



**Independent Public Service Pension Commission**  
**First Phase Submission**

**This response is submitted by Unite, the UK's largest trade union with almost 2 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 around a quarter of a million membership in the NHS, Local Government and Civil Service Pension Schemes, throughout the UK, and a small membership in various other Schemes. This response is intended to cover all the Schemes in which we have membership.**

**Unite welcomes the opportunity to make a submission to the Commission and, in doing so, to present a reasoned defence of current public sector provision.**

**We are very pleased that an independent Commission has been asked to review public sector pension provision as there is a lynch mob in full cry demanding change.**

**This has been whipped into fervour by the coalition Government, media commentary, private sector employers and by pension industry 'experts' (who are generally directly or indirectly the retainers of those same private sector employers). This lobby has already decided that public**

**sector pensions should be reduced, and has not hesitated to manipulate the facts to make a case for this.**

**Unite, as representative of many public sector scheme members and with a wider interest in promoting good quality occupational pensions for all employees, not surprisingly comes at this from a different direction.**

**We are pleased to be able to present a defence of public service pension provision which we hope will help the Commission to reach a balanced and objective view of the questions it has been asked to investigate.**

**This review will potentially affect the livelihoods of many million of past and present public service employees and their views as members need to be properly considered, alongside those of taxpayers in general. It is an unfortunate thing in relation to pension debates that members' interests are very rarely given due consideration.**

**The first stage of the Commission's work has been described as 'Interim' but it is clear from the terms of reference that in fact the first report will be required to make a final judgement on whether there is a case for change. Otherwise it could not begin to make recommendations for the short term savings the Government is clearly keen to realise. We would question whether sufficient time is being taken in order to make a full evaluation and judgement on the case for change, which will only add to suspicions that the issue has been pre-judged.**

## **Executive Summary**

- The Government is uniquely placed to provide pensions for its employees at a much lower cost than is possible for private sector employers.
- Public service pensions are being funded in a controlled and responsible manner.
- Current Government concern about its short term cash-flows in relation to scheme funding is understandable but does not provide a justification for over-riding completely sound long term funding arrangements.
- The agreed cap and share framework provides a basis as will ensure that scheme costs are sustainable in the face of rising cost.
- Members have agreed already to accept changes in their contributions and benefits as costs rise and the form of these changes should be determined in partnership rather than imposed arbitrarily.
- The imposition of a change in indexation to CPI, which can be construed as pre-judging the Commission's findings, is in breach of understandings surrounding cost-sharing, as also would be the imposition of any across the board contribution increase.
- Public service pensions are proportional to pay and earned by service and so higher pensions reflect not gold-plating but a just reward for a long career in public service.
- The perceived unfairness of final salary schemes as between low fliers and high fliers can be addressed by differential contributions as well as by career average arrangements.
- Government should continue to provide a good standard of pension to its employees both as an example to the private sector and to help recruit and retain staff in the public services.
- The increasingly apparent gap between public sector and private sector pensions has resulted entirely from the fact that private provision has got much worse and Government should focus its energies on reversing that trend.

- Reducing the quality of public service pensions is likely to lead to further deterioration in the quality of private sector provision which will limit any effect it has in closing the perceived gap
- Difficulties which private contractors have in meeting requirements to provide transferring staff with comparable pensions would best be addressed by allowing extended participation in the public sector schemes for those employed in providing public services.
- Unite does not accept that there is any case for short term changes but accepts changes only as required to meet pressures identified as arising out of the agreed cost sharing arrangements, which could be addressed either by contribution or benefit changes.

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

#### **The Government can provide pensions for its employees much more cheaply than can private sector employers**

1. The Government is uniquely placed to provide pensions for its employees at a much lower and more stable cost than it is possible for private sector employers providing pensions of similar quality. Apart from the natural advantages of scale and, for the unfunded schemes, the avoidance of the costs associated with funding the Government reaps the advantage of its permanence.
2. Because private sector employers may not be around or in a position to meet their future liabilities they are forced to fund. Schemes are required, now, to fund on a prudent basis and actuarial and accountancy requirements have required funding to be viewed on a short term market driven perspective. This makes costs higher and also more volatile.
3. Public sector schemes are not subject to the same risk considerations. They can reasonably take a 'best estimate' rather than prudent view of the future, which reduces immediate cost, and a long term view, which

reduces volatility. Private sector schemes would like to be able to operate on similar lines but, increasingly, have become less able to do so

4. Unite believes it would be quite wrong to judge the affordability of public sector benefits by reference to the costs that a private sector scheme would incur in providing them. Its ability to provide quality pensions at a low relative cost gives the Government an advantage in recruiting and retaining staff which it is sensible for it to exploit.

**Public sector pensions are being funded in a controlled and responsible manner which makes them affordable now and in the future**

5. All of the schemes whether funded or not are subject to actuarial valuations to regulate their long term funding. Contributions, from employers and employees, are calculated and set taking account of the full cost of future benefits as well as of any deficits (or surpluses) which need to be funded.

6. It is suggested by critics that there has been deliberate under-funding of the schemes and a concealment of the cost of benefits which requires an increasing subsidy from the taxpayer. This criticism is mistaken and has been encouraged by the focus in Treasury statistics on expenditures rather than contributions and a misunderstanding and misrepresentation of their implications.

7. The so-called 'unfunded' schemes are often described as operating on a 'pay-as-you-go' basis. However, neither of these terms adequately represents the basis of how the funding of these schemes operates. There is not planned to be any correspondence between contribution and benefit expenditure at any particular time but there is a planned correlation over the long term. This is why the accusation that the schemes are Ponzi schemes is quite ludicrous.

8. The NHS is the largest of the public sector schemes. At the present time there is a large excess of contribution income over benefit expenditure (over £2 billion in 2008/9). In effect that surplus cash flow is lent to the Government and represents hidden funding of the Scheme. The Government, in effect, promises a fixed investment return (3.5% above

inflation) on that money and uses it for other purposes. However, just as if gilts had been issued there is a liability to repay the money when it will be needed to pay benefits in the future. It would be just as wrong for the Government to seek to renege on this liability as it would be for it to renege on its other debt.

9. A key part of the Government role is providing a financing facility which allows contributions and benefits at any particular time to differ even though in the long term they are calculated to balance out.

### **The valuation basis of public sector schemes has a sound economic justification**

10. Apart from this role as Scheme banker, the Treasury is guaranteeing a fixed return on the contributions collected but not paid out in benefits. It is suggested that the rate of interest offered on this money is an unfair subsidy to the Schemes, which hides their true cost.

11. The Treasury has justified this interest rate, which effectively doubles as the discount rate which liabilities are discounted by in valuations of the scheme, by reference to the social time preference rate and this is the same rate as the Government uses many other planning purposes including, for example, discounting future benefits in relation to the evaluation of capital projects.

12. It might alternatively be justified by reference to the best estimate of investment returns that the Schemes might earn if they were allowed to invest like private pension funds in a range of assets. This will include real assets as might be expected to deliver yields well above inflation reflecting a measure of economic growth. The Government is able to offer such returns on the strength of the rise in tax revenues which such economic growth naturally produces.

13. If we look specifically at the LGPS, the funded scheme, the 3.5% rate is also planned for valuing benefits in the model scheme which will be the basis of cost-sharing. We would argue that this rate of return is a justified assumption for assessing the cost of future benefits provided by the Scheme, given the strength of the employer covenant. It is a rate that a

private sector employer with a similar strength covenant would be able to use under current funding regulations

14. It is argued by critics that Government should offer no greater returns than would be offered to others who lend money to the Government. However to impose such a constraint would be unfair to the schemes and their members as it would effectively impose on them an investment policy which no private sector scheme in a similar position would think of following.

### **The presentation of public service costs in the national accounts gives no great cause for concern about the long term cosy burden**

15. The key statistic in relation to public sector pensions is the projection of the benefits paid out by the unfunded schemes as a proportion of GDP (national income). This measure is, however, in an important sense deficient as it ignores the inflow of contribution income and so suggests this is all a straight drain on the taxpayer which is not the case.

16. The latest OBR figures suggest the pay-outs would rise from 1.8% of GDP in 2009/10 to a peak level around 10 years later of around 1.9% before dropping back again. These are hardly figures which should cause great public anxiety as the costs will be covered by contributions in the long term and they do represent the retirement income of a large section of the population. In fact they suggest that current concerns are rather hysterical.

17. The Government and (disappointingly) the 'independent' OBR have focused attention on a different measure, i.e. short term estimates of the net cost of public sector pensions. This measure is the difference in each year between the income from contributions and the pay-out of benefits, which are both big numbers, as estimated for each of the next few years. It is currently around £4 billion (less than 0.3% of GDP) and is predicted to more than double over the next four years. It is being suggested that, because that figure is anticipated to rise strongly the cost of public sector pensions is out of control.

18. This measure relates only to the unfunded schemes. It has little bearing on the long term funding position or cost of pensions, being driven by short term fluctuations in pay, prices and employment levels. This can readily be demonstrated. It would suggest that the impact of a pay freeze and public sector job cuts would increase the cost of public sector pensions, as contributions would fall but benefits paid out in the short term would not. It is clear that such developments would actually reduce public service pension costs and liabilities over the longer term and this shows how perverse the measure is.

19. It is a measure which does not include and which has no reference to the LGPS. In that scheme, in which, in aggregate contributions substantially currently massively exceed benefit outgoings e.g. by £4.6 billion in 2008/9), any reversal of the cash flow position would be met by disinvestment of the Scheme' assets rather than any extra financing from Exchequer or Council funds.

20. Current Government concern about its short term cash-flows in relation to scheme funding is understandable, given current budget deficit problems, but it clearly does not provide a sound basis for over-riding completely sound long term funding arrangements.

### **Valuing public sector schemes like private sector schemes is a mistaken and misleading approach**

21. A further line of attack on public sector pensions is to calculate figures on the cost of accruing benefits or of the total liability on the basis of what they would cost a typical private employer's scheme, or on an accounting basis, and then to argue these figures are unaffordable.

22. Costing public sector benefits on a private sector basis is a bit like setting your budget on the basis of the cost of goods in a village corner shop when you are able to shop at a big supermarket.

23. Calculating an inflated figure for the total public sector liability produces a very big and unstable number, as it fluctuates wildly as market interest rates change.

24. It is unsurprising that any figure for the total liabilities of public sector pension schemes should be very large is very large given that it represents payments to millions of present and future pensioners over an eighty year period. When this is understood it is not a very worrying figure at all.

25. The fact that these estimates fluctuate wildly ought to suggest that they are not a very reliable indicator for the value of what are defined levels of benefit.

### **The significance of the recent reforms, in particular in respect of ‘cap and share’ has not been properly recognised**

26. It is often suggested that reforms recently agreed in the main public service schemes are not significant and have not gone far enough. The main evidence for this is that changes in members’ benefits and contributions so far made have been of a lesser degree than those typical in the private sector.

27. The intention of the public sector reforms was to stop the cost of schemes rising in the future rather than to cut the cost of future benefits, immediately as has often been the case in the private sector.

28. The agreed ‘cap and share’ framework provides a basis as will ensure that scheme costs for the main schemes remain affordable both to Government and the employers by addressing the prospectively rising cost. Of benefits. This framework is not well understood not least because it is new and because nothing quite like it has been established outside the public sector.

29. The first full round of cost-sharing valuations is only just getting under way, with the 2008 Valuations of the NHS and Teachers schemes expected this summer.

30. In both these Schemes the employer contribution now is around 14%. This contribution rate was set after changes in member benefits and contribution rates were agreed after their last Valuations (as at 2004)

which meant the full cost of accruing benefits and required deficit payments was met.

31. Under cap and share the future employer contribution is capped at 14%. Any increase in the benefits which members receive over and above what was expected at the previous valuation (and fully covered by the contributions set) will register as an increase in costs and will fall to be absorbed by changes in member contribution or benefits.

32. A significantly increased cost is expected on account of scheme members living longer now and being expected to live longer still in future. Benefits paid for longer register as improved benefits in this framework. Likewise any other factor where members get higher (or lower) benefits registers as a cost (or as a saving). Overall a significantly increased cost is expected and this will require to be met through changes in member contributions and/or benefits.

33. Contribution or benefit changes as will result from the 2008 Valuation would be expected to take effect in April 2012. This highlights another reason why changes made so far have been less in the public sector which is the longer process for dealing with valuation results. A private sector scheme valuation process for an April 2008 valuation would be expected to have been completed by July 2009. However, the later implementation of changes in public service schemes is allowed for in the funding calculations and so the scheme funding is not reduced by it.

34. The only basis whereby employer contributions could increase beyond 14% is on account of a change in the actuarial method and the financial assumptions used in the valuations. There is no particular reason why these assumptions (which include the 3.5% real discount rate as discussed above) should change either at the current or future valuations.

35. An employer contribution cost of 14% is not out of line with contribution levels commonly paid in the private sector, whether in DB or in good quality DC schemes when account is taken of higher NI costs (as they are generally contracted-in) and of the cost of death in service and ill health benefits. We would contend that costs are much more closely aligned with the private sector than benefit levels.

36. Arrangements in regard to the Civil Service Scheme and prospectively the LGPS (where the final details of cap and share have not yet been fully determined) will follow soon after and cap and share is expected to work on similar principles. In the LGPS fluctuations in scheme funding due to market fluctuations affecting the asset values of the funded schemes are proposed to fall outside cost sharing. They have no bearing on benefits received by members and would be expected to even out if assets earn 3.5% real return in the long term, as we have argued they might reasonably be expected to do.

### **Deficits in the schemes are addressed through the cap and share mechanism**

37. It is important to understand that funding deficits in the unfunded schemes are dealt with in their valuations and addressed by the cap and share framework. The standard practice is for deficit to be run off over a fifteen year period.

38. For example, the longer life expectancy of pensioners is currently registering as a deficit and this means an additional contribution needs to be calculated on top of the cost of the future benefits of current active members. Under cap and share this cost is falling on the active members of the schemes and not on the Government or the employers.

39. The position in respect of the LGPS is more complex. While deficits in respect of mortality and other sources of increases in member benefits (assessed in practice via the mechanism of a representative model fund) will be dealt with by a similar cap and share mechanism, deficits (and possible surpluses) arising out of fluctuations in the schemes investments are not.

40. It falls to the individual LGPS funds to deal with deficits or surpluses as arise on account of fluctuations in the value of their assets. Because the employer covenant is very strong, it is still open to LGPS employers to take a long term view of their investments and steer a steady long term course through market turbulence. This, in principle, helps avoid short term fluctuations in contribution requirements.

41. Private sector employers are now much less able to take a long term view as they are subject to funding regulations which put under pressure to deal with deficits over shorter periods, because of concern about the potential consequences of employer failure.

**Cap and share also involved an acceptance that changes in scheme benefits and contributions should be negotiated**

42. Under cost-sharing and cap and share arrangements members have agreed already to accept changes in their contributions and benefits as costs rise. This was construed as a major concession by the trade unions and a key part of the agreement in relation to this is that the form of these changes should be determined in partnership rather than imposed arbitrarily. This is notwithstanding the fact that the Government ultimately determines the rules of the Scheme.

43. This represents a change from arrangements pre-cost-sharing when pension changes were only formally subject to consultation and there was no real negotiation.

44. The process for reform of public service pensions and the establishment of cost-sharing was set in train by the last Government's proposal to raise the normal pension age of all members to age 65. This was driven by a wish to make savings in the face of rising costs.

45. The perception that it was a defeat for the Government and for reform when it was agreed to allow existing staff to retain age 65 is mistaken. Rising costs were addressed in other ways, in part by immediate change such as contribution increases but more importantly through agreement on cost sharing and cap and share which achieved the over-riding goal of making the schemes sustainable.

46. The proposed imposition of a change in indexation to CPI is in breach of understandings surrounding cost-sharing as would be the possible imposition of any across the board contribution increase. This is not to deny that there are likely to be cost-sharing pressures arising but that such measures are conceived without regard to those pressures and because

there is no apparent intention to determine in partnership how the pressures should be addressed.

47. We do not accept that the CPI is simply a technical change motivated by a perception that it constitutes a better measure of inflation for pensioners than the RPI. Nor do we accept that it should translate into cost-sharing as a change in financial assumptions and therefore that savings derived from it should flow back directly to the Government and not count against the increase in shared costs arising in the valuations which will otherwise remain to be addressed.

48. It is quite clear that CPI indexation will mean lower pension increases and that therefore this is a reduction in member benefits. We would question the legality of such a change as it applies to past service benefits. Insofar as it does proceed, in principle, we would argue that it should register as a saving in shared costs as calculated in the Valuations as will help reduce the anticipated need for savings in other areas.

49. An increase in member contributions may well look attractive to Government as it is one of the only options as will influence net government spending within the current spending review period which the Commission has been asked initially to focus on.

50. If the Government were minded to insist on contribution rises we would argue that the savings from the increases should register as a saving in shared costs (just as recent agreed increases have) and that the incidence as between members on different salary levels of any given target for contribution increases should be determined in partnership discussions. There is an inherent danger that contribution increases will drive lower paid members out of schemes.

### **Public service scheme are evolving to address rising costs and concerns about fairness**

51. It is being suggested that public sector pensions are excessively generous which might suggest that they have been subject to improvement. This is not the case and the schemes actually offer slightly lower benefits than they did ten twenty and thirty years ago.

52. Public service pensions are proportional to pay and earned by service and so higher pensions reflect not gold-plating but a just reward for a long career in public service.

53. In the public sector there are no higher scales of benefits for those on higher salaries and no exclusion of those on lower pay from access to schemes. Such discrimination is not uncommon in the private sector. Part time staff in public service receive pensions which are pro-rata to their hours.

54. The public service schemes have been particularly successful in pensioning lower paid employees working in public service, who in the private sector are usually left un-pensioned and dependent on means-tested benefits

55. The general quality of the public service schemes has been reduced in a number of areas in recent years e.g. higher contributions, retirement at 65 for new employees and reduced benefits in the event of ill health and redundancy.

56. The single biggest pressure increasing the value of schemes, and their cost, has been longer life expectancy but this has now been addressed decisively through the cost sharing arrangements. Increased cost from mortality emerging since the Schemes last valuations (both for past and present employees) will generally be born wholly by the members.

57. The public service schemes have been criticised as unfair since, as final salary schemes, they are perceived to deliver disproportionate benefits to those who advance their careers most. This perception reinforces criticism of the level of pensions being accrued by those on high pay in the schemes.

58. The perceived unfairness of final salary schemes as between low fliers and high fliers has been and can be addressed by differential contributions as well as by the career average arrangements which have been advocated to replace final salary.

59. This is the approach adopted in the NHS and LGPS Schemes, which has also enabled the contribution levels required of lower paid staff to be retained against a background of the yield from employee contributions overall being significantly increased.

60. It is important to note that the case for and the possibility of moving to career average was considered and debated and this alternative method was what was agreed. It would be more difficult to justify differential contributions if a CARE framework was adopted.

### **Public service workers pensions should not be reduced because of failing in the private sector**

61. Unite believes that the Government should continue to provide a good standard of pension to its employees both as an example to the private sector and to help recruit and retain staff in the public services.

62. We have argued that the cost of public service pensions has not significantly increased in recent years, that the cost remains affordable and that cap and share will maintain that position and so makes the Schemes sustainable. We can see no justification, therefore, for reducing the general quality of current provision, to disrupt current arrangements and so to devalue the employer promise of pension on the back of which our members committed to careers in public service.

63. The strength of occupational pensions used to be trumpeted as a virtue and the decline in private sector employer provision has been widely lamented. Yet now that private sector provision is in retreat the maintenance of such arrangements in the public sector is now suggested as being undesirable. This is quite perverse.

64. It remains vital, if we want to see good quality occupational pension maintained and extended, that the Government continues to set a good example as an employer committed to providing its employees with a decent standard of pension in retirement. In the private sector we would challenge any employer proposal not justified in the particular circumstance of a scheme and its sponsoring employer as being an unjustified attempt to jump on a bandwagon. So also now we will resist change in the public service schemes which is not sufficiently justified and simply seeks to copy what other employers are doing.

65. Public service pension provisions are key to the recruitment and, more importantly, the retention of staff. There are many staff in key occupations

and working in stressful occupations who need to be retained and many areas where higher levels of staff turnover will greatly increase training costs. The public service pension schemes are a key ingredient of the glue which keeps people in public service jobs. In the absence of a compelling cost justification for change the Government would be unwise to tamper with this.

66. The increasingly apparent gap between public sector and private sector pensions has resulted entirely from the fact that private provision has got much worse and Government should focus its energies on reversing that trend.

67. The gap between public sector provision and average private sector provision has always been there as the employers of over half the private sector workforce, especially smaller employers, have never voluntarily provided pensions to their employees. Hopefully this problem will start to be addressed with the inception of auto-enrolment requirements and NEST.

68. What has happened in recent years is that larger and medium sized employers have been reducing the quality of provision that they provide. We would see the maintenance of public service pension provision as exercising an important restraining influence on their behaviour which could otherwise degenerate into a race to the bottom.

69. There seems to be a general acquiescence that pensioners in the future are going to be poorer because there will be more of them and because they are living longer. This will be brought about mainly by reduced occupational provision. This is hard to reconcile as it is to set against a background where the economy and general living standards will continue to grow. The Government needs to do all it can to promote quality occupational provision, if this situation is to be avoided.

### **Access to public service pensions should be maintained and extended**

70. The gap between public sector and private sector provision is highlighted when staff transfer between the two sectors. The Fair Deal policy, whereby contractors are required to maintain comparable pension

terms for transferring staff has sought to ensure that where services are 'privatised' it is done on the basis of genuine efficiencies rather than being at the expense of staff losing future pension provision.

71. Fair Deal has provided a valued, even if imperfect, measure of protection for employees pensions, without which there would be much more difficulty in implementing transition to the private sector. However, it is recognised that private sector employers are not able to provide comparable pension benefits at the same cost as the public service pension schemes can.

72. We do not accept that these problems on the fringes of the public sector justify changes in pension arrangements extending into its much larger core

73. Difficulties which private contractors have in meeting requirements to provide transferring staff with comparable pensions would best be addressed by allowing extended participation in the public sector schemes for those employed in providing public services. This would follow along the well developed lines, for example, of admitted body status in the LGPS

### **Imposition of arbitrary short term changes will destabilise and undermine a sound long-term funding framework**

74. The Commission in its Interim report has been asked to address in particular the possibility of short term changes as will impact on the current Government spending review period.

75. Its recommendations have already, unfortunately, been pre-empted by the CPI proposal, insofar as the Government succeeds in implementing that on the benefit payments of current pensioners.

76. The other obvious target which has an impact on the short term cash flow which the Government, mistakenly in our view, is focussing on would be members' contributions. Imposition of a contribution increase, coinciding as it may with a public sector pay freeze would be perceived by our members as extremely unfair and threaten to drive lower paid members out of the Schemes

77. Unite does not accept that there is any case for arbitrary imposed short term changes but it does accept changes will be required to meet pressures identified as arising out of the agreed cost sharing arrangements. All short term changes should be fully recognised within the cost-sharing framework as offsetting those pressures.

78. These pressures could be addressed either by contribution or benefit changes. We would expect any such changes to be determined through the now established governance procedures and with due process of consultation and implementation.

79. If the Government is insistent on the response to pressures being met by changes as will affect its short term cash flow position then this attitude would have to taken account of in negotiations, but the specific form of changes should be determined in partnership.

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