longer it is inevitable that we are going to spend more as a society on pensions. We only have to look at the same report's estimates of the future costs of state pensions. The graph[15] uses figures from the report to compare government spending on public sector pensions and state pensions. The costs are shown as a percentage of GDP (the total wealth produced by the country). As can be seen, state pensions cost much more than public sector pensions and are set to steadily increase. (The figure for state pensions includes not just the basic state pension but means-tested benefits and the state second pension as well. Of course if public sector pensions are cut, more people would be eligible for means-tested benefits). Longer life expectancy is not the only reason that state pension spending is set to grow. The government is due to link increases in the basic state pension to earnings in 2012. The link to earnings was broken by the Conservatives in 1979. Since then pensions have been linked to prices instead, with occasionally more generous uplifts.

Future costs of state and public sector pensions as a percentage of GDP



Another big part of the state pension bill comes from providing means-tested benefits – such as pensions credit – to people retiring with little or no pension provided by their previous employers. In other words the tax payer faces increasing bills for subsidising those employers who do not make a proper contribution to staff pensions.

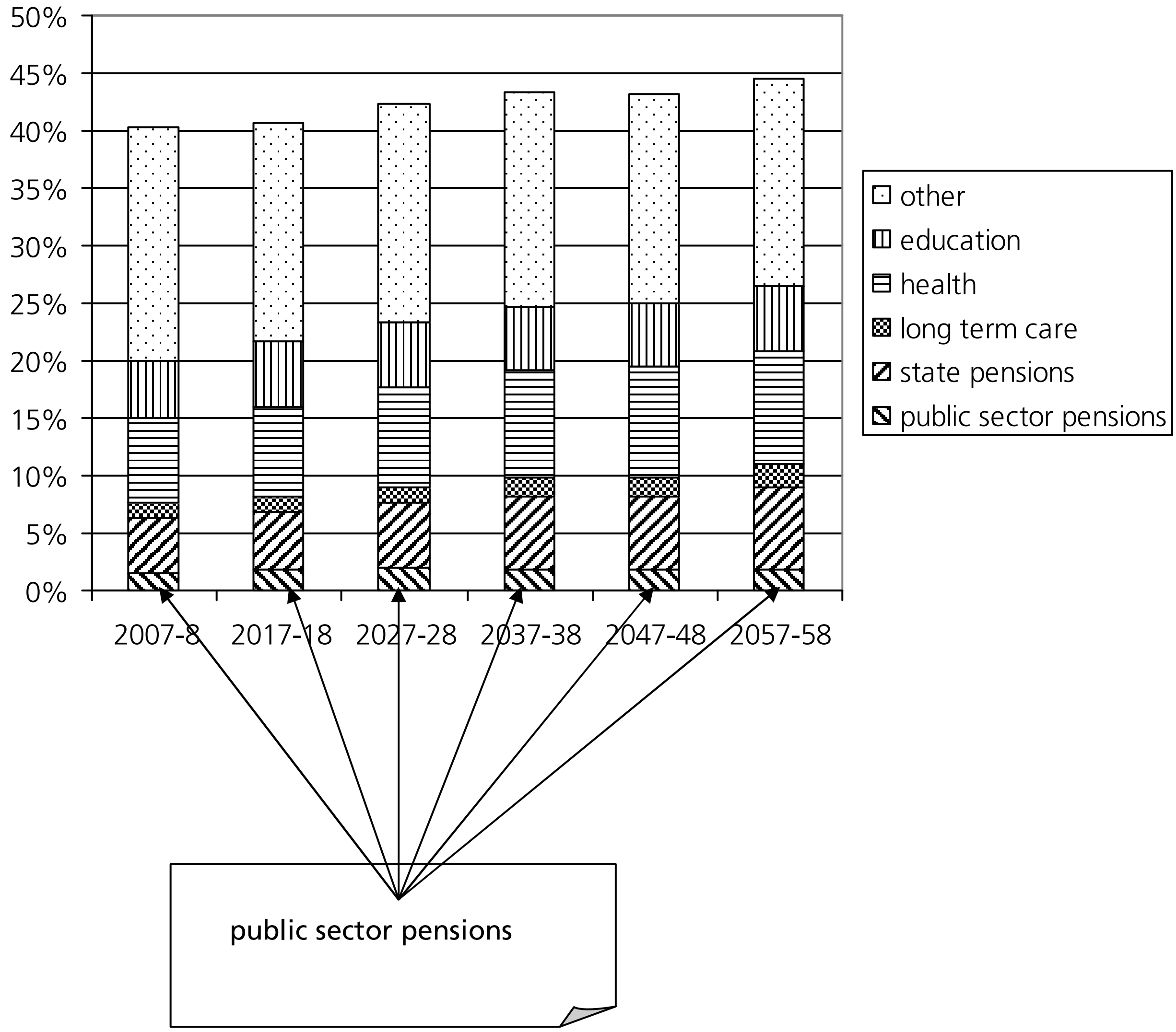
Those campaigning against public sector pensions are fond of asking why tax payers who don't get a decent pension should see some of their tax go towards paying public sector pensions. They never seem to ask why tax payers should pay for means-tested benefits for pensioners who used to work for employers who didn’t provide a pension.

This is why the government is going to make every employer from 2012 contribute to the pensions of their staff. Most employees will be automatically signed up for a pension scheme unless they choose to opt out.

The next graph makes even clearer that the future cost of public sector pensions is affordable. This shows the Treasury's estimates for public spending as a proportion of GDP for the next fifty years. It includes the figures used in the chart above for both state and public sector pensions, but also includes all other public spending with education, health and long term care shown in the graph. Of course these are estimates, and no-one can know what the cost of the health service will be in fifty years time, but they are still a useful way of looking at how the cost of public sector pensions fits in with the rest of public spending.

The bottom part of each column shows the costs of public sector pensions. They are not out of control and unaffordable. Even if the government broke the pensions promises of the millions of people who have built up a public sector pension and stopped all public sector pensions, the graph would not look very different.

Future public spending as a percentage of GDP



"A statistical howler that would make an O-level student blush"

A recent report by the British North-American Committee[16] received much publicity. The Daily Mail said:

"*Gold-plated pensions for civil servants have imposed a colossal £1.2 trillion burden on taxpayers, according to shock new figures.*"[17]

But Lord Lipsey, former deputy editor of the Times and the Chairman of Straight Statistics had this[18] to say about it:

"*The British North-American Committee sounds a solid enough organisation and its document ''The need for transparency in public sector pensions'' sounds staid, even dull. Yet The Guardian headlined the report ''Cost of Public Sector Pensions equal to 85 per cent of GDP, thinktank warns.'' This is spin on a scale worthy of the late Joseph Stalin.*

"*The figure is based on an assessment of the total net liabilities of UK public pensions put at $1,267 billion dollars. It then compares this with Britain 's current GDP to come up with – hey presto! - the 85 per cent figure.*

"*The innocent might think that this means 85 per cent of our GDP in future is going to go to support those getting public sector pensions, leaving just 15 per cent for the rest of us. This is plain rubbish.*

"*The liability to pay public sector pensions is stretched over many, many years – from now until the last existing public sector employees dies. It is a statistical howler that would make an ''O'' level student blush to compare this with the figure for GDP for a single year. To make matters worse, we can safely expect GDP to increase over the years to come (if it does not neither will pensions, reducing the actual liability). So the proportion of present GDP represented by the liabilities is even less relevant. What matters if anything is the proportion of future GDP that they represent.*"

The Tax Payers Alliance is also guilty of presenting misleading figures when they claim that the cost of local government pensions now takes up 25 per cent of everyone's council tax.

The total cost of pension contributions in local government – whose scheme is funded, unlike most public sector schemes – may well be a sum that is mathematically equal to one quarter of the money that councils receive from council tax. But councils have more than one source of income.[19] They also get cash from the business rate and from a range of charges for services.

In fact council tax only makes up 24 pence in every pound of council income, so a simple sum tells us that the cost of pensions is only 6 per cent of council income, which in a labour intensive sector, such as local government, is eminently reasonable. Or to put it another way it assumes that all local government pension costs are only paid out of one source of income – council tax.

The annual cost of pensions

Another – and in some ways more useful - figure that is used to measure the cost of public sector pensions is the ''net public service pensions'' figure that is included in the government's accounts each year.[20] It is the difference between benefits paid out to today's pensioners from unfunded schemes and contributions paid by current staff.

In the current financial year this is estimated to be £4.1 billion or about 0.3 per cent of GDP. But this figure is bound to vary from year to year. This is because it is the difference between two much bigger numbers, which while over time are linked can vary sharply from year to year. On one side of the equation is the income from pension contributions. If contribution rates remain the same, this will depend on public sector wages and levels of employment within the public sector. On the other side of the equation is the level of pensions paid out, which will be linked to prices. The costs of the latter are also dependent on the numbers in retirement.

The factors that will change most from year to year are wages and prices. While they both nearly always go up each year, there can be sharp variations from year to year. Over time earnings tend to go up more than prices (thus delivering an increase in income compared to expenditure if other factors remain equal). But as public servants can testify, there is no guarantee that their wage packet will go up more than the cost of living every year.

If a government were to freeze public sector pay and staff numbers this would have the effect of freezing the income from pension contributions too. While a pay freeze would cut public spending (albeit at the cost of public sector staff living standards and service quality), it would have the perverse effect of making pensions appear much more expensive as contributions would fail to go up that year. This would inevitably produce ''public sector pension costs out of control'' headlines. But the cost of pensions remains entirely predictable and although income from pension contributions would be down, the public sector would spend less overall as the cut in the pay bill from a wages freeze would more than make up the difference.

Similarly increasing the size of the public sector and giving a pay rise in excess of price inflation would reduce the net cost of pensions in payment as income from contributions would rise faster than the cost of pensions in payment.

Other factors can produce big or unexpected changes in the net pension cost. Just as pay can vary from year to year, so can price inflation (RPI) with blips above or below the historic trend.

It is easy to present a number that can sharply vary every year in this way as ''out of control'', but because different factors affect the costs and the income each year this is inevitable, even if over time these changes average out. Public servants do not have to join their pension scheme and it is quite wrong to exclude the income from their contributions. Yet critics of public sector pensions will happily ignore employee contributions one minute when they are looking for the biggest possible number for the cost of pensions, but then take them into account if they want to show the cost varying from year to year.

Because the net annual cost of pensions includes employee and employer contributions it is more useful than simply looking at the cost of pensions in payment. But it still needs to be treated with care as there can be these fluctuations.

This is not just an unfunded pension issue. Funded pensions also face fluctuations from year to year. They can face the same kind of changes in contributions and pension levels as pensions, but in addition have to cope with the volatility of their investments.

The critics of public sector pensions often concentrate their fire on unfunded pensions, yet if the Local Government Pension Scheme was unfunded and included in the net public cost of public sector pensions would actually show a surplus as contributions and investment returns in the LGPS exceeded pension payments across the UK by £6.5 billion in 2007-8.[21]

Working out the costs of public sector pensions is not easy. As we have seen there is more than one way of doing so. Beware any glib claims about the future costs of public sector pensions by their critics as almost certainly the statistics have been chosen to mislead or misinform. The key question is whether they are affordable now and in the future. The answer is yes.

The State second pension

Another point ignored by many is that members of public sector pension schemes will not receive the state second pension.

This is the least understood and most complex part of the state pension system. This is partly because its scope and function has been frequently changed.

It was originally set up as the State Earnings Related Pension (SERPS) in the 1970s with the aim of giving everyone a pension based on their pay on top of the flat rate basic state pension.

But the Conservatives changed it. They not only made it less generous, but individuals were also allowed to opt-out of it and indeed encouraged to do so, with the state putting some money into a private pension instead – (although this has turned out to be a mistake for most people who opted-out as investment returns in their private pensions have delivered worse returns than keeping the money in SERPS).

Labour changed the state second pension again, moving away from its original purpose of providing a pension related to pay to instead giving it the prime purpose of boosting the pensions of the less well-off.

But throughout the history of the state second pension, occupational pension schemes have been able to opt-out of the state second pension as long as they fulfilled minimum standards. Most did – including those in the public sector – as it saved the employer money through lower NI contributions.

This means the state will not have to pay this additional state pension for public servants on top of the basic state retirement pension and their public sector scheme pension. Any real attempt to cost public sector pensions should take this into account.

Taxes subsidise all pensions

Public sector pension critics rarely accept that taxpayers provide a subsidy for private sector pension savers too. Money saved in pensions gets tax relief. In other words if you save some money in a pension scheme, the cost of that to you is subsidised by cutting your tax bill.

The cost of this tax relief is substantial. Using the same methodology[22] as the Pensions Policy Institute but more up to date figures[23], the gross cost of tax relief on pensions in 2007/8 was £37.6 billion or 2.7 per cent of GDP – higher than the cost of paying every public sector pension and almost ten times the net cost of public sector pensions.

The tax system provides relief on contributions made during the savings stage of building up a pension but charges tax on pensions in payment for those with sufficient income. But the tax raised from pensions is around £10 billion a year, leaving a net cost of £27 billion.

While tax relief on pensions is available to every pensions saver (including workers in the public or private sector) and provides a helpful boost to modest earners, the bulk of this tax relief goes to the better off.

This is not just because they tend to save more, but because higher rate tax payers get more tax relief. 60 per cent of the gross tax relief – more than £22 billion a year – goes to higher rate tax-payers (or those who would be higher rate tax payers if it wasn't for this relief).[24]

A quarter of tax relief– nearly £10 billion a year – goes to the one per cent of the population who earn more than £150,000[25] - though that will change when the Chancellor's 2009 budget proposal to limit tax relief on incomes above £150,000 to 20 per cent comes into force.

Of course public servants also benefit from tax relief on their pension contributions, but very few are in this super-rich bracket. Only 40 per cent of tax relief goes to the very many more pensions savers – including the big majority of public sector staff – who do not pay higher rate tax.

Many public sector pension critics say that it is unfair that private sector employees with no pension are subsidising public sector pensioners – most of whom are receiving modest pensions after doing vital jobs. Yet (with the exception of the Liberal Democrats) the critics have not proposed any limits on tax relief on pensions to the super-rich. Indeed the TaxPayers' Alliance attacked the proposals in the last budget to limit tax relief on pensions for top earners.[26]

The net cost of paying unfunded public sector pensions this year (2009/10) is projected to be a little under £4 billion pounds[27]. The cost of providing tax relief to the one per cent of those earning more than £150,000 is more than twice as much. The cost of providing tax relief to all higher rate taxpayers is more than five times as much.

One of the standard arguments from those who attack public sector pensions is to ask why modest tax-payers who do not have a pension should pay for the pensions of public sector staff. A much better question is whether tax-payers are happy to spend £2.50 on reducing the tax bill of the top one per cent of the population for every pound going towards providing a modest pension to retired nurses, teachers and all the other public sector staff who make a huge contribution to society.

Turning unfunded pension schemes into DC schemes

Many critics of public sector pensions say they should be replaced by defined contribution schemes – as has happened in much of the private sector.

But because most public sector schemes are pay-as-you-go unfunded schemes, this would only save money after many years. For decades taxpayers would have to fund two pension schemes at the same time. Tax payers would have to pay pensions due under the current unfunded schemes and would also have to pay sufficient employer contribution in the new funds to pay future pensions due under any new DC scheme.

This is such an important point it is worth explaining in a bit more detail and recapping some of the differences between unfunded public sector and private sector schemes.

- In unfunded schemes, public servants' pensions are paid directly out of public funds. Current employee pension contributions also get paid into public funds, and thus help pay for pensions in payment. There is no separate pension fund built up to pay these pensions. Even if unfunded schemes ended tomorrow, pensions would still be paid for decades to come. However they would not get any further contributions from public sector employees to help pay them, thus making them more expensive.
- Any new defined contribution scheme would be based on building up a new fund separate from the general public finances. Employee and employer contributions would no longer help meet pension commitments already made, but instead would have to be put towards paying pensions in the future.

Tax payers would have to pay out on pensions promises already made, without any help from current employee contributions, *and* pay enough to fund future pensions commitments built up under the new scheme. Taxes would have to fund today's and tomorrow's pensions at the same time. You would only start to save money when enough people with any pension built up under unfunded arrangements have died. But before that date it would be vastly expensive to fund both types of pension. In other words, tax payers would have to pay for both today's pensions and tomorrow's pensions at the same time – a double pensions whammy.

Replacing public sector unfunded DB schemes with new DC schemes would not carry these costs, but there would be unintended consequences across the economy. The assets left with the closed DB scheme would be switched to safer and more conservative investments, thus depriving industry of investment funds.

4 How big are public sector pensions?

Two claims are persistently made about public sector pensions by their critics. They pay out fat cat pensions and that they have not changed in response to people living longer. Neither is true.

Let us first look at pensions in payment.

The mean average public sector pension is £7,000 but the majority of public sector pensioners have pensions of less than £5,000.

The armed forces regularly risk life and limb in the service of their country. There are approximately 257,000 armed forces pensions currently in payment, and 197,000 – over three-quarters – of these pensions in payment are for amounts less than £10,000 a year.

The average civil service pension in payment is £5,400 a year with a quarter of civil service pensions in payment being less than £2,000 a year. The average pension in local government is even lower at £3,800. Even in the Teachers' Pension Scheme, where one might expect longer average tenure and higher average pay, 53 per cent of pensions in payment are for amounts less than £10,000 a year. Among teachers with less than 20 years' service, the average pension awarded in 2006-2007 was £3,750 a year.

Some care needs to be taken when looking at the size of the biggest pensions paid. The big difference between top pensions in the private sector and the public sector is that senior public servants – unlike many boardrooms – do not have special pension schemes.[28] A chief constable is in the same scheme as a constable. It takes both long service and a high final salary to build up a big public sector pension.

For example just 1.36 per cent of the pensions (fewer than 1 in 70) being paid in the Forces Pension scheme are for amounts of £30,000 a year or greater. In the Teachers' Pension Scheme, 0.64 per cent of the pensions currently in payment (fewer than 1 in 150) are for amounts of £30,000 a year or greater.

Compare this to Sir Fred Goodwin. Even after agreeing to cut his pension, it is still £345,000 a year. This is on top of a tax free lump sum of £2.7 million. He retired at 50 after only ten years service with RBS.

The TUC's 2008 PensionsWatch[29] showed just how generous the pensions of Britain's top directors will be. The table shows the transfer value of the most valuable DB pensions among top directors. The transfer value is a measure of the value of the DB pensions promises built up in a scheme. It is the charge another pension scheme would levy to take on those commitments if the pension was transferred to them.

Company	Transfer value of biggest director's pension
BP	£21,552,000
Unilever	£15,137,001
Royal Dutch Shell	£13,367,170
Daily Mail	£12,903,000
HSBC	£12,780,000

Some public sector schemes have graduated contributions so that better paid staff pay a bigger proportion of their pay into the scheme. This is the case in the Local Government scheme, where member contributions vary from 5.5 per cent for earnings under £12,600 and 7.5 per cent for those in excess of £78,500. There is a proposal for an even higher rate for those earning more than £100,000. In the NHS scheme contributions range from 5.0 per cent for pay under £20,709 and 8.5 per cent for earnings over £107,847. (All these figures are for full time equivalent earnings).

Any attempt to create 'savings' from public service pensions will have a greater impact on women pensioners, who have lower average pensions than men, due to their lower average salary levels and service records. The average pension in payment is £1,600 to women in the local government pension scheme. In the Teachers' Pension Scheme, 65 per cent of pensions currently in payment for women are for amounts less than £10,000 a year.

Average pensions for women pensioners in public service schemes are not high, and in many cases do not lift them above means-tested benefits. If these levels of pension are too high, public sector pensions critics should tell us what the 'correct' level of pension should be.

Are public sector pensions unreformed?

Critics allege that public sector pensions have not changed. But negotiations have concluded in almost every public sector pension scheme, making similar changes to those agreed by private sector DB schemes to face up to greater longevity.

In 2002 the government set out proposals for change in a green paper *Simplicity, security and choice: Working and saving for retirement (Cm 5677).* The main objectives were to control future costs and to raise the normal pension age (NPA). The normal pension age is the earliest age at which members can retire on a full pension, though it is not a compulsory retirement age. Some people retire earlier on a reduced pension, and some work beyond the NPA and defer taking their pension.

This has produced the following changes to NPA:

- The normal pension age for new joiners in the teachers', NHS and civil service schemes is now 65, up from 60.

- The normal retirement age for members of the 2006 Fire Fighters pension scheme is 60, up from 55.
- The normal pension age in the local government pension scheme remains at 65. However, the 'rule of 85', which allowed local government workers to retire at 60 without employer consent if their combined age and years of pensionable service equalled 85 or more was abolished from 1 October 2006, though there is some protection for existing members.
- The standard retirement age in the new Police scheme remains at 55, but there is no longer the option to retire at 50 with 25 years' service.

In addition the Civil Service scheme moved from a final salary scheme to a career average scheme for new members. In most DB schemes the pension is worked out by looking at the salary the pensioner earned in the years immediately before they retired or left the scheme. In a career average scheme the pension takes into account pay throughout service with the employer.

Together with other changes these moves will reduce the costs of public service pensions and indeed reduce the value of the pension to new entrants from 24 per cent to 21 per cent.[30]

In many schemes existing members are now being given the opportunity to move to the scheme for new members with a higher pension age in return for somewhat better benefits.

One of the most common accusations against public sector pensions is that they are out of control. But in fact changes negotiated to most public sector schemes include cost-sharing and cost-capping arrangements. These agreements mean that unanticipated future increases in costs – such as people living longer than expected – will be shared between public sector employers and the members of the schemes. Before public sector employers would have had to pick up the whole cost. The agreements could limit employer contributions in future, particularly as employer contributions will be subject to an overall cap.

As the independent Pensions Policy Institute[31] say:

> "For example, if estimates of life expectancy increase by 1 year more than expected, this could cost employers in these schemes an extra £200 million a year in the absence of the cost sharing and cost capping agreements. Now the extra costs may be met almost entirely by the members of these schemes."

Critics of public sector pensions who say that public sector pensions are unreformed conveniently ignore this fundamental innovation in pensions funding.

Do public sector pensions make up for lower pay?

It is often said that good pensions in the public sector make up for poorer pay than the private sector. But those attacking public sector pensions say that this is no longer true. Here's Paul Farrow recently in the Daily Telegraph:

> "There is the argument that public sector workers are paid lower wages in exchange for security and a decent pension. Yet in terms of average salaries, it is private sector employees who are worse off. According to the Office for National Statistics, the average full-time wage in the public sector was £523 per week in April 2008 compared with the average wage of £460 in the private sector."[32]

And Conservative MP Mark Field in the Daily Mail:

> "Pensions are vital to everyone's aspirations. But our expectations - especially in the public sector - must be made more realistic in the light of this country's financial plight. Now that public sector workers are paid on a par and often above private sector equivalent levels, the time when final salary schemes were seen as compensation for low levels of public sector pay are well and truly over."[33]

But the truth today is a little more complicated. There is a big range of jobs in the private and public sectors. Simply comparing averages does not tell us very much about the differences between the two sectors.

The first thing to stress is that there are different types of jobs in the public and private sectors. While there are many low paid jobs in the public sector, there are very few that pay the minimum wage.

Some people in the public sector are well paid by most peoples' standards, but none are on the kind of bonuses now returning to the City or the huge salaries paid in bank boardrooms.

In other words there is a bigger gap between top and bottom in the private sector.

But there has also been a change in the types of job done in the public and private sectors. Under the Conservative government elected in 1979, the public sector was expected to contract out services. Inevitably this has affected many more low paid jobs such as cleaners, canteen and care staff. Transferring these low paid jobs to the private sector makes average pay lower in the private sector and higher in the public sector. Average pay in the public sector increases even if no-one gets a pay rise when you remove the lowest paid jobs from the public sector.

But the critics of public sector pensions try to imply that higher average pay in the public sector is something new. It isn't. In 1997 when the Conservatives left office, the median weekly pay was £349 a week in the public sector compared to £309 in the private sector – 12.9 per cent higher[34] – not that much different from the 13.4 per cent difference in 2008.

The only sensible way to compare pay in the public and private sector is to ask whether someone doing the same job in the public sector gets more or less than someone doing the same job in the private sector.

This is not an easy question to answer as jobs are rarely identical, and there are few obvious statistics. But one estimate [35] shows that:

- Highly skilled workers in the public sector earn 5.5 per cent **less** than they do in the private sector.

- Unskilled workers in the public sector earn 7.2 per cent **more** than they do in the private sector.

This is not surprising. It shows that at the top, people doing well paid jobs in the public sector could earn more by transferring to the private sector. The traditional defence that public service leads to lower pay is true for better paid staff.

But at the bottom end of the scale the public sector is – as most people would expect – a better employer than the worst parts of the private sector. The public sector usually pays more than the minimum wage and provides benefits such as sick pay, a pension and holidays above the legal minimum. Low paid workers on average do better in the public sector.

Again we stress this is an average. It is not true for everyone. There are many low paid people in the public sector who could earn more in the private sector - including many who make a positive choice to serve the public fully aware they could earn more in a less fulfilling private sector job. Taking away or cutting their pension however could drive them into another job.

Not surprisingly it is among the low paid that we find the biggest pension gap. Only one in five private sector employees earning between £100 and £200 has an employer sponsored pension, compared to 70 per cent in the public sector.[36]

Of course these won't be fat cat pensions. They will only produce a modest income in retirement, but this is the real gap between public and private. If you go up the income scale the gap narrows. More than 60 per cent of private sector employees earning more than £600 a week are members of an employer run pension scheme.

So while we don't use the language of apartheid, there are two big pensions gaps:

- There is a big gap between low paid private and public sector employees. Private sector employers of low paid workers rarely provide a pension. Public sector employers do. The logic of many of the critics of public sector pensions is that the public sector should not provide pensions to low paid staff - and that only the rich should have pensions.
- But the biggest gap is between everyone at work and the real gold-plated pensions in Britain's boardrooms. Not only are top directors getting huge payments into their pensions, but everyone else is subsidising this through the enormous amount of tax relief paid on the pensions savings of the super-rich, which will still be substantial even after the very welcome changes recently made by the Chancellor.

We have been here before

When a Conservative government was elected in 1979 they too said that they wanted to cut the cost of public sector pensions. The scare in those days was that the country could not afford to pay pensions linked to inflation (which of course was much higher then) They set up an inquiry under businessman Sir Bernard Scott – a former chairman of Lucas Industries and deputy chairman of Lloyds Bank. This reported in 1981. He concluded that there was nothing wrong with defined benefit schemes producing index-linked pensions if contributions were set at the right level. Rather than recommend that the public sector should abandon decent pensions, he said the private sector should follow the public sector.

This is how a leading pensions academic describes the report:

"It concluded that, since "it is a highly desirable social objective that the standards of living of those in retirement should be protected", and since "there is no doubt that the occupational pensions of the vast majority of public sector employees are superior to the schemes in which nearly all private sector employees find themselves" it could see nothing wrong with the principle of fully indexed pensions being extended to the private sector (indeed, "the feeling of injustice so widely held in the private sector must be recognised")" [37]

Unions would argue this today too. And despite the controversy whipped up about public sector pensions in the run up to the report, the issue went away for more than twenty years as public sector pensions continued to be affordable.

Conclusion – time to level up

Providing decent pensions is not cheap. Much of the cost of public services comes from employing the people who deliver them. But society would be much poorer, less safe and all together less civilised without good public services.

It's not just schools and hospitals, the police, armed services and fire-fighters who provide a vital part of the glue that holds society together. There are thousands of dedicated public servants in not very glamorous jobs who we might not notice but would soon miss if they were not there.

Society needs the inspectors who keep meat safe in abattoirs, the driving test examiners, the forensic scientists, the job centre plus staff who help the unemployed get new jobs, those who collect the taxes that pay for all the other services and thousands of other staff doing equally vital if unsung jobs.

Providing them all with pensions does require significant sums of public money, just as it does to pay them their wages every month. But the share of national wealth this will take is not set to get out of control and is eminently affordable.

Pensions are not just a cost. Decent pensions help to recruit and retain staff. We may be suffering from the worst recession in a generation at present, but recruiting good staff and hanging on to them has always been a challenge in parts of the public sector.

Public sector jobs – contrary to some of the propaganda from those who want to shrink the state – are not cushy. Many of the jobs most subject to violence are in the public sector. There is much working of non-standard hours as the health or emergency services cannot shut down at night or the weekend. The public service ethos – the chance to help fellow citizens and contribute to social cohesion – motivates many people in the public sector and helps keep them in vital jobs when they could earn more or have easier jobs elsewhere.

Pensions reward long-term commitment and loyalty in a way that pay does not. That is what we want from public sector staff. It takes time - and does not come cheap - to train a teacher, nurse or doctor. We want them to make a life-long commitment to working to provide excellent public services. A decent pension is the best way to do this.

High quality public services are a crucial ingredient in a civilised society. Decent staff with proper rewards – including pensions – is part of the price we pay to make the UK a decent place to live and work.

But the critics are right to say that it is unfair that public sector staff get decent pensions while a growing proportion of private sector staff do not. But to use a cliché – two wrongs don't make a right. The real problem is not in the public but the private sector.

At least from 2012 employers will face a new duty to enrol their staff in a pension scheme, and make contributions to their pension, unless the staff member opts out. This is a very significant advance as it is the first time that employers have been compelled to contribute to staff pensions in this way.

But it is only a start. The contribution rates are modest, and are only payable on a band of earnings.

The real challenge is to build on the new 2012 system and turn it into a decent pension system that can ensure everyone at work builds up a reasonable retirement income.

The solution to the public sector pensions ''problem'' is decent pensions for all.

Let us give the last word to the influential *Pensions Week* magazine. This is what a recent editorial[38] said:

> **Good pensions bludgeoned by stats**
>
> Public sector employees are lazy, overpaid and receive unaffordable gold-plated pensions. It's the view of right-wing think-tanks and an impression gaining currency in newsprint and online.
>
> David Cameron has already let slip that he'd prefer these workers to make do with a vastly inferior defined contribution pension, and even the sainted Vince Cable maintains that public sector pensions are ''completely out of control''. But the claim that really gets the spittle flying from the lips of the detractors is that pensions make up a quarter of council taxes. Quelle horreur! Well no, actually.
>
> Council tax accounts for only 24% of expenditure by town halls and the rest comes from business rates and Whitehall. The actual figure is a quarter of that, way down at 6%, which is comparable to the private sector.
>
> The British North-American Committee has also had a go, declaring that public sector pension liabilities constitute 85% of GDP. Of course, this is nonsense, calculated by rolling up liabilities and describing them as a debt owed in a single year, and it was promptly rubbished by Straight Statistics, a pressure group that campaigns against the misuse of data.
>
> Amazingly, the rest of us are not left with just 15% to live on while town hall dinner ladies live the life of Riley.
>
> The problem isn't public sector pensions. The real problem is the devastation of private sector provision and the abject failure of the three main political parties and the industry to offer any meaningful solution.

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