date: 30 July 2010

TUC evidence to the Independent Public Service Pensions Commission

Submission in response to the initial call for evidence

Executive Summary

1. Introduction

The TUC is pleased to be able to assist the Commission in its work and we support the stated objective of establishing a sustainable future for public service pensions. Circumstances can change and a genuinely independent review has the potential to shed some light on the often heated debate about public service pensions. However, extensive reforms have already been negotiated to ensure the future affordability and sustainability of public service pensions. Any process of change should be based on detailed evidence and be the subject of negotiation and agreement between the appropriate trade unions and the Government: not the outcome of arbitrary and unjustified prejudice against the public sector.

2. Background

The TUC shares the concern about the widening gap between pension provision in the public services and that in the private sector, but this should be addressed by improving provision in the private sector rather than cutbacks where pension provision is adequate. The TUC is pleased to see some recognition by the Government of the need for the good occupational provision and emphasises that this is not consistent with an assault on public sector provision, driven solely by the aim of cutting public expenditure or dragging pension provision down to the lowest common denominator. The TUC hopes, therefore, that the Commission will adopt the aim of improving pension provision across the workforce as the basis for its considerations.

3. Identifying the problem and establishing the framework

The TUC's submission looks at the following issues that relate to the longer term work of the Commission:

- how the cost of public service pension provision should properly be assessed;
- the steps that have already been taken to adapt such provision to changing circumstances; and
- some initial considerations regarding possible changes to the future framework for public service pensions.

The cost of public service pensions

The Government's own figures for projected expenditure on public service pensions show that it is neither an unsupportable burden on future generations, nor that it is out of control.

When looking at the cost of providing public service pensions, the TUC urges the Commission to disregard some irrelevant figures that are often introduced in this context, including the cost for the individual (as if they were to save up for the pension on their own account) and accounting figures (which represent a notional provision, not a cost). The figures that should be used - based on the need for stability and consistency - should be on the following bases, making the important distinction between funded and unfunded schemes:

- the cost of unfunded schemes should be assessed using the Social Time Preference Discount Rate set out in the Treasury's Green Book; and
- the cost of the funded scheme (Local Government Pension Scheme) should take account of its specific circumstances.

The steps that have already been taken

The TUC believes that the steps that have already been taken through negotiations to adapt public service schemes to new circumstances are sufficient. All the 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, detailed cost sharing arrangements discussed below have been introduced to the three main unfunded schemes (NHS, Teachers' and Civil Service) and are in the final stage of implementation in the LGPS. These limit the level and volatility of future benefit costs to employers and the taxpayer.

The future framework

The TUC believes that the existing framework for public service pensions is broadly correct and that there is no need for further changes in addition to those that will arise under the existing cap and share arrangements. However, given that the Commission has asked for views on "... the objectives that should guide public service pensions in future", this submission sets out some considerations that it urges the Commission to keep in mind. This includes the role of "comparability" in setting the appropriate level of public service pensions; some of the implications of adopting alternative benefit structures; the scope for improvements in governance and disclosure of public service pension arrangements; and the crucial role for full, open negotiations with the relevant trade unions in making any changes.

4. Savings on public service pensions within the spending review period

The TUC is opposed to arbitrarily imposed savings on public service pensions. Any changes in public service pension schemes need to be agreed through collective bargaining, as has been seen to work successfully in the past, rather than imposed by the Government. The TUC is therefore adamantly opposed to any arbitrary and precipitate increase in member contributions. Such an increase should certainly not be proposed in advance of a proper comparability exercise, if this were to be the Commission's approach, as this lies outside the Commission's terms of reference.

5 .Conclusions

The TUC's main conclusions can be summarised as follows:

i. The TUC shares the concern about the widening gap between pension provision in the public services and that in the private sector but this should be addressed by improving provision in the private sector, rather than cuts to public service provision.

ii. The Government's own figures for the projected expenditure on public service pensions show that it is neither an unsupportable burden on future generations, nor that it is out of control.

iii. The market based cost to a private sector employer or an individual of securing a given pension is not an appropriate basis for quantifying the cost of that pension to the Government.

iv. The correct basis for quantifying the pension liabilities that accrue in respect of unfunded public service pensions is that set out in the Treasury's Green Book and the use of a discount rate of 3.5per cent is sound.

v. The correct basis for quantifying the value of funded public service pensions, such as the LGPS, is on a scheme specific basis.

vi. The changes that have already been made to public service pension schemes, including the cap and share arrangements, have produced significant savings and will provide a sustainable and affordable basis for their future.

vii. Some of the suggestions for changes to the framework for public service pension provision are counterproductive, as they would lead to increases in public expenditure and reductions in the overall level of pension provision, neither of which are in line with Government policies.

viii. Any changes in public service pension schemes must be agreed through collective bargaining, as has been seen to work successfully in the past, rather than arbitrarily imposed by the Government.

ix. The TUC is adamantly opposed to any arbitrary increase in member contributions, especially in advance of a proper comparability exercise, as this lies outside the Commissions terms of reference.

Section one

Introduction

The TUC represents 60 affiliated trade unions with over six million members. We welcome the opportunity to submit evidence and views that will assist the Commission in its review of current pension provision for public service employees and the objectives that should guide such provision in future.

The TUC notes that the stated intention, at this stage of the Commission's work, is to identify the problem with public service pensions and to establish a framework for possible solutions. There will subsequently be a second stage, when views will be sought on what alternative pension provision should look like. This immediately raises some concern on the part of the TUC since it suggests that it has been taken for granted by Government in setting the terms of reference that first, there is a material problem; and secondly, because of the problem, alternative provision will be required.

The TUC wishes to emphasise that while it has no objection in principle to having a review of public service pensions, it would be entirely wrong for the Government to pre-empt the process of the Independent Commission's review at this early stage by adopting any conclusions in advance of any agreement about the nature of what, if any, problems confront public service pensions as part of the work of the Commission. Such conclusions need to be argued and supported by the weight of the evidence. The first part of this submission therefore looks at the background to the review, to highlight our concern that the Government, for its part, has already reached some decisions about changes it wishes to make, the implementation of which would be seriously detrimental to our members.

The second part of the submission considers what might be regarded as the big picture, looking in particular at the cost of public service pension provision and the steps that have already been taken to adapt such provision to changing circumstances. In broad terms, the TUC contends that the arrangements already in place, in particular the agreement to "share and cap" increases in cost, are an appropriate and proportionate response to the changing nature of public service pension provision.

To the extent that there are growing disparities between public and private pension provision, the appropriate response is to support measures that will lead to improvements in private provision, rather than cutbacks in public service pensions. The TUC believes that this is in line with the Government's responsibility to act as a good employer and wider policy objectives aimed at securing decent incomes in retirement for all.

If the aim of pension policy in both the public and private sector is to provide everyone with the opportunity of accruing an adequate pension, there is nothing that is excessive or unwarranted about the current level of public service pensions. To the extent that good schemes remain in the private sector they are still on a par with the main public service schemes. This is why figures from the National Audit Office (NAO) in its March 2010 report *The cost of public service pensions* demonstrate that public sector pensions are actually modest and affordable:

- Employee contributions to these schemes have increased faster (56per cent) than pension payments (38per cent) since 2000.
- There has only been a 2per cent real terms increase in the average pension in payment since 2000 – the average teachers' pension has actually fallen by 4per cent over that period and the NHS average pension is unchanged.
- The vast majority of pensions in payment are modest. Most pensions paid in both the NHS and civil service are below £110 a week. A quarter of NHS pensions are less than £40 a week and a quarter of civil service pensions are less than £60 a week.
- Fewer than 0.2per cent of teacher pensioners, 1.8per cent of civil service pensioners and 2.5per cent of NHS pensioners get pensions of more than £40,000.
- In addition, although this was not covered by the NAO report, Audit Commission data shows that half of all Local Government Pension Scheme pensions in payment are less than £3,000 a year[1]

The TUC concludes that the real problem that needs to be addressed is that of inadequate pension provision in the private sector and the measures that need to be taken should be aimed at correcting that, rather than cutting back where provision is adequate. The reforms to workplace pensions from 2012 that flow from the recommendations of the Pensions Commission, and the subsequent Pensions Acts 2007 and 2008, are a move in the right direction. The concepts of auto-enrolment for all workers and employer pension contributions are vital to improving pension provision in the UK. However, it is clear that much more

[1] Audit Commission July 2010

needs to be done if the kind of support that employers once commonly gave to pensions is to become universal, and for everyone to have a dignified retirement.

The third part of the submission considers the Government's request that the Commission should consider the scope for savings on public service pensions within the spending review period. The TUC's conclusion is that any such proposal would be precipitate and unfair, if it goes beyond the arrangements to limit the Government's pension costs that are already in place, particularly at a time when earnings in the public sector will be subject to severe restraint.

The submission concludes with a summary of the main points that the TUC considers that the Commission should have in mind when considering the need for and the nature of any further changes in public service pension provision.

The TUC is pleased to be able to assist the Commission in its work as it supports the stated objective of establishing a sustainable future for public service pensions. The general approach of the TUC is based on a recognition that circumstances can change. But any process of change should be based on detailed evidence, scheme-specific and the subject of negotiation and agreement between the appropriate trade unions and the Government: not the outcome of arbitrary and unjustified prejudice against the public sector. The approach of the trade union movement over the last ten years, during which significant change has been agreed, demonstrates that it is possible to establish a consensus on public service pensions that will be both sustainable and affordable. The TUC hopes, therefore, that this submission will help to dispel the many myths that surround the issue.

Section two

Background

As mentioned in the introduction to this submission, the TUC has some serious concerns about the process of the review because it appears that the Government has already made up its mind on some of the key issues that are to be considered by the Commission. This is not in any way to impugn the integrity of the review process, and we have welcomed the Commission's assurances of independence.

Much of the media debate has been characterised by ill-informed and exaggerated claims about public service pensions. A key focus of parts of the press has been the growing gap between public and private sector pensions, although much of the evidence about this gap is either general in the extreme or anecdotal, with few detailed figures that quantify the overall extent of this "gap". One of the Commission's first tasks, therefore, should be to establish a more solid statistical backing for the extent and the direction of pension developments in the private sector, in order to provide a solid foundation for the Commission's work as it goes forward.

The TUC shares the concern that has been expressed about the growing disparity between public and private sector provision. It should be understood, however, that this is caused by the employer retreat from the provision of decent pensions in the private sector. It would therefore be wrong to conclude that the answer to the discrepancy is to level down public service pensions. We hope that the Commission will reject simplistic calls for public sector workers to "share the pain" and for public service pensions to be cut to the inadequate level found in the private sector. Unions seek to defend public service pensions but not as a special case. The aim of public policy must be for everyone at work to look forward to an adequate pension when they retire.

The TUC's concern that the Government has already made up its mind is given substance by a series of statements by leading members of the present Government, going back over the last two years. For example there have been the following statements:

> David Cameron MP, Prime Minister *"My vision over time is to move increasingly towards defined-contribution rather than final-salary*

schemes" for employees in the public sector. "We have got to end the apartheid in pensions."[2] – reported in www.dailymail.co.uk, dated 28 November 2008

George Osborne MP, Chancellor of the Exchequer *"We need to do something about the spiralling costs of public sector pensions"*[3] – reported in www.guardian.co.uk, dated 22 June 2010

Nick Clegg MP, Deputy Prime Minister *"So can we really ask them to keep paying their taxes into unreformed gold-plated public sector pension pots? It's not just unfair; it's not affordable."*[4] *Reported in* www.news.bbc.co.uk, *dated 15 June 2010*

Vince Cable MP, Secretary of State for Business, Innovation and Skills *"Spending on public sector pensions is completely out of control"*.[5] – reported in www.publicservice.co.uk, dated 28 November 2008

Further grounds for concern can be found in the Liberal Democrat manifesto for the 2010 election. On the one hand this foreshadows the current review, with the promise of "*... an independent review to agree a settlement that is fair for all taxpayers as well as for public servants.*" So far, so acceptable. Unfortunately, in another section the manifesto goes on to say that there should be a Comprehensive Spending Review that "*... will focus particularly on savings that can be made across Government – such as on pay, public sector pensions, and ...*" Given these comments there is clearly appearance concern that the Government's approach, like that of the Queen of Hearts in Alice in Wonderland, is 'Sentence first — verdict afterwards'.

None of this is necessarily fatal to the work of the Commission. To this end, the TUC welcomes the Commission's assurance of independence and urges the Commission to reach its own verdict on the need for and form of any changes to public service pension provision. In any event, the TUC welcomes the opportunity to use the review to make the strongest possible argument in favour of the provision of decent retirement incomes for all and not just workers in the public sector.

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[2] http://www.dailymail.co.uk/news/article-1089956/David-Cameron-pledges-end-pensions-apartheid-public-sector-retirement-costs-rocket.html (5 July 2010)
[3] http://www.guardian.co.uk/uk/2010/jun/22/budget-public-sector-cuts-pay (6 July 2010)
[4] http://news.bbc.co.uk/1/hi/politics/10305817.stm (2 July 2010)
[5] http://www.publicservice.co.uk/news_story.asp?id=7860 (5 July 2010)

The TUC is therefore pleased to see some recognition by the Government of the need for the good occupational provision. The Conservative Party Manifesto for the 2010 election commits a Conservative Government to *"re-invigorating occupational pensions*". Subsequently David Cameron stated in a televised public question and answer session, after he became Prime Minister, that, *"We want to have good pensions in the public sector"*[6]. Neither of these statements is consistent with an ideologically based assault on public sector provision, driven solely by the aim of cutting public expenditure or dragging pension provision down to the lowest common denominator. The TUC hopes, therefore, that the Commission will adopt these objectives that have been set out on behalf of the Government as the basis for its considerations.

The work of the independent Commission provides an interesting echo of the work of the Committee on the Value of Pensions, popularly referred to as the Scott Committee, which reported in 1981 on increases in public service pensions[7]. The Committee was appointed by the newly elected Conservative Government against the background of concern about the contrast between public service pension schemes with index-linked pension increases and private sector schemes with no requirement for any pension increases. The common expectation was that the Committee would recommend limits on the increases in public service pensions. In the event, however, the Committee decided, in effect, that as far as possible all schemes, both public and private, should provide pension increases. To this end, it recommended that the Government should issue index-linked bonds and this led directly to their introduction in 1981. Given this precedent, the TUC urges the Commission to focus its work on how to ensure adequate pensions for all, rather than looking at ways of reducing standards of provision.

[6] http://www.bbc.co.uk/blogs/nickrobinson/2010/06/cameron_and_cle.html (2 July 2010)
[7] Inquiry into the value of Pensions, Cmnd 8147, 1981

Section three

Identifying the problem and establishing the framework

This section deals with the 'big picture', within which the future of public service pensions should be assessed. This covers, in turn, the following topics:

- how the cost of public service pension provision should properly be assessed;
- the steps that have already been taken to adapt such provision to changing circumstances; and
- Some initial considerations regarding possible changes to the future framework for public service pensions.

1. Assessing the cost of public service pensions

The TUC understands that the Commission, as part of the initial stage of its review, wishes to establish greater clarity about the numbers. There are two separate sets of figures relating to public service pensions that need to be looked at, as follows:

- first, there is the cost that is expected to arise in terms of expenditure on benefits and income from contributions; and
- secondly, there is the cost in terms of the liabilities that are being assumed from year to year in respect of current public service employees.

These are dealt with in turn below, with a focus on the unfunded schemes.

Projections of public expenditure and income: unfunded schemes

As far as public expenditure is concerned, there are already figures that are readily available and are not, as far as the TUC is aware, subject to any real dispute. These are set out in the Government's normal projections of expenditure, which have now been endorsed by the Office for Budget Responsibility (OBR). These figures, as demonstrated below, make it clear that there is no substance to the oft-made claim that expenditure on public service pensions is "out of control", either in the short or the longer-term. Closely associated with such claims is the widespread practice when discussing public service pensions for commentators to produce "big scary numbers" that are intended to pre-empt debate, rather than to illuminate discussions. The relevant figures are those in the Government's projections. As shown below, these make it clear that the anticipated expenditure on public service pensions - when looked at in context - will not increase substantially, does not represent an unsupportable burden, and is not out of control.

It will be understood that public sector pension liabilities go a long way into the future. Young people at work today building up a public sector pension could well live for another eighty years. So if you estimate the costs of all public service pensions for decades into the future and then present it as a bill that has to be paid immediately, it is hardly surprising that you end up with a frighteningly big number. As one example among many, there is the figure produced by an organisation called the British North America Committee in a report[8] in June 2009 stating that the cost of public service pensions was 85per cent of GDP (the total wealth produced by the country each year). Its press release stated:

> *"Public sector pension liabilities are £1,177 billion, about £20,000 for every person in the UK, equivalent to 85per cent of GDP"*

Even leaving on one side arguments about the "false precision" of the basis upon which these particular figures have been calculated[9], they mean little in practice and are certainly not a basis for rational decision making. They represent just another attempt to intimidate by working out the total cost of public service pensions going for decades into the future and expressing it as if it all had to be paid in one go, rather than over the decades the pensions are in payment. This is what David Lipsey, the chairman of Straight Statistics – a pressure group that campaigns against the misuse of statistics – said about this report[10]:

> *"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 bowler that would make an "O" level student*

[8] http://www.bnac.org/files/BNAC%20Public%20sector%20pensions%20BN49%20-%208%20June%2009.pdf

[9] For comments on the basis adopted in this and similar exercises, see the item "public pensions" in the Financial Times leader column for 12 July 2010.

[10] http://www.straightstatistics.org/blog/2009/07/08/nonsense-about-public-sector-pensions

> *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."*

In other words, these big scary numbers are meaningless, even if they are based on long-term rates of interest. The Government does not have to put aside this money to pay for future pensions liabilities, as this is not how the pension system works for these unfunded schemes. What it has to work out is whether it can afford each year to make not just the pensions promises it has already built up (which is what the liability figure tries to catch) but also the pensions promises that will be built up in the future too. In other words it should want to know whether in 2025 it can meet not just the pensions promises already built up by current staff who will have retired and today's pensioners who are still alive then, but also pensions built up by current and future staff who will have retired by 2025.

Public service pensions as a proportion of GDP

Given this approach the Treasury's practice is to estimate what pension payments will be as a proportion of the gross domestic product (GDP), i.e. not taking into account contributions[11]. In other words, it looks simply at what the cost of meeting the pension commitments will be in the future and it is these figures that the National Audit Office (NAO) focuses on in its March 2010 report *The cost of public service pension.* They were also adopted subsequently by the OBR in making its own projections. The NAO explains that this approach is correct for the following reasons;

- *"projected cash payments are considered by the Government to be the most relevant measure of the cost of UK public sector pay-as-you-go pension schemes over the next fifty years;*
- *projected annual cash payments can be related to estimated annual Gross Domestic Product as a measure of the country's ability to pay;*
- *cash projections include pensions expected to be earned in the future, and are useful for decision-making about changes to schemes, whereas liabilities represent only pensions already earned that would be unaffected by scheme changes; and*
- *liability calculations can fluctuate substantially because of changes in one significant assumption, the discount rate, which does not affect cash payment projections."*

[11] 2009 Long-Term Public Finance Report, The Treasury, 2009

Given that this is the correct approach, the NAO sets out the Treasury's estimate that payments for expenditure on public service pensions (for the teachers, NHS, civil service and armed forces schemes), expressed as a percentage of GDP, will reach a peak of nearly 1.9 per cent of GDP between 2018-19 and 2033-34, before falling to just below 1.7 per cent by 2059-60. This compares to a rise from around 1.5 per cent to 1.7 per cent over the last decade. It is not surprising that there is some cost increase in the next few decades, as we live in an ageing society. Either the cost of pensions will increase or many more pensioners will live in poverty. But the increase in the cost of public service pensions as a share of GDP is forecast to be significantly less than the increase in the cost of other age-related expenditure such as state pensions and long term care.

While these figures expressing expenditure on public service pensions as a percentage of GDP are readily available, it would help the debate if they were more widely known. The TUC also recognises that questions have been raised about the figures, as they are based on the assumption that public sector employment will remain constant. This is despite the expectation of a growing overall number in employment and increasing demands for some public services due to demographic change, both of which might lead to a conclusion that there will be an expansion in public sector employment. On the other hand, the present Government's policies, if implemented, would lead to a fall in public sector employment. The TUC would therefore welcome a fuller report on these estimates, showing their sensitivity to changes in the various assumptions.

In summary, while the annual costs expressed as a percentage of GDP are obviously substantial, there is no indication that they are insupportable or that, as some commentators have suggested, that they run the risk of causing national bankruptcy.

The second claim is that expenditure on public service pensions is "out of control". This is also not the case and the claim is clearly based on a misunderstanding of the figures. As explained above, expenditure on public service pensions as a share of the country's wealth is less than 2per cent of GDP every year in the Treasury's projections. In addition, the 'cap and share'[12]

[12] The cap and share arrangements are described by the Pensions Policy Institute:

"There are two parts to these agreements:

Cost sharing: Any unanticipated increases in the cost of the schemes will be shared 50:50 between employers and scheme members. As the employer currently meets around two-thirds of the cost of the schemes, this means that future increases will fall disproportionately on members, compared to today.

changes that have already been negotiated mean that for the principal unfunded schemes there is a ceiling on the cost to the employer, expressed as a percentage of pensionable payroll, with employees picking up the bill if people live longer than expected and pension costs rise more than expected. In each scheme, the cost sharing and cost capping agreement will apply to increases resulting from changes in the demographic assumptions that are used by actuaries to estimate the costs of the schemes (such as future longevity). It will generally not apply to cost increases that result from changes in the financial assumptions used (such as the discount rate) or from changes to the actuarial valuation methodology.

Where there is some greater variation is in a completely different figure, i.e. what is shown in the Treasury's expenditure forecasts as the cost of "net public service pensions". This is a balancing item rather than a measure of the true cost, and is based on the difference between benefits paid out to today's pensioners from unfunded schemes and current contributions paid by current staff. This figure can and does vary a lot from year to year; for example, it is projected to increase over the next few years. But such variations are due to the way in which the figure is derived and not in any real sense because of bad planning or anything being "out of control". It is simply because it is the difference between two much bigger numbers that are not linked to each other in the short term and are really nothing to do with each other, except that they both relate to pensions.

The two big numbers that go to make up the figure for net public service pensions that is shown in the Treasury's figures are:

- the cost of benefits paid out each year, which is linked to number of beneficiaries and the cost of living; and
- the total contributions paid by staff and employers in the public service, which is linked to the numbers of staff and the year's pay settlement.

It is clear that there is no direct connection between these two figures. Over time earnings tend to go up more than prices, so if all else were equal, it might be expected that the difference between the underlying figures would tend to

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Cost capping: Employer contributions will be capped at a certain level, for example, at around 14per cent in the NHS and Teachers' schemes and at around 20per cent in the Civil Service scheme. These caps are all very close to the current levels of employer contributions in the schemes, so any unanticipated increases in costs may, in fact, be paid almost fully by members of the schemes.

from.http://www.pensionspolicyinstitute.org.uk/default.asp?p=12&publication=05& (our emphasis).

fall over time. But there can be sharp variations from year to year – particularly when pay in the public sector is restricted.

In 2009/10, for example, the increase in the cost of benefits was determined largely by the 5per cent increase in the cost of living (RPI) in September 2008 but the increase in contribution income was determined largely by the size of pay increases in the public sector during 2009/10. So when politicians freeze or hold public sector pay below inflation it has the odd effect of appearing to make pensions more expensive, even though those extra costs are more than met by reduced expenditure on the wider wage bill.

Of course factors other than changes in prices and public service pay will affect net expenditure on public service pensions. For example the number of people that retire each year and how long pensioners live will affect the amount paid as benefits, while the number of current staff and what grades they are on will determine the income figures. But these change relatively slowly over time and do not produce the big changes between years that critics seize upon. In fact, while both the expenditure on public service pensions and the income from member contributions do not necessarily move in step, they are relatively predictable when compared to many other demands on the public purse, as they are determined largely by long-term trends, rather than the short-term exigencies of public policy.

The most recent figures for the cost of net public service pensions are shown in the briefing note prepared by the OBR, *Pre-budget forecast: Public service pensions*[13], which sets out forecasts for receipts and expenditure up to 2014-15. The figures for the receipts are almost entirely the employer and employee contributions, set as a proportion of pay from current public service workers, while the expenditure is the spending on current public service pensioners. The OBR figures also show the anticipated saving from the cap and share agreement between the unions and the last Government, which will be discussed later in this submission.

Table 1. OBR Pre-Budget forecast: Net public service pensions							£ billion
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Gross expenditure	22.5	24.3	25.4	27.0	28.5	30.4	32.1
Pensions receipts	-19.4	-21.2	-21.3	-21.5	-21.3	-21.4	-21.8
Cap and share					-1.0	-1.0	-1.0
Net public service pensions	3.1	3.1	4.0	5.5	6.2	8.0	9.4
Notes. 1 These numbers do not include expenditure on the Local Government Pension Scheme; Police Pension Scheme; and, Firefighters Pension Scheme.							

[13] http://budgetresponsibility.independent.gov.uk/d/obr_forecast_public_service_pensions.pdf

The OBR explains in the briefing note that just over half of the increase in gross cash expenditure in this period is due to expected inflation, with the rest due to past real terms increases in earnings; longevity increases; and a larger number of pensioners due to improved pension rights (under general pensions law) for a public service workforce that has grown considerably since the 1950s.

What all this demonstrates is that while the cost of paying public service pensions is certainly increasing, it is being closely monitored, with an appropriate allowance for the major drivers for the increasing expenditure. The cost might be subject to variation but there is no support for the claim that it is out of control.

Quantifying liabilities for public service pensions

The second area of interest for the Commission, in terms of the numbers, will be the right way to quantify the additional liabilities that are currently being assumed in respect of the pensions being accrued by the current workforce. In other words, what is the current cost of providing the pensions that are being promised now to the current workforce but they will not normally receive until they retire. It is these figures that the Government has used to make judgments about the affordability of the pension promises that are being made.

It has been indicated that the aim of the Commission is to achieve some sort of consensus around the figures that are quoted on the current cost of the pensions that are being accrued. While this is obviously desirable, the difficulty of the task should not be underestimated. This is because the approach that is taken to estimating these liabilities is not just a matter of judgement about what will happen in the future, leading inevitably to the possibility of disagreements; it is also politically loaded. Unfortunately the possibility of such disagreements has been exploited by those with an ideological bias against public service pensions, with the result that the issue has been obscured by the introduction of figures that are irrelevant or immaterial. Consideration of the issue might be facilitated, therefore, by first of all setting on one side the various figures that are often quoted in these discussions but are not germane to the issues that actually need to be resolved.

The first group of figures that are not relevant to the task in hand are estimates of what it would cost an individual to provide an equivalent benefit by making provision on their own account. One common cause for confusion in this context is the difference between the cost to the State of the obligation that it has undertaken and the value to the individual of the rights that they accrue.

There is no doubt that the cost of providing a guaranteed level of benefit through a personal pension would be substantial but this is a reflection, in large part, of the inefficiencies of personal provision. But in this context we are not looking at what it would cost an individual acting on their own; what we need to know is the cost that is incurred by the State. There is no doubt that significant savings can be achieved by providing benefits collectively, particularly in the public sector, and it would be wrong for members to be charged for costs that are not actually being incurred. To the extent that this puts public sector workers in a better position than those in the private sector the discrepancy should be removed by improving the efficiency of private sector provision, rather than placing artificial constraints on the public sector.

One claim that is often made in this context is that the provision the Government makes when it promises risk-free pensions for members of public service schemes, should be the same as that made by private sector employers when they provide benefits through a private sector scheme, or by individuals with contract based arrangements. Although this belief is widespread and underlies the suggestion that public service pensions are unaffordable, there is no logical basis for such a claim, which is based on a failure to comprehend the inherent differences between public service and private sector pension arrangements. The significance of these differences is discussed below.

The second group of figures that are irrelevant for the purposes of the Commission are figures for the liabilities produced for accounting purposes. This is not to say that accounting figures are unnecessary – just that they are not relevant for the task that is in hand. Some commentators are fixated on the idea that the figure for the liabilities that is calculated for accounting purposes represents the "true" cost but, in reality, they are simply not designed as the basis for making judgments about the funding of pension promises. The important point to appreciate is that the accounting figures do not represent the cost of the promises that are made; they are simply a provision that enables a judgment to be made about the current overall financial health of a particular entity. And it is clear that when such figures are produced for the public sector unfunded schemes it is done more as an attempt to achieve equality of process with the private sector, rather than because the figures are of any practical value in themselves.

This point about the irrelevancy of the accounting figures was well made by the then Government Actuary, Mr. Chris Daykin, in giving oral evidence to the Treasury Select Committee on the 1 November 2006. In answer to a question about the choice of discount rate, he said in relation to the rate used for accounting purposes that "*It is an accounting device for putting a value on liabilities which are going to fall due over many years into the future. The* *accountants have decided that is an appropriate way to value it for the purposes of the balance sheet; it has many advantages in terms of objectivity; it has many disadvantages because that value has no real meaning in terms of actually paying the liabilities in the long term*." Similarly, while the Pensions Regulator (tPR) uses the accounting figure as one of its "trigger points", it is clear that it does not regard it as an indication of the true scale of pension liabilities, which are calculated on a different basis. The suggestion that the accounting figures in any sense represent the "true" cost of public service pensions can therefore be rejected.

Given that these preceding figures are not relevant, the obvious question is what figure should be used to make the crucial judgement about the affordability of future benefits of public service pension schemes. The first point to make in this context is that all public service pension schemes are provided by an employer with a strong covenant and it would be wrong to regard this as irrelevant. Many commentators want public service pension schemes to be treated as though they cost the same to provide as private sector schemes, despite the fact that the latter are bound to have sponsors with a weaker covenant. It cannot be overstated that this is an assumption without any theoretical or practical justification. The simple truth is that it is less expensive to provide pensions where the employer has a strong covenant, because they can take a longer term view and, hence, base the cost on the assumption of higher rates of return without sacrificing the necessary degree of prudence. This is on top of the savings that are available from the large scale that is typical of public service schemes.

A second distinction to make is between funded and unfunded schemes. Many commentators confuse the two and make the elementary error of concluding that the same rules should apply to unfunded schemes as apply to funded schemes.

This is a crucially important point. Funded and unfunded pension schemes are different and it should be no surprise that different considerations apply to the way they operate and the choices that are made.

In these discussions it is sometimes implied that unfunded pensions are an inferior substitute for funded pensions, but this argument is supported by neither logic nor the interests of members and taxpayers. They are different types of entity and it is entirely rational that they should be treated differently when considering what they cost to provide. In particular, such differences should not be considered as being artificial, nor are they accounting sleights of hand. They, most definitely, do not indicate any lack of honesty, as has been suggested by some commentators.

Put simply, funded and unfunded schemes are different and applying the approach that applies to one to the other creates unnecessary and wasteful results. For those who argue that unfunded public service pensions are unaffordable, the assumption that they should be treated as though they were funded has become a simple assertion to which the data is made to conform, rather than a hypothesis to be considered against actual data and modified or rejected as appropriate.

Those who attack the funding position of the funded public service pension scheme, the LGPS, also make the mistake of ignoring the unique employer covenant provided for the scheme. There is no logic to applying the rules relating to schemes with a weak covenant from their sponsor to a statutory scheme. Deficit funding periods and target funding levels should all be viewed in the particular LGPS context. Past underfunding of the LGPS due to employer contribution holidays and previous governments that actually encouraged a low level of funding also need to be recognised by the Commission.

This submission therefore looks in turn at the best way to quantify the liabilities being assumed in public sector pension schemes, depending on whether they are unfunded or funded.

Unfunded Schemes

As explained above, an unfunded scheme is different from a funded scheme and there is no logical reason why it should be treated as a notional funded scheme with notional investments. There are some advantages in having an unfunded scheme which have been highlighted by the impact that the recent economic turmoil has had on private sector DB and DC schemes. Savers in DC schemes have seen the value of pension pots plummet. Unfunded public sector schemes have not been hit by market turbulence, enabling Government to plan for the future funding of public service pensions over the long term.

Private sector schemes, on the other hand, ought to be funded simply because otherwise there can be no guarantee that the resources will be available to pay the promised benefits when the scheme members retire. Private sector schemes are therefore regulated to ensure they accumulate sufficient funds to meet their future commitments. This is essentially a practical decision, leading to the various statutory requirements for the funding of such schemes, including, in particular, the need for prudence laid down by tPR. In such circumstances it is inevitable that there will be a difference between the security, often referred to as the covenant, that is offered by private sector employer, when compared to that offered by the State, in that the latter is bound to be greater than that of any private sector employer.

What this difference means, in practice, is that it is significantly less costly, in terms of the obligation that is incurred, to provide a pension through a State sponsored pension scheme (whether funded or unfunded), than through any private sector arrangement. In other words, because the State can provide a strong covenant at no cost, it is bound to be less expensive to provide a given pension through a State sponsored scheme than it would be for a private sector employer with what is bound to be a weaker covenant or, even more so, for an individual. What this means as far as unfunded Government sponsored pension schemes are concerned is that treating them as though they were invested in index-linked gilts makes no sense. It does not increase the security of members by being subject to the constraint of having to invest in physical assets, so there is no reason why it should be treated as though it is. In the same way, as will be discussed later, there is no reason to treat the LGPS as though the employer has the same covenant as a private sector employer.

Much of the criticism of unfunded public service pensions arises from a failure to understand this point. In particular, it has led to considerable criticism of the use of a 3.5per cent discount rate to value future liabilities. What most of this criticism demonstrates is a simple failure to understand the nature of unfunded pension liabilities in the public sector and how, more generally, political judgments should be made on issues of public policy that depend on income or expenditure that is incurred at some time in the future. It is quite clear that such issues do not only relate to pensions. They might involve judgements about capital investment, or on current expenditure that is aimed at reducing future social expenditure.

Such "inter-generational" judgments are difficult but they have to be made and, when they are made, they obviously need to be made on a consistent basis. To this end the Treasury has laid down the policy it wishes to see adopted when making such judgements in its publication: "*HM Treasury, The Green Book. Appraisal and Evaluation in Central Government*" (2006)[14]. This explains the approach in its introduction, as follows:

> *"The Treasury has, for many years, provided guidance to other public sector bodies on how proposals should be appraised, before significant funds are committed – and how past and present activities should be evaluated. This new edition incorporates revised guidance, to encourage a more thorough, long-term and analytically robust*

[14] http://www.hm-treasury.gov.uk/d/green_book_complete.pdf

approach to appraisal and evaluation. It is relevant to all appraisals and evaluations"

The argument that is presented in the Green Book is relatively straight forward, with the report itself stating that it is not "rocket science". The full explanation can be found in the Green Book itself and it is unnecessary for it to be repeated at length in this submission. However, the key section reads as follows:

> *"5.49 For individuals, time preference can be measured by the real interest rate on money lent or borrowed. Amongst other investments, people invest at fixed, low risk rates, hoping to receive more in the future (net of tax)to compensate for the deferral of consumption now. These real rates of return give some indication of their individual pure time preference rate. Society as a whole, also prefers to receive goods and services sooner rather than later, and to defer costs to future generations. This is known as 'social time preference'; the 'social time preference rate' (STPR) is the rate at which society values the present compared to the future.*
>
> *The discount rate is used to convert all costs and benefits to 'present values', so that they can be compared. The recommended discount rate is 3.5per cent. Calculating the present value of the differences between the streams of costs and benefits provides the net present value (NPV) of an option. The NPV is the primary criterion for deciding whether Government action can be justified."*

In essence, what the Green Book explains is that when policy decisions are made that involve income or expenditure in the future, there is a proper distinction to be made between the discount rate that it is appropriate for individuals to use and the one that should be used for society as a whole. One of the key differences is that the former is subject to the exigencies of investment markets, while society as a whole is not. A useful explanation of this point was provided by the Government Actuary, Mr. Chris Daykin, in evidence to the Treasure Select Committee on 1 November 2006, as follows:

> *Mr Daykin: "I think the concept is all part of the Treasury financing of public sector liabilities, so whether it is a true value or not depends on your understanding of what the cost to Government of providing pensions would be. The concept ... is that the cost to Government of providing pensions is not directly dependent in any way on the market; it is to do with the Government's ability to raise taxes in the future and to finance its long-term liabilities. So from one point of view, from Government liabilities, it should just be looked at as a cash flow issue as to what the call on the budget and on borrowing will be in the*

future—what the percentage of GDP will be that is allocated to paying for these liabilities. From another perspective the valuation process is intended to place a discipline on the employers and employees of public sector pension schemes, and the mechanism that we have does that without making it unduly volatile. It does ensure that the costs are brought home to the employers and employees at the time, whilst not subjecting those changes to the volatility of using market interest rates."

As a result the STPR does not go up and down with movements in markets, but is set for the long-term. The Green Book explains that for projects with very long-term impacts, over thirty years, a declining schedule of discount rates should be used, rather than the standard discount rate. What it makes absolutely clear is that it has got nothing to do with the current market rate on index-linked gilts. There is an extensive literature on the subject of the STPR, with many learned academic papers, including many that are referenced in the Green Book. It is also clear from the literature that the UK Government is not alone in using both the approach in general and a discount rate in the region of 3.5per cent. The general view is that the technique is valid and the use of 3.5per cent is not unreasonable. In any event, it really goes without saying that it would not have been adopted by the Treasury if it did not have considerable legitimacy.

There are two important corollaries that flow from the use of the STPR for the valuation of public service pension liabilities.

- First, because the use of the STPR is not restricted to the assessment of the cost of public service pensions, any suggestion that it is an invalid approach to making decisions about policies with an impact on future expenditures or income - or even that the assumption of 3.5per cent is wrong - would have profound implications for decisions on a wide range of Government policies and programmes; and
- Secondly, while the "big scary numbers" for the current cost of public service pensions that have been produced by many commentators do not represent the understatement of the liabilities for public service pensions, what they do indicate is the additional burden that would be placed on taxpayers by any decision to ignore the specific characteristics of the public sector.

At a time when public expenditure is under severe pressure it would clearly be perverse to change the process set out in the Green Book in a way that would result in a massive increase in the cost not just of public service pensions but also public services more generally.

Funded schemes

As explained in the introduction to this part of the TUC's submission, the treatment of funded public service schemes will not be the same as that for unfunded schemes described above.

The main example of a funded pension scheme for public service employees is the Local Government Pension Scheme (LGPS). Given the circumstances of the LGPS that bear directly on the ongoing funding of the Scheme, it is reasonable that its funding parameters reflect its unique context. In particular, it is reasonable that the bodies that control the individual sections of these schemes should have a much longer perspective than private sector DB schemes when deciding how the Scheme should be funded, given the exceptional covenant that is provided. Consequently, it is also reasonable for them to adopt a longer than typical recovery period and to assume that the strength of the covenant allows the Scheme to invest a greater proportion of its funds in risk-bearing assets, such as equities. As a result, it can expect in the longer term to earn a higher return on its investments than the generality of schemes in the private sector where the employer's covenant is weaker.

Of course, the administering authority that runs each LGPS fund has the responsibility to make up its own mind about its approach to funding its liabilities. But it is the approach outlined above, based on the strength of the employer covenant, that should determine the provision that is required from time to time to fund future liabilities. Appropriate funding strategies should be decided by each fund, in consultation with the appropriate trade unions, in accordance with reformed guidance on funding approaches that unions have called for the Scheme Regulator (the Department for Communities and Local Government) to lay down. As explained above, the strength of the covenant allows each fund, if it so chooses, to assume that it will earn a return on its assets in excess of the risk-free rate, similar to the way that the Pensions Regulator (tPR) allows private sector employers with a strong covenant to make comparable assumptions. And the TUC understands that for such schemes tPR is prepared to allow discounts rates of around 3.5per cent per annum greater than the RPI.

It is also important to note the wider role that the LGPS plays in the economy as a major investor and often with individual funds or groups of funds acting as leading players in promoting responsible investment. The market value of the LGPS funds in England alone at the end of 2008-09 was almost £100 billion[15], and more than a quarter of the income to the scheme came from investment returns.

2. Changes already made

The TUC believes that the changes that have already been agreed in the principal public sector schemes, including but not limited to what are described as the 'cap and share' arrangements, offer them a secure future. In other words, the cost of public service pensions is already under control. Unions accept that all pension schemes must consider the need for change from time to time and increased longevity, changing social structures, and changing working patterns as more women have entered the workforce have all required such changes. This is why there have been extensive negotiations across the public sector that led to these significant changes being introduced after negotiations and on the basis of agreement. A summary of some of the changes taken from the Pensions Policy Institute (PPI) October 2008 report, *An assessment of the Government's reforms to public sector pensions,* is included as Annex 1.

It can be seen that 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, the detailed cost sharing arrangements that are discussed below have been introduced to the three main unfunded schemes (NHS, Teachers' and Civil Service) and are in the final stages of implementation in the LGPS, in order to limit the volatility and overall cost 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 has undertaken 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 were reformed resulting in reduced cost to employers and a redesign of benefits and contribution rates for members. In particular there has been a move to banded employee contributions, which means, for example, that the highest paid in the

15 http://www.communities.gov.uk/localgovernment/localregional/localgovernmentfinance/statistics/pensionscheme/summarydata/summarydata200809/

NHSPS now pay 8.5per cent. In the LGPS the trade union side proposed that the highest paid workers in the scheme could pay as much as 10per cent. Other major changes include a move to a career average scheme for new entrants in the civil service. These changes have generated, and will continue to generate to an increasing extent, significant savings for the Government. Some of the initial savings were shared with members by retaining the lower retirement age or by improving the accrual rate or other benefits, but from the date the changes were implemented the overall effect was a reduction in the expected cost to the Government of providing public service pensions.

In the LGPS, similar changes have been made to accrual rates, ill health and other provisions, with the increasing cost of the scheme to the Government due to greater longevity being offset by an increase in the average member contribution rate and the introduction of a cost sharing mechanism. Aside from the difference in the way the LGPS is funded there are also other key factors relating to the LGPS that justify TUC's call for the Commission to adopt a scheme specific approach. First, the LGPS reforms were applied to all members, existing as well as 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 already the cheapest public sector pension scheme with an employer cost of 14per cent, and the further reforms costed by the Government Actuary and agreed by unions, employers and the scheme Regulator are set to reduce the cost of the scheme to the employer still further to a long term rate of around 12per cent.

Given the extensive changes that have been agreed to all the public service schemes it is clear that the result will be significant reductions in the cost of these schemes. Unfortunately, there are no authoritative figures about the extent of those savings. One figure that is sometimes quoted dates from 2005, when the changes were still under discussion, and is the Treasury's indicative estimate for the discounted value of the net saving to the taxpayer from the reforms in respect of the NHS, teachers and civil service. This amounted to a total of £13 billion, using 2005-06 prices, over a 50-year period from 2006. However, the estimate was based on approximate methodologies to indicate the savings that might result from the proposals then under discussion and were heavily rounded to allow for factors such as the possibility of a few years variation in start dates.

Many commentators are still quoting this indicative figure to suggest that the savings achieved by scheme changes are limited. But in answer to a written parliamentary question on 2 April 2009[16] the then Chief Secretary to the Treasury explained that the £13 billion figure was now obsolete. This was because the various packages of changes that were actually introduced included further reforms, such as cost sharing and cost capping mechanisms, that would further limit employer costs. She went on to state that revised estimates of the capitalised savings and extensions of the estimates to other schemes on the assumptions used in 2005 could be provided only at disproportionate cost. This is unfortunate in the context of the work of the Commission, as the savings from the cost sharing and cost capping mechanisms can be expected to be considerable.

Some figures are available, however, as set out by the Chief Secretary in answer to another written question on 6 November 2008[17]

> *"The Government are committed to providing good quality public service pension schemes that are affordable and sustainable in the long-term. To achieve this, we have undertaken a programme of reforms that have included mechanisms such as cost sharing and capping, as well as measures such as increases in pension age. The savings resulting from such measures will appear in future pension valuations.*
>
> *The packages of reforms vary considerably between schemes, as will the effects on employer pension contributions and payments of pension benefits, and the values placed on such effects will depend on the time frames over which they are measured. Detailed questions about the financial effects are for the Departments responsible for the schemes.*
>
> *However, figures that Departments have already published indicate that employer costs should already be around one and a quarter to one and a half billion pounds a year lower than they would otherwise have been and the long-term annual savings should be substantially more than this."*

These figures are reasonably consistent with those by the OBR in its pre-budget forecast on public service pensions[18] which indicated anticipated savings

16 http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090402/text/90402w0022.htm

17 http://www.publications.parliament.uk/pa/cm200708/cmhansrd/cm081126/text/81126w0090.htm

18 http://budgetresponsibility.independent.gov.uk/d/obr_forecast_public_service_pensions.pdf

under the heading “Cap and share” of £1 billion per annum from the financial year 2012-13 onwards (these figures do not include the LGPS). Given the expected turnover in scheme membership, the proportion of members on the revised benefit structure will steadily increase and, as a result, the annual savings from the benefit changes can be expected to increase substantially over time. For instance, although it is less than 3 years since it was opened, 14 per cent of members of the PCSPS are already in the nuvos (career average) section. This is before account is taken of possible savings from the Government’s intention to switch the basis for increases in benefits in public sector schemes from the Retail Prices Index to the Consumer Price Index, which is discussed below.

Another criticism of the changes that have been made to public sector schemes is that because the new benefit structure only applies to new entrants (except in the LGPS), it will be many years before they have any significant impact on the cost of accruing benefits. What this claim fails to acknowledge is the level of turnover in public sector employment and the extent to which public sector workers already work on past their normal retirement age. The reason why many stay in the scheme, leading to significant savings in the outgo on benefits, is that because of low pay and/or short service, they simply cannot afford to retire. The result is that the average retirement age in public sector schemes is increasing significantly.

This is illustrated in figures from the Pensions Policy Institute (PPI) in its 2008 report “An assessment of the Government’s reforms to public sector pensions”. This reports as follows:

> *“The average (Normal Pension Age) NPA in private sector occupational pension schemes has remained stable at around 63-64 over the last 35 years. The average NPA of members of the public sector pension schemes will increase gradually as a result of the reforms, as current members with an NPA of 60 leave the public service and are replaced by new entrants with an NPA of 65. On one broad projection, the average NPA in the public sector could reach the current average for private sector occupational schemes by 2016, 8 years after the final introduction of the reforms ... . However, the average NPA in the private sector could also increase over the same period”*

The TUC therefore urges the Commission to undertake an authoritative study of the impact on the cost of public service pensions of the changes that have already been agreed, including the cap and share arrangements.

3. Establishing the future framework

The TUC believes that the existing framework for public service pensions is broadly correct and that there is no need for any further changes in addition to those that will arise under the existing cap and share arrangements. However, given that the Commission has asked for views on "... the objectives that should guide public service pensions in future", there are some important points to make at this stage of the Commission's work. These relate to the following and are dealt with in turn below:

- the role of "comparability" in setting the appropriate level of public service pensions;
- the implications of adopting alternative benefit structures;
- the importance of protecting the "Fair Deal" arrangements for employees in contracted-out public services and the scope for building on "admitted body status";
- the scope for improvements in governance and disclosure of public service pension arrangements; and
- the crucial role for proper and open negotiations with the relevant trade unions in making any changes.

Comparability

The clear implication of the Commission's terms of reference is that the Government envisages public service pensions being set in future on the basis of some form of comparability with pension provision in the private sector. It mentions, in particular, "*the growing disparity between public service and private sector pension provision, in the context of the overall reward package*". The TUC wishes to make clear that it does not wish to endorse comparability as the basis for setting pay and conditions in the public service – this is a matter for affiliated unions to decide in negotiations with each employer. However, if this approach was adopted by the Commission some important factors would need to be borne in mind.

There are some fundamental questions for the Government about what role it sees for comparability when setting the terms and conditions of employment for public service workers in general, not just in relation to pensions. It is self-evident that it would be wrong to look at pensions on their own, as it is obvious that pay in either sector might well be set at a level that takes the pensions that are provided into account. In other words, the Commission needs a solid base of evidence on whether and, if so, the extent to which, pay in the public service is lower than that in the private sector because of the pensions that are provided.

There are a number of difficulties with undertaking a comparability exercise that will take some time to resolve, as follows.

First, there is a distinct lack of authoritative studies and, as a result, the Commission simply does not have enough readily available data to undertake an adequate comparability exercise. It would be possible to obtain such data but, if the exercise is to command support within the public sector and among taxpayers more generally, it should not be rushed. It cannot be overemphasised that this is a major exercise and not one that can be completed on the back of an envelope.

Secondly, many simplistic comparisons are made without allowing for key factors which mean that taken as a whole, the public and private sector workforces are not directly comparable. The proportion of skilled and professional graduate jobs in the public sector is higher than in the private sector. Comparatively more women work in the public sector – and the gender pay gap is smaller. Conversely there are many more unskilled and very low paid jobs in the private sector. In addition, whilst in private sector DB schemes it is commonplace for executives to receive different and better benefits than their employees (such as better accrual rates and early retirement arrangements), the public sector schemes do not give any additional benefits to senior staff other than those attributable to their pay and service. As a result simple comparisons between the public sector and private sector on pensions can be as misleading as the regular attempts to compare pay. Some examples of how such comparisons can be misleading are given in an article in *The Guardian.*[19]

Thirdly, it is necessary when undertaking the exercise to be clear about the appropriate comparators. We have already noted the Prime Minister's expressed support for "*good pensions in the public sector*" but the unfortunate truth is that the private sector taken as a whole does not provide good pensions. It will be necessary, therefore, for decisions to be made about what sections of the private sector provide the sort of good pensions that should be matched in the public sector. In any event, there is clearly an obligation on the Government to act as a good employer and, hence, to provide decent pensions, even when many private sector employers fail to do so.

Fourthly, any consideration would also need to take account of the implications of the exercise on public policy concerning pension provision. All political parties and most commentators agree about the need to strengthen occupational provision and it would be unfortunate if cuts in the public sector

[19] See http://www.guardian.co.uk/science/2010/jan/09/bad-science-ben-goldacre

led to even greater cuts in the private sector and a race to the bottom in terms of standards of pension provision.

Fifth, there are considerable difficulties in making comparisons given the fractured nature of pension provision in the private sector, including contract-based provision. The starting point for many commentators is that public service pensions are better than those in the private sector but there is now no standard private sector comparator, as pension provision is extremely uneven. Most in the private sector have no employer backed pension. A few senior company directors have genuinely "gold-plated pensions", as evidenced by the TUC's annual PensionsWatch survey of FTSE100 company directors' pensions. This study consistently finds that many directors in the private sector are members of different schemes from their employees with far superior accrual rates, retirement ages and other benefits. There are DB pensions, hybrid schemes, good DC pensions that produce comparable benefits to DB schemes and poor DC schemes – some are trust based, some contract. It is not immediately obvious, therefore, how public service schemes can be made like private sector schemes, when there is such diversity in the private sector. This is not to say that the task is impossible but it is clearly difficult and potentially time consuming.

Despite all these difficulties, unions are not opposed, in principle, to taking part in discussions about the role and extent of comparability with the private sector as a significant factor in determining the pay and conditions, including pensions, for public service workers. However, even if it is assumed that the Government is serious about setting public service pay and conditions on the basis of comparability with the private sector, it would not be possible within the timescale set for the first stage of the Commission's work, for it to undertake a fair and proper comparison.

Alternative benefit structures

The TUC notes the statement that consideration will be given in the second stage of the Commission's work to alternative benefit structures and that after the interim report is published there will be a further round of evidence-gathering on what such provision should look like. The TUC is not opposed in principle to such a process, if and when it appears necessary. This was shown, for example, by the agreement of the Civil Service unions to the introduction of a career average arrangement, nuvos, for new entrants to the PCSPS. Nevertheless, we are concerned at any implication, even before the first stage has really started, that further benefit changes are inevitable. The TUC will give careful consideration to the outcome of the first stage but we would urge the Commission to consider the possibility that the benefit changes that have been negotiated and the measures that are already in place to adapt public service schemes to changing circumstances, i.e. cap and share, will be found to be adequate. This is the TUC's position unless and until there is compelling evidence to the contrary.

Nevertheless, the TUC is aware that a number of changes in the structure of public service pension provision have already been proposed and we believe that it might be helpful to the Commission, even at this early stage, to highlight particular problems with these proposals.

One proposal that has been made is that public service pensions should be provided on a defined contribution (DC) basis, matching the shift in provision in the private sector from defined benefit to defined contribution schemes. For example, there is the suggestion for such a shift from the Prime Minister, David Cameron MP, that is quoted above. In DC schemes (also known as money purchase schemes) the pension payment depends on the value of the investment in the individual's pension pot upon retirement. This compares with the overwhelming majority of public service pensions that are on defined benefit (DB) basis.

The important point to understand is that if new or existing staff were switched to a normal DC arrangement, then Government spending on pensions would increase. This is because most of the cost to the Government of paying pensions at any time is covered by using the contributions paid by or on behalf of current employees. These will amount to £21.5 billion in 2011-12 and if this amount, of anything approaching it, were to be paid into members' own DC accounts it could not then be used to pay for the pensions of already retired public employees. In other words tax payers would be paying at the same time for the pensions of those who have already retired and to build up funds to pay pensions in the future for staff currently working – a double whammy.

This problem of switching unfunded public service provision to a DC basis is now more widely understood and, in response, it has been proposed that such provision should be on a notional basis. The idea is that the money in members' personal accounts is not invested as the members themselves choose, which is invariably the practice in private sector DC schemes, but is put automatically into notional accounts, where the rate of return is determined by the Government. The end result is that the Government keeps hold of the money and does not need to raise revenue from elsewhere. Such arrangements are not unknown in other countries, with Sweden being a prominent example. It needs to be understood, however, that the difference between such arrangements and the existing unfunded approach used for public service pensions in the UK is ultimately a matter of presentation, rather than substance. The cash flows are essentially the same, depending on the notional rate of return that is adopted, except to the extent that the differences in presentation lead to changes in policy.

A further point that is relevant in this context, if there were to be any suggestion that the quality of public service pensions should be substantially reduced, is that such cutbacks will lead to significantly more retired public employees being reliant on Government funded means tested benefits. This is because many public sector employees are low paid workers, whose pension entitlements are already relatively low. The Commission will need to consider, therefore, the extent to which any saving on pension contributions in the longer term would be offset by increased spending on means tested benefits.

Fair Deal

The TUC believes that it is important to maintain the "Fair Deal for Staff Pensions" that was agreed in 2000. This included an arrangement to protect the pensions of workers transferring from public to private sector employment in order to fill the gap left in the Transfer of Undertakings (Protection of Employment) Regulations (TUPE) for the protection of occupational pensions. This was augmented in the local government sector by the "Two Tier Code" in 2003 and the 2007 Directive, which requires the provision of the LGPS (through "admitted body status") or a "broadly comparable" scheme for transferring employees. While the TUC does not accept the supposed rationale that transferring the provision of services to the private sector achieves advantages of innovation and efficiencies harder to achieve in the public sector, there is agreement where transfers do take place it should not simply be a matter of driving down the conditions of service of the employees concerned. If Fair Deal does not continue there will not be a level playing field and any private sector contractor would be able to undercut an in-house bid on pension costs alone. It is also worth noting that removal of Fair Deal would undoubtedly lead many contractors to close their "broadly comparable" pension arrangements, thus worsening pension arrangements for many, usually poorly paid, private sector employees who had formerly been public sector workers.

The TUC concludes that any threat to Fair Deal and the associated admission and passport arrangements requiring comparable pension provision would constitute a barrier to the 'greater plurality of services in the public sector' that is referred to in the Commission's terms of reference. The reason most staff agree to go over to outside contractors is because TUPE and Fair Deal require broadly comparable pension provision. However, while the principle is clear, unions have for some time sought improvements in the way the Fair Deal actually works with, for example, consideration being given for facilitating ways in which the employees concerned would retain their membership of a relevant public service pension schemes. The success of such an approach can be shown by the admission agreements that have been established in the LGPS for over 10 years and have allowed contractors to participate in the scheme. Indeed, more than 7,000 employers now participate in the scheme. In the same way, teachers in private schools can belong to the Teachers' Pensions Scheme. Such arrangements have worked well, with steps being taken, based on discussions between employers and the trade unions, to make such arrangements as seamless as possible with the result that they are the option of choice for most contractors taking on staff. We understand that the CBI is supportive of measures along these lines, providing there is an appropriate allocation of cost and risk between the private sector employer and the scheme concerned.

The TUC believes, therefore, that mechanisms for admitted body status mean it is possible for all contractors and in-house providers to bid for service provision contracts on an equal basis and that consideration should be given to extending the scope of admitted body status. We believe such a model fully facilitates mobility and simplifies pension considerations for those private sector contractors providing public services as they do not then need to run a scheme themselves. When the relevant employees again transfer they can retain access to the same pension scheme, instead of constantly having to transfer pension savings from scheme to scheme every time they are transferred to a new employer.

Governance and greater transparency

The TUC is happy to discuss any measures that are aimed at providing better governance and greater transparency in public service pension schemes.

As far as governance is concerned, all the main public service schemes have now established governance structures that, in particular, have an important role in the cap and share arrangements. These arrangements have been agreed between the relevant departments and the trade unions and there seems no reason to seek any significant changes in how they operate, at least until those concerned have experienced one full valuation cycle.

The exception to this approach is with respect to the LGPS, where the trade unions concerned have sought for some time to increase member involvement in the governance arrangements. Whilst many LGPS funds have arrangements for union representatives to act as observers, there is no statutory requirement for member involvement in scheme governance and some schemes still resist any member involvement. Trust-based pension schemes in the private sector must have at least one-third of the trustee board constituted of member-nominated trustees, and unions have long called for this proportion to be increased to 50 per cent. The TUC believes that analogous provisions should be applied to the LGPS.

On the issue of transparency, the TUC believes that it would be to the advantage of all, scheme members and taxpayers alike, for there to be greater disclosure of information about public service pension provision. While most information that people need is already available publically, this is not all to be found in the same place and some can be hard to locate. The result is the various myths about public service pensions are allowed to grow.

The TUC suggests, therefore, that there should be an annual Treasury publication that includes the key information needed to undertake a serious discussion of public service pensions. This should include for each public service scheme the following information:

- Details of pensions in payment, as in the NAO report, with disaggregation of the figures by gender and decile ranges.
- The number of pensioners; deaths; and new retirees with projections into the future for an appropriate period.
- The range of pensions that are paid per year of service, showing the decile ranges.
- The accounts for each scheme and the results of the most recent actuarial valuations.
- The figures used for accounting purposes.
- The cost of pensions that are accrued each year by active members expressed in cash terms and as a percentage of pay.

Negotiations

It is a point of principle for the TUC that changes should only be made to public service pension arrangements following full negotiations between the appropriate trade unions and the Government. Each of the public service schemes is different, reflecting the particular needs of the relevant area of employment and wishes of the workforce. There should be no one-size-fits-all approach to decisions about these schemes and no arbitrary dictate on the part of the Government.

The experience of the last decade demonstrates that this is a practical approach. Where they consider it appropriate the relevant unions have been prepared to agree reductions in benefits and increases in retirement age as ways of responding to rising pension costs because of factors like greater longevity. Unions have also been prepared to agree fundamental changes in benefit structures, for example in the Civil Service, with the agreement to a career average revalued earnings (CARE) arrangement for new entrants. Most importantly, they have accepted the need for the Government to cap its pension costs with members bearing the brunt of future developments through further increases in contributions or reductions in benefits.

Section four

Savings on public service pensions within the spending review period

We note that the Commission has asked for thoughts and observations on whether, given the long term nature of any structural reform of public sector pension provision, there is a case for more immediate action on public service pensions, within a context of affordability and fairness. In particular, there is the suggestion that consideration should be given to options that might deliver savings within the spending review period that would contribute towards the reduction of the structural deficit.

The TUC is opposed to any such immediate action, both in practice and as a matter of principle. The practical problem, given the Government's commitment to the protection of accrued rights, is that there no scope for material savings in the expenditure of benefits during the spending review period, as this will relate almost entirely to the pension rights that have already accrued. The only potential exception to this is the Government's proposal to change the basis for the revaluation of pensions in payment and in deferment from the retail prices index (RPI) to the consumer price index (CPI), which is discussed below.

This means, leaving the change in index to one side, that the only possible proposal that would deliver savings within the spending review period would be an increase in member contributions. However, the TUC is adamantly opposed to any such action, apart from any increase that might arise under the existing cap and share arrangements or changes to the member contribution schedule that have been agreed following appropriate negotiations. In this context it should be noted that the first series of valuations under these arrangements will shortly be under consideration and it is possible that these will, in any event, lead to contribution increases.

There is also the real danger that any additional significant increases in pension contributions would have the effect of forcing people to exercise their right to leave the scheme, reducing even further the provision of decent pensions.

Before making any proposal to increase contribution rates the Commission should undertake a study of the likely impact on entry and drop-out rates for each scheme.

Finally, central Government has already announced its intention to freeze public service pay and local authority employers have followed suit, meaning that it would be doubly unfair if, at the same time, pension contributions were to be increased.

The objection in principle, given the timescale for the current review, is that any such increase would have to be decided upon before the work on comparability could be completed and, hence, would be arbitrary and precipitate. It would, in effect, be a straight-forward cut in the pay of public service workers, without any reference to pension provision. As such, it is clearly outside the Commission's terms of reference. To the extent that measures are taken to address the deficit, these should be shared equally and not placed unfairly by what would be, in effect, a stealth tax on public servants.

A further reason why it would be unreasonable to make any decision about increased contributions is that it is unclear what exactly members of public service schemes are paying for. As mentioned above, the Government's proposal to change the revaluation basis in public service schemes from RPI to CPI does have the potential to reduce expenditure within the spending review period. But, as such, it is clearly contrary to the Government's promise to protect the accrued rights of the members of public service schemes. This is not the place to discuss the rights and wrongs of the change but there is no doubt that it leads to a diminution of members' accrued rights, as explained in Annex 2. What this shows is that while members have up to now expected and paid for benefits that will increase in line with the RPI, the Government is now seeking to pay increases that the Treasury itself states will be, on average, 0.5per cent per annum less[20]. Unions have expressed disappointment at the sudden introduction of this major change without prior consultation or notification, which significantly reduces the value of public service pensions and raises immediate problems for the administration of these pensions.

The Budget report sets out figures for the overall savings for State pensions and the public service schemes funded by central Government that will arise from the switch in the index and these are shown in Table 2. Subsequently the figures were given for the savings that are expected to arise specifically from those public service schemes (not including the LGPS) in answer to a

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[20] The Treasury, *Consumer Price Indices - Technical Manual - 2007 Edition*

parliamentary question on 27 July 2010[21]. It will be seen that by 2014-15 the reduction in public service pensions will be around £1.3 billion.

Table 2. OBR Pre-Budget forecast: Savings from the RPI/CPI Switch					£ billion
	2010-11	2011-12	2012-13	2013-14	2014-15
Gross saving	0	1.2	2.2	3.9	5.8
Saving on public service pensions	0	0.3	0.6	0.9	1.3

The TUC will be doing whatever is possible to persuade the Government to reverse the decision to apply the switch retrospectively to accrued benefits in contravention of its unambiguous commitment not to do so. However, it would be unreasonable to apply any increase in contributions to active members until the matter is resolved.

Private sector employees have been hit hard by the employer retreat from good pensions. But this does not justify punishing public sector workers. Two wrongs do not make a right. Public service pensions support lower-paid members of the workforce. Well-paid private sector employees are likely to get a decent pension on top of their pay. The real difference between public and private sectors is among the low and average paid. The attack on public service pensions may be wrapped up in rhetoric about fat-cat public servants, but it is really an attack on the low paid in the public sector. Only 20per cent of private sector employees who earn between £100 and £200 a week are members of an employer-sponsored pension scheme whereas 70per cent of public sector employees in the same pay range are pension scheme members.

[21] See HC Deb, 27 July 2010, c1017W

Section five

Summary of conclusions

The TUC welcomes the opportunity presented by the Commission to defend good pension provision for the public services and to seek the extension of such provision to the private sector. While we have some concerns about the terms of reference of the Commission and any pre-emptive decisions that may already have been made by the Government, we hope that the Commission will give the TUC's submission proper consideration and look forward to continued and meaningful engagement as the work of the Commission progresses. The TUC's main conclusions are as follows.

i. The TUC shares the concern about the widening gap between pension provision in the public service and that in the private sector but this should be addressed by improving provision in the private sector, rather than cutbacks where pension provision is adequate.
ii. The Government's own figures for the projected expenditure on public service pensions show that it is neither an unsupportable burden on future generations, nor that it is out of control.
iii. The market based cost to a private sector employer or an individual of securing a given pension is not an appropriate basis for quantifying the cost of that pension to the Government.
iv. The correct basis for quantifying the pension liabilities that accrue in respect of unfunded public service pensions is that set out in the Treasury's Green Book and the use of a discount rate of 3.5% is sound.
v. The correct basis for quantifying the value of funded public service pensions, such as the LGPS, is on a scheme specific basis.
vi. The changes that have already been made to public service pension schemes, including the cap and share arrangements, have produced significant savings and will provide a sustainable and affordable basis for their future.
vii. Some of the suggestions for changes to the framework for public service pension provision are counterproductive, as they would lead to increases in public expenditure and reductions in the overall level of pension provision, neither of which are in line with Government policies.
viii. Any changes in public service pension schemes must be agreed through collective bargaining, as has been seen to work successfully in the past, rather than arbitrarily imposed by the Government.

ix. The TUC is adamantly opposed to any arbitrary increase in member contributions, in advance of a proper comparability exercise, as this lies outside the Commission’s terms of reference.

Annex 1 – Summary of the main elements of the reforms to public sector pension schemes

This Appendix reproduces, with kind permission, Table 1 of the Pensions Policy Institute's October 2008 report, *An assessment of the Government's reforms to public sector pensions*. The table details the changes that have been made over the last few years and relate to new joiners only, unless otherwise stated. NB. The table is not fully up to date, particularly in respect of the LGPS, but provides a useful general overview.

	NHS[22]	**Teachers'**	Civil Service[23]	LGPS (reformed for all members)	Armed Forces	Police	Fire
Normal Pension Age (NPA)	60 → 65	60 → 65	60 → 65	Remains 65; Rule of 85 abolished with transitional protection	No change from 55	50 with 25 years' service (below 50 with 30 years); 55 (57 or 60 for higher ranks)→55	55 (or 50 after 25 years' service) →60
NPA for early leavers	Same as NPA	Same as NPA	Same as NPA	Same as NPA	60 → 65 (all members)	60→65	60→65
Basic design	Remains final salary	Remains final salary	Final salary → Career average	Remains final salary	Remains final salary	Remains final salary	Remains final salary
Accrual rate	80ths →60ths	80ths →60ths	60ths →2.3%	80ths →60ths	69ths (91ths after 22 years)[24] →70ths	60ths (30ths after 20 years) →70ths	60ths (30ths after 20 years) → 60ths
Additional lump sum?	3 x pension → commutation	3 x pension → commutation	Commutation only	3 x pension → commutation	No change from 3 x pension	Commutation → 4 x pension	Commutation only
Late retirement enhancement?	No →Yes	No →Yes	No →Yes	No →Yes	No	No	No
Draw-down option?	Yes	Yes (all members)	Yes (all members)	Yes	No	No	No
Rate of e'ee contributions[25]	6% (5%) →5-8.5% (for all members)	6% → 6.4% (for all members)	No change from 3.5%	6% (5%) →5.5-7.5%	Remains non-contributory	11%→ 9.5%	11% → 8.5%
Cost sharing?	Yes	Yes	Yes	Yes	No	No	No
Eligibility for survivor's pension	Now includes non-legal partners and payable for life (but only for new joiners in the Police and Fire schemes)						
Survivor's pension on death in retirement	Remains a 160ths pension	Remains a 160ths pension	160ths →3/8ths of member's pension	Remains a 160ths pension	50% →62.5% of member's pension	Remains 50% of member's pension	Remains 50% of member's pension
Ill-health benefit	1-tier → 2-tier	1-tier → 2-tier	Remains 2-tier	1-tier → 3-tier	1-tier → 2-tier	1-tier → 2-tier	1-tier → 2-tier
Timescale	1 April 2008	1 January 2007	30 July 2007	1 April 2008	6 April 2005	6 April 2006	6 April 2006

22 The scheme for salaried staff is illustrated. Self-employed members, such as GPs and Dentists, have a career-average scheme that is not shown
23 The Premium section of the Civil Service scheme is illustrated here, since the Classic section has been closed to new members from 2002.
24 For other ranks. Officers have higher accrual rates.
25 If a range is shown then employee contributions depend on pay. Figures in brackets denote special provisions for certain categories of workers.

Annex 2 – The Impact of CPI Increases rather than RPI Increases

The Government's proposal to change the basis for revaluing public service pensions, both in payment and in deferment will have serious consequences for members' accrued rights. The change that is proposed is to use the Consumer Price Index (CPI) rather than the Retail Price Index (RPI) for the indexation of benefits, tax credits and public service pensions from April 2011. The CPI and the RPI are both measures of the cost of living. One important difference between them is the basket of goods and services upon which they are based, with only the RPI including housing costs. So whenever housing costs increase faster than other prices, increases in the RPI will be higher than those in the CPI. But the reverse also applies, like at present, and the CPI can be higher than the RPI. In the long term the effect should be neutral, except to the extent that people consistently increase (or reduce) what they spend on housing. In the short-term housing costs are expected to increase faster than the average, as interest rates return to more normal levels, so the RPI is likely to be higher for some years to come.

But there is also a significant technical difference in the way that the RPI and the CPI are calculated. The RPI is an arithmetic mean of price changes (the increases are added together and divided by the number of increases), while the CPI is a geometric mean (the increases are multiplied together and the nth root is taken – where n is the number of increases). While this appears abstruse, of interest only to mathematicians, the Treasury's own estimate[26] is that:

> *"… the CPI annual rate would typically have been about 0.5 percentage points higher if the elementary aggregates had been calculated using arithmetic means as in the RPI."*

In other words, pension increases will in future average about 0.5per cent less each year, simply because of the change in the way the index is calculated.

The issue of which index is the right one to use is a topic of much debate among statisticians and, of course, there is no single correct answer. It all depends on what you are trying to measure. But for most people, looking at what they buy themselves at the shops and elsewhere, there is little doubt. They want to know how much more their basket of goods will cost today, compared to what it cost yesterday. And this is shown by an arithmetic mean.

[26] Consumer Price Indices - Technical Manual - 2007 Edition

As a very simple example, imagine the basket of goods is a loaf of bread and a kilo of potatoes. Initially they cost 50p each so the total cost is £1.00. But then, over the year, the price of bread increases by 4per cent, while that for potatoes increases by 8per cent. So the bread costs 52p and the potatoes cost 54p, which means the basket now costs £1.06, an increase of 6per cent. It can be seen that this is the weighted average of 4per cent and 8per cent.

But the geometric mean of increases of 4per cent and 8per cent with equal weights is 5.98per cent. In this example it makes only a minor difference in the result but, as mentioned above, the Treasury estimate that in practice it means a difference on average of 0.5per cent per annum, when compounded across a whole basket of goods.

Table C2 in the Budget report shows the pension increases that can be expected over the next 6 years, i.e. the increases due in April of the respective year, based on the forecast price increases in the previous year. These are summarised in the following table:

	Table A.3 – Comparison of CPI and RPI Increases Forecast Increase (%)						
Year of increase	2011	2012	2013	2014	2015	2016	Overall
CPI	2.7	2.4	1.9	2.0	2.0	2.0	13.7
RPI	3.7	3.2	3.2	3.3	3.4	3.5	22.1
Shortfall	1.0	0.8	1.3	1.3	1.4	1.5	7.4

What this shows, using the Treasury's own figures as endorsed by the OBR, is that over the next six years increases in SERPS/S2P and public service pensions will total 13.7per cent, rather than the 22.1per cent that was previously expected. This is, in effect, a cut of 7.4per cent, of which about 4.3per cent is due to differences in the coverage of the respective indices and 3.1per cent is due to the way it is calculated.

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