



**HM Treasury : Consultation on the discount rate used to set unfunded public service pension contributions**

**This response is submitted by Unite, the UK's largest trade union with almost 1.5 million members across the private and public sectors. The Union's members work in a range of industries including manufacturing, financial services, print, media, construction, transport and local government, education, health and not for profit sectors.**

**Unite has about a quarter of a million members in public service pension schemes, whose pensions might be directly or indirectly affected by this Review**

**Executive Summary**

- Unite supports fully the submission to the Consultation made by the TUC, which argues that the current basis on which the discount rate is determined remains valid, and this submission is intended to emphasise and expand on some aspects of it.
- This Consultation is an attempt to put an economic rationale on a politically driven initiative to reduce member benefits and increase member contributions

- The cost of public service pensions is under control and fully accounted for, as it should be, on a basis consistent with all other public expenditure
- The Government can provide pensions much more cheaply than private employers can; the lower cost of benefits is not a product of an inappropriate discount rate but rather its unique position as a provider
- The Government may wish to reduce the benefits of public service pension schemes but its case will not be strengthened by placing an artificial figure on what it costs to provide them which is inconsistent with the way other public expenditures are evaluated

### **The Unite case in detail**

1. Unite does not believe there is any valid reason why the discount rate used to value the unfunded schemes needs to be changed, and that a rate of 3.5% above inflation remains appropriate.
2. In its Interim Report, the IPSPC (Hutton) Commission called for a review and asserted that the current rate was at the top end of a range of what might be appropriate. We believe this conclusion was driven by a failure to understand fully the basis on which the rate is set and a comparison with a range of generally inappropriate measures.
3. It is important to note first that the discount rate does not affect the cost of benefits provided by the schemes. The cost is determined by the benefit rules and factors such as the mortality, and changes in the numbers and pay increases of the members. These costs are already controlled by the provisions for cost sharing and capping in the largest schemes.
4. Assessments by the IPSPC, the National Audit Office, and by the Office of Budget Responsibility (OBR) have all confirmed that the cost of benefits as a share of national income will fall substantially. This means there is no problem of affordability of the schemes given their current benefits and levels of member contribution

5. A change in the discount rate will affect the level of combined employer and employee contributions, as is calculated as being required to pay for the benefits. This is because an alternative conception of the discount rate is of a notional investment return earned on contributions, and if it is lower then more of the cost needs to be met from contributions (and vice versa).
6. A lower discount rate might lead to decisions either to reduce members' benefits, so as to reduce contributions, or to increase either members or employer contributions. The Treasury might save money either at members' expense or if public sector employers were required to set aside a greater proportion of their current spending to pay for pensions and their overall budgets were not increased to compensate. The latter would amount in effect to a cut in public spending.
7. In the Consultation Document it is stated that any change in the discount rate will not affect past service benefits and that Departmental Budgets will not be adversely impacted by any change in respect of the future. From this it can be concluded that the current discount rate will continue to apply for all past service benefits and that for the future the outcome of the review, in terms of any attempt to offset any increased contribution cost, will fall entirely on the members.
8. So, the purpose of the review is to support a case that either benefits are too high or that member contributions are too low.
9. As far as the Treasury is concerned money spent on providing pensions for public service workers is no more costly than money spent on any other type of public expenditure. It all comes from the same pot and is accounted for centrally. There is only one discount rate applied across all government spending and for this reason there is no economic logic in identifying issues peculiar to any particular area of spending when considering what that overall discount rate should be.
10. An alternative frame of reference would be to compare the government's general discount rate with that used overseas and on that basis our understanding is that the UK rate is at the lower end of the range which other countries consider to be appropriate.
11. It is only the discount rate in relation to public service pensions that is being reviewed, rather than the discount rate as it applies generally or the

discount applying to each type of spending. Even the discount rate used to assess the cost of something as closely related as State Pensions is not subject to review.

12. It is a fact that the Government is in a position which allows it to provide pensions much more cheaply than private sector employers can. It has the advantage of scale, greater financial strength and it can avoid the costs inherent in funding.

13. A lot of the suggestions that the cost of public service pensions are not properly accounted for is based on ignoring this cost advantage. The suggestion is that public service schemes only provide current levels of benefit because they are not properly accounted for. The prescription which follows is that benefits should be accounted for as if provided by a private sector employer, with the implication that they should be reduced.

14. This concept, generally, does not recognise that the discount rate used should reflect the different criteria as might be applied to a private sector employer. The comparator should be with a private sector employer with the very strongest employer covenant, not with private sector employers in general. On that comparison a discount rate of 3.5% above inflation would not actually be at all unreasonable.

15. A more legitimate debate might be on the question as to who should benefit from the Government's ability to provide pensions more cheaply. The answer should not simply polarise as whether it should be either the taxpayer or the scheme member.

16. The Government should see advantage in using pensions as a cost-efficient means of recruiting and retaining good staff to work in the public services. It is much cheaper for it to compete on pensions than on pay.

17. The use of a lower discount rate would amount to the Government deciding to forego its natural advantage as a pension provider and voluntarily handicapping itself.

18. The concept that the discount rate should be set so that pension provision was not a barrier to greater plurality of public services is going down this line. To follow it would be to allow the tail to wag the dog. In practical terms it would also fail to account for the fact that contractors

could have very different strengths of covenant and therefore different discount rates and pension costs.

19. Changing the discount rate will not alter the cost of the benefits to government, but it will create a distortion in government accounting.

20. If the Government wishes to make proposals for pension benefits and contributions then it should make those proposals on their merits, rather than seeking to justify them by manipulation of the discount rate.

This response is submitted on behalf of Unite by

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