

# IPPR speech – Pension reform in the public services

23 June 2011

Good morning everybody.

Can I start by thanking the IPPR for giving me this opportunity to say a few words about pension reform in the public services and also to thank the Institute for the way it engaged with the work of the Commission I recently chaired? I am grateful to you.

Pension reform, never far from the top of the list of politically sensitive issues, has once again burst into the headlines. And this time they are not very good ones. After the publication of my Final Report in March, negotiations had begun between Ministers and the TUC on whether the reforms I proposed could form the basis of a new agreement. An agreement that would help us sustain good quality defined benefit pensions in the public services, whilst at the same time addressing the legitimate concern of taxpayers about their rapidly rising cost.

Today, the talk is of provocations, disruption and industrial action.

Amidst all of this noise, I want to begin my remarks today with some comments on why reform is necessary. Because it is important not to lose sight of the problem that we are trying to fix.

We should be clear about one thing. There is a problem.

Britain is becoming an ageing society and pension reform in the public sector, began by the last labour Government, did not in my view keep pace with the accelerating nature of these profound demographic changes. Here are some

examples from the major public sector schemes which I hope will put this into context.

In the year I was born, 1955, it was estimated that teachers would live on average until they were 76. Today that figure is 89 and still rising. In that same year, 1955, it was thought that a woman retiring from the NHS would live another 20 years. By 2004 this had risen to 28 years and by 2010 it was estimated that it would rise to 32 years. In 1983, civil servants were expected to live until they were nearly 80. In 2010 that figure had increased to 88. Put simply, we have not been putting enough aside to deal with these extra costs. Taken together, the cost of providing public service pensions has increased by a third in the last decade alone. These additional costs have been met by taxpayers, not scheme members. So my first and fundamental conclusion was that we needed to get the system into a fairer and more sustainable balance, because I do not believe we could have gone on as were. Incidentally, neither did the trades unions. They had agreed a mechanism to address these rising costs and re-distribute between employers and employees. I want to say more about this in a minute.

So my first responsibility was to try and find a way to sustain good quality pensions that could set a high standard of adequacy and fairness, but which against this background of rising costs could also be more affordable over the long term to taxpayers. This remains the key challenge going forward. We need a better balance so that public service pensions do not become an unsustainable burden on public finances and the wider economy whilst minimising the risk that public service workers will need to rely on means tested welfare benefits in retirement. We should do all we can to avoid this outcome, which would undermine any sense of personal responsibility to save

for your retirement – one of the great things that public service pension schemes have achieved to date with the vast majority of people in the public services contributing to employer sponsored schemes.

That is the context. But we also need perspective. The fact that we are rapidly becoming an ageing society probably does represent probably the biggest policy challenge facing this generation. But it does not have to mean the end of the world as we know it. So my first conclusion was that there was a way in which we could strike this better balance. We did not have to take the advice of some and simply pursue a scorched earth policy - a race to the bottom. Pensions in the public sector are not, after all, as gold plated as some claimed. Most pay out less than £6000 a year. We should try and find a way to avoid reducing the value of these benefits any further.

In my view therefore, there is an alternative that avoids the injustice of forcing increasing numbers of public service workers into poverty when they retire. But it does involve some hard choices.

Not everyone shares my analysis. That is clear. Some say that the rising cost of providing these pensions has been exaggerated. That the costs are due to come down over the long term and that in any event, cap and share will put the system onto a more sustainable footing for the future.

My response is this. The costs increases are real and are set to continue for some time. It is true that my report contained a summary of the predictions going forward which show a gradually falling share of GDP being taken up in meeting these pensions costs. But we must avoid torturing the data until it confesses. My report was very clear on this point. These long term assumptions on the share of GDP are highly sensitive to assumptions about the

size of the public sector workforce, earnings growth and the implementation of reforms. My conclusion was that the public could not be sure that schemes will remain sustainable in the future. Given how wide of the mark we have been over many years, I do not think we should bet the house on one set of assumptions. That was certainly the view of the recent report from the Public Accounts Committee.

I welcome cap and share. It marked a turning point in the debate. People recognised that we could not go on asking taxpayers to take all of the longevity risk inherent in DB schemes. But it would also be a mistake in my view to argue that cap and share deals with all of the problems we face. It does not. Many schemes are not covered by cap and share at all. Even when they are it is an untried system that may not be sustainable if rising longevity costs are mainly borne by increasing pension contributions or cutting benefits. It does not address the recent increase in costs. I am not clear that it will provide coherent results and therefore leaves too much risk and uncertainty with taxpayers.

So my second fundamental conclusion was that if we are to maintain DB in the public sector then we needed a better mechanism for re-distributing risk. And not just longevity risk.

Final salary schemes leave all of the salary risk with taxpayers. In my view this is neither reasonable nor sustainable. All DB schemes involve a certain amount of cross subsidy. I have no problem with this in principle. It is common in any risk sharing arrangement. But what is unacceptable in my view is the fact that final salary schemes involve those on low and middle incomes subsidising the higher pensions of those who earn the most. Those at the top have their pensions subsidised by those at the bottom. This just cannot be justified any longer.

That is why I have recommended a move to a career average scheme which will ensure a better match between pension contributions and pension payments. This recommendation is not about saving money. It will just be a fairer system to scheme members. Ministers will still have to decide how generous they want this scheme to be. I hope a way will be found to make the new CARE schemes of broadly equivalent value to the present schemes. This is something that Danny Alexander spoke about last week. I am glad he made these comments. I hope it will address the real concerns that people have that “reform” really means the same thing as “slash and burn”. It must not. Using a measure of income indexation as I have proposed will also help maintain the real value of a person’s contributions into such a scheme.

Some of the other reform options I considered, particularly lump sum accrual systems could have offered an equally good solution. But they are much more complicated to describe and run the real risk of being mis-described as a form of defined contribution. I did not want to run these implementation risks. My conclusions present enough of a challenge as it is.

My report therefore made one further vital recommendation. But the key shock absorber – the best way we can deal fairly with the rising costs of life expectancy without having to slash scheme benefits or put up contributions even more than is being proposed, is to increase retirement ages and ensure they keep in step with longevity increases going forward. This is not a “work till you drop” proposal. I want there to be maximum flexibility about when people can elect to retire. And a lot will depend on a person’s accrued rights under the existing schemes. Someone in the mid 50’s today will not be affected very much if at all by the changes I have proposed. This is right and proper. We have to treat people closest to retirement fairly and sensitively. However the way

we have approached this issue up to now has been to only ask those joining the public services to work longer. Where is the inter-generational fairness in this approach? Why should the baby-boomers pass the cost and burden of change entirely onto those who come behind us?

I fully understand that this is a very difficult choice to confront people with. But this issue is coming down the track at us whether we like it or not and we can't afford to duck it or fudge it. It will require us all to re-think the balance of our adult lives we spend in work and how much we can look forward to spending in retirement. There are powerful lifestyle choices than are involved in this. At present, someone retiring from the public services at the age of 60 will probably spend about 45% of their adult life in retirement – up from about a third in the 1980's. This is unsustainable. If my proposals are accepted then people can still expect to spend more than two decades of their lives in retirement. I do not think this is unreasonable.

If we are prepared to make these changes then I believe we can put the sustainability of public service pension schemes onto a much stronger footing. Hopefully we will not need to make any further changes as we go along. But just in case we do, there needs to be a ceiling set for the amount that employers (the taxpayer) can be asked to contribute.

If these reforms have any chance of succeeding then people need to know that they are being treated fairly. We have seen this week the anger that has been triggered on the state pension when older women feel the finishing line is being put back at the last minute with very little time to adjust. So there should be full and proper consultation and discussion with the trades unions. That is how we do things in Britain – the public would take a very dim view of any government that fails to honour this basic requirement. We must try and avoid

the confrontation and division that marked previous decades and must not turn the clock back.

There must also be full protection of accrued rights. And here I have taken the widest interpretation open to me. So I am proposing we retain the link to a person's final salary at the moment of retirement to value their pension entitlement in the final salary schemes, not their final salary at the point these schemes close to future accruals. This should help smooth the transition. This will be very important too, in helping establish a baseline of fairness. We should go the extra mile here.

The barriers to successful reform are substantial. Ministers will, I hope, in particular listen very carefully to concerns that have been expressed about the proposed increases to pension contributions in the Local Government Pension Scheme. Employers and trade unions have put forward some substantial arguments that there might be better options open to us that can achieve the same affect without running a high risk of an increase to drop out rates. I hope these are given serious consideration.

In my Interim Report, I argued that there was a clear rationale for increasing member contributions across the pay as you go schemes. I stand by that judgement for the reasons I set out in October. It was properly a matter for Ministers to decide by how much these contributions should rise. As I said at the time, there must also be a careful examination of the implications of any possible increase in opt out rates in these schemes as well.

There is also the issue of Fair Deal. We need to tread carefully here and search for a creative solution that allows new providers to come into the public sector and generate innovation and improvements in value for money, but does not

move us back to the bad old days when every outsourcing deal seemed to involve industrial action and allegations that low paid workers were seeing their wages and conditions cut even further. Moving to a new career average system across the public sector will certainly help remove much of the risk inherent in final salary schemes and which is now becoming an obstacle to new providers coming forward. New providers could still be asked to provide a comparable scheme to that currently on offer but switch to a career average scheme when this has been agreed in the present negotiations. We have to avoid a new race to the bottom here.

Negotiations must be seen to be genuine and open. Ministers have said that they accept my recommendations as a basis for consultation. I fully understand that there should always be room for manoeuvre in any consultation. I hope people stay at the table and look for an agreement. There is a lot at stake. Over 12 million people depend on these pensions for some or all of their retirement income. We have to get this right. People are fearful about the future. There is mistrust. It can only be overcome by being straight with people about the case for change, treating people fairly and by reaching a sensible agreement that offers the prospect of sustaining good quality pension schemes for the future.

All of these things are possible, as long as we are willing, all of us, to face the hard choices that lie ahead.

None of this is going to be easy. The road already looks strewn with barriers and barricades. It is not made any easier by the fearfully technical nature of much of the discussion which leaves most people unsure about what is on offer and what it means for them. Ministers can help by setting out how generous they want these new schemes to be. The sooner they can do this the better.

Today we are deep in the controversy of what reforms to make and how we should go forward. Perhaps the best way for me to end is on a note of consensus – not a bad word in politics. I hope we can all agree that a benchmark of any decent society is how it treats its pensioners – especially the most vulnerable.

I hope everyone involved in the negotiations would share this view, and will look to ensure that public service pensions continue to set the gold standard for pension provision in our country. That is very much in line with what my reform proposals are designed to achieve.

Ends