Daylight Robbery, the truth behind public sector pension's

Firstly, I would like to start by extending my support for the millions of public sector workers who felt that the Government had failed to listen to them and failed to engage in sensible dialogue as opposed to dictating to them and chose to attack their pensions, thus, galvanizing millions in to strike action on November 30th. Now let us be clear, nobody relishes the prospect of going on strike, least of all the unions themselves, people loose pay, which given the current economic climate comes at a time when they can ill afford. The ballots are time consuming and expensive to conduct which impact on the unions finances and lastly the general public who also suffer as a result of the inevitable disruption. Given the above I am sure you can appreciate how difficult the decision to strike was but out of sheer desperation, was the only choice they believed was left open to them.

I think it is important to remind ourselves that this is not a public v private sector argument but to see it for what it actually is and that is an attack on future deferred earnings of Hard working men and women across Britain who have chosen to serve the people of United Kingdom in vital services that we all rely on like nurses, teachers, firemen and the armed forces to name but a few, many of whom are remunerated at considerably lower levels of pay than the national average which stands around £26,500. The actual public sector worker average pay is just over £21,000 with many more on less than £15,000. Let us examine the facts as opposed to listening to the government rhetoric spouted by many including Danny Alexander, which at best is misinformation and at worst out and out lies.

Let us be under no illusion the promise of pensions allows companies and government to employ their Labour more cheaply today so it gets the benefit of their services now, in return for a cost in the future, which in essence is no different to taking a loan out to benefit a business today which has to be serviced and repaid at some point in the future.

The government claims that as a result of increased longevity the current defined benefit schemes that are currently available to public sector workers are no longer affordable or sustainable to the taxpayer. This is simply not true, if you examine the underlying infrastructure behind public sector pensions you quickly realise that public sector pensions are in actual fact in quite good health with the biggest threats coming from the government's policies themselves, let me explain.

All public sector pensions are Defined Benefit (DB) schemes also known as final salary. There are two main types DB schemes within the public sector, **funded** which are operated in the exact same way as DB schemes in the Private sector and **unfunded** which are known as pay as you go public services pensions which operate in a similar manner but contain some fundamental differences.

Do not be fooled by the spin that this is the first time that public sector pensions have been targeted there has been wholesale reform across a number of the main schemes between 2005 and 2008 in particular for new starters in the NHS, Police, Armed forces, principal civil service and teachers. Existing members have also seen changes put in place most notably an increase in their retirement age which is now 65 like many in the Private sector.

There are around 6 million public sector workers employed across the UK today. They are essentially split in to the two different pension categories for example those in the local government scheme which is a **funded** scheme and those in the pay as you go scheme which as highlighted above is an **unfunded** scheme.

The Local government scheme is by far the largest scheme at present with 4.6million members split into 89 separate funds all with their own administration functions. They are basically administered and funded in exactly the same way as private sector defined benefit schemes are funded and are governed by a set of trustees or in some cases by a pensions committee, which are essentially of no material difference, and as such are subjected to the same legislation that requires those funds to undergo actuarial valuations at least every 3 years which are carried out by the Government Actuarial Department (GAD).

The valuations carry out a full financial health check of those schemes at a point in time. It measures the value of the investment assets held by those funds and using a number of prudent assumptions assesses them against the amount of money that will be required to meets all the pensions that it will have to pay to those members in the funds over its lifetime (i.e. until the last person dies) this is called the liabilities. If there is a shortfall in the amount of monies in the assets compared to the liabilities this is what is called a pension deficit, then the scheme sponsor, which the case of public sector workers is either a local authority or central government, must agree additional payments under a deficit reduction plan which must be agreed by the pensions regulator. The reality in these funds is that the public sector pension schemes have ring fenced assets that are in pretty good health, with serviceable deficit reduction plans where those deficits exist.

The situation in relation to the pay as go scheme or **unfunded** scheme as it is sometimes known is a little more complex but I will try to provide a simplistic overview. These schemes cover around 7.5 million past and present public sector workers. The government will claim that these pension schemes cost the taxpayer £23 billion a year and are simply unaffordable, but a more sensible and realistic way of looking at these schemes is known as the “net public service pensions” This is the difference between benefits paid out to today’s pensioners from those unfunded schemes and current contributions paid in to unfunded schemes by current staff who are members of those schemes. In the current year this around 0.3% of GDP or to put it in monetary terms £4.1 billion.

The biggest threats facing pensions and to these statistics actually arises from making public sector workers redundant, which reduces the level of contributions being paid in but the benefits paid out either remain the same or increase if people are retired early. Further problems are created by freezing public sector pay below inflation, this is because pensions in payment rise in line with inflation (now CPI) but contributions (income) do not.

The third factor that threatens to destabilize pensions not only in the public sector but the private sector as well is the Tories current fiscal policies and so called debt reduction plans attributable to the banking crisis which arose in 2007 and that is Quantitive Easing (QE). QE is a posh term for what is effectively printing money, which in turn will drive gilt yields down. It is estimated that a reduction of 0.25% in gilt yields will increase liabilities in the FTSE 350 (private sector pensions) by around £25 billion pounds; this is on top of the £74 billion incurred as a result of the first QE injection of £200 billion at the beginning of last year. It is fair to say there is very little cost implications if any at all for the unfunded public sector schemes in the short to medium term because the government can plan for future payments. In addition QE measures are also squeezing earnings in real terms the likes of which have not been seen for 30 to 40 years.

As you are no doubt aware the average public sector pension is just £5,600 with many more receiving a considerable amount less for example many dinner ladies and teaching assistants will only get an annual pension of £2,300 per year, hardly a bankers bonus, in contrast to the boardroom bigwigs who can look forward to annual pensions of around £220,000. The government proposals mean public sector workers will have to pay more in to the schemes, to work longer and to receive less when they retire. To add insult to injury what they fail to take in to account is the fact that as a result of the 2 year pay freeze imposed on public sector workers that their pay in real terms has been reduced on average around £1,400. Which as highlighted above has actually increased the contribution costs, both factors will be compounded even further by the chancellors decision to impose a 1%cap on public sector pay increases for 2013 & 2014 and increase the scale of public sector redundancies by a further 310,000 in his autumn statement announced on the 29th November.

Cameron himself has suggested that if the public sector does not accept these changes then the government may be forced to scrap DB schemes within the public sector altogether like many private sector companies have and force public sector workers in to Defined Contribution (DC) schemes to save costs. For clarity DC schemes are where the workers themselves bear all the risk in other words the amount they pay towards their pensions is defined but the benefit they will receive upon retirement is unknown and depends on how well the funds their contributions have been invested in performs. However in reality this is an empty threat because this would cost the government considerably more in the short and the medium term, this is because instead of using the money that current public sector workers are paying in to the funds to pay the pensioners, they would have to pay those contributions in to a fund to invest for the future DC pensions whilst at the same time continuing to pay the pensioners, as highlighted above this would be in the region of around £23 billion pounds a year thus adding a further £19 billion to the pensions bill.

Despite all the claims made by the government a recent report published by a former treasury official Con Keating (now head of Brighton Rock Group) entitled "Don't stop believing" launches a vigorous defense of both Private and Public sector pensions. He advances that that pensions are both affordable and sustainable and whilst he acknowledges that pension costs are rising, they are rising less rapidly than economic out. In other words as % of GDP the real cost of pensions is continuing to reduce.

I think it is also worth noting a couple of other points that were contained within the chancellor's autumn statement. It is a fact that as a result of improvement in medical science and technology the population continues to live longer which on the whole good news is. As highlighted above the government continue to cite this factor as the underlying reason attributable to the un-affordability of pensions and is undoubtedly the excuse that will be rolled out over the next few weeks and months by government officials in order to defend the decision to bring forward the rise in state pension age to 67 from 2034 to 2026. However, if we examine this decision in a little more detail and in particular look at the financials behind it you quickly realise that this is just another smoke screen. Because according to the pensions minister Steve Webb (whilst addressing the Society of Pension Consultants a couple of months ago) he stated that "there is a £14 billion boost to GDP for every year people are asked to work longer, to put that into context the chancellor has just grabbed a further £112 billion out of our pockets, or to put it another way he can continue to fund public sector pensions at today's benefit levels and still have £10billion spare. As I have highlighted in previous articles (the medicine is not working) that growth is being stifled and the debt reduction is not actually working as a result of the economic policies they are employing, it came as no surprise to me that also contained within his autumn statement were downgraded growth forecasts down to 0.9% from 1.7% for 2011 and 0.7% from 2.5% in 2012, which in turn has increased government borrowing by an extra £100 billion over the next 4 years, more than the extra £16 billion worth of cuts, thus creating a 78% debt to GDP ratio which is over double Labour's debt to GDP ratio for 10 years prior to the banking crisis occurring and still 50% less than when Labour had to bail out the banks.

In conclusion if we are all in it together as they claim and this is a generous offer to the public sector pensions then perhaps Cameron and co can explain why the only public sector pension excluded from these proposals is the Members of Parliament pension scheme, which incidentally accrues at double the rate of other public sector pensions 1/40th as opposed to 1/80th with the average pension in retirement currently standing at £18,600.