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Public Sector Pensions in a Time Warp - we need honesty and transparency

Taxpayers are giving public sector workers a first class air ticket to retirement and charging them just for an economy fare, while the taxpayers themselves have to wait for the bus.

The Coalition Government leaders have said that public sector pension schemes are unfair and unaffordable. Public sector pensions are generally far better than private sector pensions. Government has hidden the costs and says they are worth 20% of salary, when the true figure is around double that. It is time to be honest and open about this issue, instead of sweeping it under the carpet and hiding behind fiddled figures.

The Report by the Independent Public Sector Pensions Commission adds further evidence of the lack of transparency and honesty about the true costs of public sector pensions, which Governments have hidden for many years. The valuation, costing and accounting for public sector pensions are stuck in the past. They have not caught up with present realities and are a long way behind the future funding constraints faced by UK taxpayers. For most public workers, no money has been put aside to meet the costs of future pension commitments. Government is pretending the pension costs are half their true level. While pension provision has been fading fast in the private sector and even the National Insurance system is creaking under the strain of supporting ever-increasing numbers of pensioners, public sector schemes are stuck in a time warp.

Lack of Transparency

Taxpayers have not been told the true costs of providing pensions for public sector workers, even though it is taxpayers who have to guarantee the payment of those pensions for many years to come. This means that neither taxpayers, nor the workers themselves, understand the true value and cost of these pension promises. At a time when state national insurance pensions are not even guaranteed by taxpayers (as pension ages are set to rise), it is important that public sector workers and taxpayers understand the value of the guaranteed public sector pension promises being made.

A £5,000 public sector pension is worth £200,000!

Of course public sector workers deserve good pensions. They do vital work for our country and I would not deny them a right to a decent retirement. The average public sector pension is less than £10,000 a year, but that does not change the fact that there is a hugely growing disparity between pension provision in public and private sectors. The average public sector pension does not sound like a huge amount, however it is far more than most private sector workers could dream of receiving from their own pensions. In order to achieve a guaranteed pension of £10,000, increasing with inflation, paid from age 60, a private sector worker would need to have saved £400,000. Just to have a guaranteed £5,000 a year pension, private sector workers would need to have saved £200,000. This is beyond the wildest dreams of most taxpayers. In fact, the average private pension fund is just around £30,000.

So taxpayers are guaranteeing pensions that they themselves cannot achieve

Taxpayers are being forced to guarantee good pensions only for one group of the workforce (public workers are around one quarter of all workers), when they themselves cannot hope to achieve such retirement income. Private sector pensions

have been cut consistently over the years, as employers close their final salary schemes and far less generous defined contribution pension schemes have suffered from poor investment returns and falling annuity rates, leaving private pensions far lower than expected. The State National Insurance pension has also been cut and now the Government is saying it does not have enough money to keep paying out even this very low Basic State Pension from age 65, so workers will have to wait longer - till age 66 and even later in future. Yet public sector pension schemes remain immune and taxpayers have to keep funding the pensions from age 60 or even lower in many cases.

Better pensions can no longer be justified on grounds of lower pay

Public sector pay is already higher than equivalent private sector pay. The ONS figures show public sector workers earn more than equivalent private sector workers, except for the top ten per cent of earners. The value of pensions on top of this higher pay today is equivalent to an extra 40% of salary for most public sector workers. This differential between public and private sectors is not admitted. The Government has consistently hidden the true scale of this cost behind fiddled figures and fudged assumptions.

Wrong calculations of contribution rates values the pension at 20% of salary, but real figure is double that

In theory, public sector workers and the public bodies employing them (i.e. taxpayers) are contributing to pay for their pensions. But the Government's calculations of the level of contributions required to pay for the pensions being promised is based on a discount rate that bears no relation to reality. It assumes that Government can borrow at an interest rate of 3.5% above inflation, when the real yield on index-linked gilts is less than 1%. So the calculation of contributions is stuck in the past as if in a timewarp. The contributions made today do not even cover the cost of today's pensions, never mind the future costs that are mounting all the time. It is difficult to fathom why we are not valuing the pensions using today's interest rates, since these are the realities that taxpayers face. As pensions have to be paid, taxpayers have to borrow more to pay for them.

Incorrect calculations of future liabilities - these are not private sector schemes

The Government also uses inappropriate figures to calculate the costs of the pension liabilities already built up. These pensions are guaranteed by taxpayers, have an unlimited inflation-linking guarantee and are often paid from age 60, not even age 65. Yet, when valuing the liabilities, the Government uses a discount rate that a private company would use, which is much higher than that which is relevant to the Government itself. Discounting future liabilities by the yield on corporate bonds, rather than using the rate which the Government itself borrows at, again serves only to make the future costs look far lower than they really are. The Pensions Policy Institute recently tried to justify this choice of discount rate by suggesting that private pensions are just as secure as public sector pensions, so it is fine to use the same valuation basis. This is patently flawed. Private pensions are not taxpayer guaranteed, they are not 100% inflation-linked and if the private employer fails, the pensions will be reduced significantly in the Pension Protection Fund.

Most are unfunded, no money is put aside, higher burdens for future taxpayers

The Government's unrealistic figures serve only to make the pension costs appear much lower than they really are. Using an artificial discount rate saves money for both public sector workers and Government departments today, while heaping hidden costs on taxpayers in future. For most of these pensions, there is no money

set aside to pay the costs. The pension payments rely on future taxpayers to foot the bill. This is irresponsible budgeting which bears no relationship to reality.

Pensions are worth twice as much as Government has admitted

Using the index-linked gilt yield, the pension promises which Government says are worth 20% of salary, are actually worth around 40%.

So what can be done?

There are various options.

- a. Contributions can be increased to 40% of salary to reflect the true cost of pensions
- b. Benefits can be reduced in future to reflect the 20% of salary being charged
- c. Taxpayers can continue to pay an extra 20% or more to fund these generous pensions

Menu of options

The Public Sector Pensions Commission report sets out a menu of choices for possible reforms. A combination of changes could achieve whatever the desired outcomes are.

1. Ending the contracting out arrangements will save money both immediately and in the longer term
2. Changing the accrual rate will cut the costs
3. Changing the pension age will cut costs
4. Capping pensionable pay rises
5. Capping the amount of pension that can be earned
6. Increasing employee contributions
7. Moving to a different type of pension altogether

Past pension rights protected

It is important to stress, however, that the Commission is not recommending changing past pension rights already earned, only making changes for the future. This means there is already a huge bill to be met, because the Government has failed to budget, account for or fund the commitments already made.

Each year, the cost of paying already retired workers, and those coming up to retirement, will increase by billions of pounds. Even on the Government's own figures, the funding required will be nearly £30billion each year. Contributions received from public workers are only a fraction of this cost. The shortfall between contributions and pension payments is set to accelerate rapidly in the next few years.

We must move public sector pension accounting into the real world. The longer we delay, the bigger the disparity becomes.

ENDS

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The Report of the Public Sector Pensions Commission can be found at: www.public-sector-pensions-commission.org.uk . The Commission was chaired by Peter Tompkins, Fellow of the Institute of Actuaries and the Commissioners were:
David Acland CBE DL, CHK Charities Ltd
[Ros Altmann](#), [London School](#) of Economics
Philip Booth, Institute of Economic Affairs, Vice Chairman
Andrew Lilico, Policy Exchange
Neil Record, Institute of Economic Affairs
Malcolm Small, Tax Incentivised Savings Association
[Corin Taylor](#), Institute of Directors, Secretary