

PRESS RELEASE

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Public sector pensions twice as valuable as previously thought

- **Public sector pensions worth, on average, at least 40 per cent of salary**
- **Warning that contributions may need to rise sharply if benefits remain unchanged**
- **Independent inquiry sets out menu of options for reform**

In a new report published today, the Public Sector Pensions Commission has found that the true value of the main unfunded public sector pension schemes is over **40 per cent of salary**. The report, which is being launched this morning, also finds that a **lack of transparency over the true costs** of public sector pensions has made it easier to delay reform in the past. Without more transparency, the true costs are **unreasonably forced onto future taxpayers**.

Today, the Public Sector Pensions Commission, an independent body comprised of experts in pensions policy and chaired by an independent actuary, is also setting out a **menu of reform options** to ensure that public sector pensions remain affordable in the long run.

The key findings of the report, the product of nine months of research and consultation, include:

- The Government uses **artificially high discount rates** to report unfunded liabilities and to calculate the employer and employee contribution rates, which **appear to lower the cost** of providing public sector pensions.
- The main unfunded schemes have **combined employer and employee contribution rates artificially set at around 20 per cent of salary**, but the **true value of such schemes**, when measured using a discount rate based on the current yields on index-linked gilts, **is over 40 per cent of salary**.
- Reform should **apply to all current members of schemes** and not just new members as the changes in 2005 applied, while protecting past accrual.

The Commission's recommendations include:

- There are a number of reform options that would bring down the cost of the main unfunded public sector pensions towards the 20 per cent of salary

currently contributed by employees and employers. A **reformed defined benefit pension** could deliver substantial savings.

- A reduction of accrual rate to 1/80 or a switch to career average revalued earnings as the benefit structure would **each save around £10 billion per annum** and an increase to a pension age of 65 for all members would save **around £5 billion**. The reduction in the degree of index-linking – from RPI to CPI – set out in the emergency Budget will **save around 10 per cent of costs**.
- A simple and immediate way of altering the financial burden on the taxpayer is to **increase employee contribution rates** – a 2 percentage point increase could raise up to **£2 billion a year** – but it is not a substitute for longer-term reform.
- Serious consideration should be given to **ending the contracted-out status** of public sector pensions, as they are generally paid from age 60, compared with 65 rising to 68 or even higher for the State Second Pension.
- Other options considered by the Commission include a switch to **funded defined contribution** or **notional defined contribution** arrangements, which would reduce the risk to the taxpayer. There would, however, be considerable transitional issues with a move to funded defined contribution.
- **Hybrid schemes**, combining a core DB benefit and flexible DC top-ups, could represent an important compromise.
- Any reforms must start with **transparency of costs**. Meaningful agreements between public sector employers and employees are not possible unless both sides understand the baseline from which reform can be measured.
- The reform options set out by the Commission apply equally well to a **national or a decentralised approach**. With a decentralised approach, different public sector employers could choose different options, provided that they and their employees faced the full actuarial costs.

Peter Tompkins, Fellow of the Institute of Actuaries and Chairman of the Commission, said:

“A true assessment of the value of pensions in the public sector today shows that they are worth twice what the Government suggests in its calculation of the contributions that public sector employers pay. It is a matter both of justice and good economics that public sector employees and employers should bear the full cost of their pension provision.

“Increasing longevity means that pension provision has to be looked at again, and the public sector cannot continue to remain immune. The question of why the majority of the workforce should be expected to pay through their taxes to support pensions that they cannot afford for themselves must be raised.

“As Greece has been experiencing, increases to retirement ages or cuts in benefits are not popular at the best of times, but implementing them as part of a package of crisis cuts is the least palatable option of all. It is essential that reforms are conducted early in a measured way rather than waiting until we have a crisis.”

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NOTES TO EDITORS

- 1) The Public Sector Pensions Commission (www.public-sector-pensions-commission.org.uk) comprises seven Commissioners and one Secretary. Its views do not necessarily reflect those of the organisations to which the individual Commissioners are affiliated:
 - Peter Tompkins, Fellow of the Institute of Actuaries, Chairman
 - Philip Booth, Institute of Economic Affairs, Vice Chairman
 - David Acland CBE DL, CHK Charities Ltd
 - Ros Altmann
 - Andrew Lilico, Policy Exchange
 - Neil Record, Institute of Economic Affairs
 - Malcolm Small, Tax Incentivised Savings Association
 - Corin Taylor, Institute of Directors, Secretary
- 2) The full report of the Public Sector Pensions Commission can be found here: <http://www.public-sector-pensions-commission.org.uk/wp-content/themes/pspc/images/Public-Sector-Pensions-Commission-Report.pdf>
- 3) The Public Sector Pensions Commission was established in the autumn of 2009 by the Institute of Economic Affairs, the Institute of Directors and other groups. It is chaired by an independent actuary. Its terms of reference are to improve transparency and public understanding of public sector pension costs and present to the new Government a realistic set of options for reform of the present public sector pension arrangements. It is entirely separate from, although warmly welcomes the establishment of, the official commission on public sector pensions headed by John Hutton.
- 4) Please direct *media enquiries* to Ruth Porter on 020 7799 8900 or 07751 717 781 or email rporter@iea.org.uk
- 5) The launch of the Public Sector Pensions Commission report will be held in the Burton Room at the Institute of Directors (116 Pall Mall, SW1Y 5ED) on Wednesday 7 July from 9 for 9.30 to 11-11.30. If you would like to attend, please email corin.taylor@iod.com to reserve a space.
- 6) For all enquiries relating to *filming at the launch event*, please call Alistair Tebbit on 020 7451 3278 or 07800 850 460.