Principal Civil Service Pension Scheme

Consultation on Proposed Increases to Employee Contribution Rates Effective From April 2012

FDA Response

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Introduction

1. The FDA is the trade union and professional association dedicated to representing the interests of senior managers and professionals in public service. Our 18,000-plus members include civil service administrators, policy advisers, tax inspectors, schools' inspectors, NHS managers, lawyers, economists, diplomats, senior museum staff and statisticians.

Key points

2. Before considering and responding to the Consultation there are some key considerations (as far as the FDA is concerned) that should underpin any discussion of changes to pension arrangements, including proposals to increase pension contributions:

(i) Pension provision has a significant importance within the civil service, and is at the heart of the "contract" between civil servants and the State;

(ii) Historically, pay levels in the more senior grades have been set at lower levels than for comparable jobs in both the wider public and private sectors;

(iii) The gap in pay between the civil service and the private sector represents, in part, the contribution to pensions made by FDA members. This gap has increased substantially in recent years. As a consequence, pay rates in the more senior civil service grades, are:
- between 21.7% and 97.6% lower than for comparable jobs in the private sector; and
- between 12.2% and 31.3% lower than for comparable jobs in the wider public sector.

(iv) Base pay represents a much smaller proportion of total remuneration in the private sector (between 49% and 73%) than it does in the public sector (between 80% and 83%);

(v) Although pension provision may be generally inferior in the private sector, the value of other benefits more than compensates for the difference; and

(vi) Any consideration of savings and affordability in relation to the cost of civil service pension provision must be undertaken within the context of a review of all aspects of total remuneration.

Initial comments on the consultation

3. The main points the FDA would like to make on the consultation exercise are as follows:

(i) The scope of the consultation is so narrow as to be almost meaningless. The consultation does not seek views about the overall amount to be raised, or when. Nor does it consider alternative means of raising the amount specified; instead, the consultation is merely about the distribution of the pain of pension contribution increases;

(ii) An increase in contributions is a significant further reduction in take home pay and thus living standards. During a pay freeze, with high inflation rates, it is particularly damaging and resented by our members;

(iii) Pensions are part of the total remuneration package and any proposal to increase pension contributions must form part of a wider consideration of total reward;

(iv) The current proposals are not about securing long-term sustainability of public sector pensions. The increased contributions proposed have not been determined following any assessment of the costs of providing pensions for FDA members, and the finance raised will not be used for that purpose. Instead, the contribution increase is nothing more than a levy on civil servants as part of the deficit reduction programme;

(v) There is significant evidence to show that the costs of public sector pensions are falling;

(vi) The proposals must be subject to a full equality impact assessment;

(vii) There is a high risk that, if implemented, these proposals will lead to an increasing number of scheme members opting out;

(viii) All the key issues – employee contribution increases, the Hutton recommendations, the impact on total reward and the move from RPI to CPI - should be considered together to try and find an acceptable package of reform; and

(ix) The FDA is opposed to the imposition, without agreement, of any increases to employee pension contributions.

Scope of the consultation

4. In May 2010 the Government commissioned Lord Hutton to undertake a review of the future of public sector pensions. The terms of reference for this review included a requirement for an interim report to identify short-term savings to be made over the term of the current parliament. Lord Hutton's interim report was published in October 2010 and recommended increasing pension contributions as the preferred method of making savings in the short term, though it indicated that the level of increase was a matter for the Government.

5. The Chancellor announced in his Comprehensive Spending Review statement in October 2010 that he planned to raise £2.8bn during the Spending Review (SR) period through increases to the pension contributions of public sector employees. He stated that pension contributions would increase by an average of 3.2% in the three years commencing from April 2012. The scope of this consultation is with respect to the

Government's plans to increase contributions by 1.3% on average in the year commencing April 2012.

6. The Cabinet Office claims in the Consultation document that Lord Hutton's report justifies the £2.8bn increase in scheme member contributions being imposed across some of the unfunded schemes in the public sector. Whilst Lord Hutton's report does state that contribution increases are an effective way of generating short-term savings, the report does not quantify the level of contribution rise. The report does, however, state that increasing scheme member contributions must be carefully considered alongside the maximisation of participation and in the context of longer-term reform.

7. In the Consultation document, the Government indicates its preferred approach. In essence, this is to tier contributions depending on salary level, with the lowest paid (those earning less than £15,000 per annum) having no increase in their contributions.

8. The Consultation exercise is simply about the distribution of increases in employee contributions in order to average 1.3% from 2012, with further increases planned over the following two years. The Government is seeking to raise £2.8bn with a ratio of 40:40:20 over the three-year period. The Government has refused to consider any alternatives to this increase or look at the timing of implementing any contribution increases, for example, not seeking increases until the pay freeze has ended.

9. The scope of the Consultation is therefore so narrow as to be almost meaningless. The lack of flexibility in looking at alternatives and the tiered nature of the contributions simply sets one group of civil servants against another as the only alternative available for consideration. This is unacceptable.

10. The FDA believes that the Government's proposals for increases in pension contributions are not fair and cannot be justified for the reasons set out below.

Contribution increases during a pay freeze

11. The Government has imposed a two-year pay freeze in the public sector and a three-year pay freeze on the Senior Civil Service (SCS). This has not only dramatically reduced the real value of salaries for FDA members, at a time when RPI inflation is currently at a 20-year high, but in itself will reduce the cost of pensions. If the Government were serious about the sustainability of pensions, then this would have been taken into account.

12. The civil service has for many years fallen behind the level of pay increases across both the public and private sectors, as a result of political interference in the pay remit process and the lack of separately-funded pay progression.

13. The Government is seeking to impose a contribution increase of up to 2.4% in 2012 during a pay freeze, with inflation running at 5% and significant increases to the cost of energy bills and train fares to come. The pay freeze already means that many FDA members are experiencing a real-term reduction in take-home pay of around 10%. An increase in pension contributions represents a further reduction in take-home pay and living standards for FDA members. This comes on top of years of below-inflation pay awards.

14. In addition to the pay freeze, a substantial proportion of civil and public servants are currently at risk of losing their jobs as a consequence of massive reductions in the budgets of government departments. For those who remain, workloads are increasing, career opportunities are disappearing, and terms and conditions have worsened.

15. Public servants did not create the fiscal crisis, yet they are being expected to accept an unfair burden for resolving the country's financial crisis. The Government is seeking more from a pensions levy on public sector workers (£2.8bn) than it is expecting to raise from a levy on the banks (£2.5bn).

Total reward

16. Pensions are part of the remuneration package. That package for FDA grades has been falling behind the rest of the public sector and the private sector for many years. The Government's own pay research predicts that this gap will widen over the coming years.

17. The Government's own evidence (Hay Group pay data prepared for the Cabinet Office, "drawn from a database of around 600,000 organisations throughout the UK economy") shows that for equivalent jobs:

(i) people in the private sector are paid between 21.7% and 97.6% more than civil servants; and
(ii) in the rest of the public sector people are paid between 12.2% and 31.1% more.

18. Again, the Government's evidence to the Senior Salaries Review Body (SSRB) from 2009 shows that the median starting salary for new joiners to the SCS was £19,000 (28%) higher at pay band 1 for external recruits compared to those promoted internally. Indeed, the evidence shows that at every level and for every year the median salary for external joiners is significantly higher than for internal promotees.

19. The Government's evidence to the SSRB also highlighted the fact that, "Although external recruits make up only a fifth of all the SCS, they constitute over half (56%) of the top decile of earners."

20. The Hutton Review of Fair Pay in the Public Sector confirms that pay in the more senior grades of the civil service is lower than for comparable jobs in external markets:

"Independent comparisons based on job complexity have found that median total remuneration (including pensions) for civil service directors was just 53% of median remuneration for comparable private sector jobs.

"In the civil service there is clear evidence that external recruits do command higher salaries than internally recruited colleagues. With the majority of external recruits coming from the private sector, this to some extent reflects the premium needed to attract such candidates (it also reflects the fact that a premium is needed to attract candidates from elsewhere in the public sector, as pay levels in the senior civil service are generally lower)." (*Hutton Review of Fair Pay in the Public Sector* – March 2011).

21. By any measure, FDA members are paid at significantly lower rates than the private sector and the rest of the public sector for equivalent work. The imposition of a pensions levy on FDA members will further widen that gap and will disproportionately affect the very grades that are furthest behind in terms of pay comparability.

22. Lord Hutton acknowledged in his final report the strength of the FDA's case that any contribution increases should not be implemented in isolation from a consideration of total reward:

"Employee contribution rates fit into an overall remuneration package. In some schemes low rates may be matched by lower pay. At the extreme, the armed forces pay no contributions but an allowance for this is recognised when considering overall remuneration. Arguably, adjustments could be made to salaries to remove such effects across schemes without impacting on take-home pay to the employees, or to the cost of employment. However, in order to do this, an assessment would be needed of how much of the difference in contribution rates between schemes is as a result of pay effects. The implications for total remuneration extend beyond the scope of this report and may require separate consideration". (*Independent Public Service Pensions Commission: Final Report* – 10 March 2011).

The contribution increase is not about sustainability

23. The FDA, together with all other public sector unions, agreed changes in 2007 to ensure the sustainability of public sector pensions. In the civil service this included closing the final-salary schemes to new entrants and introducing a career-average scheme – Nuvos – which has a pension age of 65 and a contribution rate of 3.5%. The 2007 agreement required that there should be a scheme valuation in 2010 to determine whether there were any increased costs. These arrangements have been abandoned following the Government's refusal to allow scheme valuations to proceed.

24. Even before the 2007 changes were implemented, the costs of the civil service pension scheme were falling. It was by no means certain that a valuation in 2010 would have shown increased costs.

25. The Public Accounts Committee reported in May of this year on the impact of the 2007-08 changes to public sector pensions. The report stated that projections made by the Government Actuary's Department suggested that the 2007-08 changes to the civil service, NHS and teachers' pension schemes will bring substantial savings in taxpayer costs worth £67bn over 50 years and stabilise their costs at around 1% of GDP. Additional changes announced in 2010 are also expected to reduce costs. Lord Hutton's report also projects costs falling as a proportion of GDP.

26. This shows that the increase in contributions is not about the costs of the pension scheme, but rather that it is a levy on public sector workers – a form of additional taxation - which goes straight to the Treasury. This action, only four years after unions had negotiated measures to deal with sustainability, undermines confidence in the potential for a negotiated settlement on wider issues of pension reform.

Public sector pension costs are falling

27. The Prime Minister has tried to justify the Government's plans to reform public sector pensions with the assertion that "the pension system is in danger of going broke". (Speech to Local Government Association Conference – 28 June 2011). Others have suggested that radical changes are needed because the costs of public sector pensions have spiralled out of control.

28. Yet the evidence shows that the cost of public sector pensions is falling.

29. Lord Hutton in the *Independent Public Service Pensions Commission: Interim Report* in October 2010 said public sector pension payments:

"are expected to peak at 1.9% of GDP in 2010-11 and remain at about 1.8% of GDP for the following decade before falling to around 1.4% of GDP by 2059-60. Net of employee contributions, payments peak at about 1.5% of GDP in 2010-11, before falling to below 1.1% by 2059-60."

30. The Office for Budget Responsibility (OBR) – set up by the Government "to provide independent and authoritative analysis of the UK's public finances" – says:

"Gross public service pension payments are projected to fall from 2% of GDP in 2015-16 to 1.4% of GDP in 2060-61.... the decline in payments over the projection period is due to the decision to switch from RPI to CPI uprating of pension payments, which reduces payments considerably particularly in the latter half of the projected period, combined with the effect of the current public sector pay freeze and workforce reductions... In these projections we do not make assumptions about the implementation of the final IPSPC report recommendations". (OBR: *Fiscal Sustainability Report* – July 2011)

This means that the cost of public sector pensions will fall considerably before any further changes are made following the Hutton report, such as increased pension age or increased contributions.

31. The National Audit Office (NAO) says:

"By making changes in 2007-08 to pension schemes for civil servants, NHS staff and teachers, the Treasury and departments overseeing the schemes acted to tackle potential future growth in costs to taxpayers. As a result of the changes, which are on course to deliver substantial savings, long-term costs are projected to stabilise around their current levels as a proportion of GDP. The changes are also set to manage one of the most significant risks to those costs, by transferring from taxpayers to employees additional costs arising if pensioners live longer than is currently projected" (NAO: *The Impact of the 2007-08 Changes to Public Service Pensions* – December 2010).

32. The House of Commons Public Accounts Committee (PAC) says:

"Government projections show that the expected cost of public service pensions has reduced substantially because of changes made in 2007 and 2008. The Treasury expects the cost of pension payments to retired civil servants, NHS staff and teachers to stabilise over the next 50 years at around 1% of GDP, as a result of the 2007-08 changes. This would be a significant achievement". (PAC: *The Impact of the 2007-08 Changes to Public Service Pensions* – May 2011).

33. FDA members are being asked to consider the details of sweeping changes to the current civil service pension scheme, including substantial increases in pension contributions, at a time when a major reduction in the long term value of pensions has already been implemented by the change of indexation from RPI to CPI. The indexation change alone will produce huge savings for the civil service schemes (KPMG estimates £250bn over 40 years for the whole economy) and this raises further, serious doubts about whether any increases in contributions are justified or necessary at this time.

34. The FDA rejects the assertion that there is a crisis in public sector pensions. The real crisis facing the country is the abandonment of decent pension provision in the private sector. Since 1997, membership of workplace pension schemes in the private sector has fallen from 46% to 34% in 2010. By contrast, the vast majority of FTSE 350 companies have formal pension arrangements for their executive directors.

35. Recent evidence produced by the TUC and the High Pay Commission shows that pensions for directors and other senior managers in the private sector are increasing in value. These are the only pensions that could be fairly described as “gold-plated”.

Equality impact

36. FDA members who work part-time will pay the percentage increase in contributions relevant to the full-time equivalent salary level. In some cases this will result in FDA members paying the same percentage increase as those earning significantly more but, crucially, they will not benefit from the higher rate of tax relief applicable at that salary level.

37. FDA members in this position challenge the Government to justify this proposal. The Government must equality-proof their proposals.

Other issues

38. There is a high risk that many scheme members will opt out of the scheme, if contributions increase. This would cause difficulties for the future - not just around increasing pensioner poverty, but also scheme viability. HM Treasury’s estimate of the reduction in pension participation across the public sector is 1% of the pensionable pay bill. There is no evidence put forward to support this assertion.

Fair negotiations

39. The FDA has always taken a view that sustainable public sector pensions are an integral part of the total reward package for the its members. The union has shown consistently that we are prepared to look at measures to maintain the sustainability of the scheme, as we did in 2007 when we agreed a new pension scheme for the civil service. The proposed increase in contributions has nothing to do with the sustainability of the scheme and is simply an additional levy on public sector workers, at the time of a pay freeze, to support the Government’s fiscal requirements.

40. The FDA has argued that all the pensions issues – employee contribution increases, the Hutton recommendations and the move from RPI to CPI should be taken together to try and find a package of reform that meets FDA members’ expectations and the Government’s objectives. This has been ignored.

41. The FDA has argued that pensions are part of the total reward package and that, according to the Government’s own evidence, FDA members are paid significantly lower salaries than for comparable jobs in both the wider public and private sectors. The Government has so far refused to consider the broader issue of ‘total reward’ as part of this Consultation.

42. The FDA has also sought to explore with the Cabinet Office alternatives to increasing

pension contributions for scheme members that would deliver the savings the Government says it requires. This has been dismissed.

43. The FDA is opposed to the imposition, without agreement, of any increases to pension contributions. We believe that issues around sustainability must be considered as part of the wider pensions negotiations, which would allow any new scheme to find a balance between benefits payable and the costs to both employees and taxpayers as part of an overall package.

Conclusions

44. The FDA does not accept that there is a need or justification for a pension levy on the civil service pension scheme. The Government has not provided any evidence of the need for such a levy, in particular given that the following changes have already generated savings:

(i) The introduction of NUVOS in 2007;

(ii) The removal of the compulsory retirement age;

(iii) The reduction in the indexation factor used for pensions in payment (the move from RPI to CPI);

(iv) The reduction in the indexation of pensions in deferment (the move from RPI to CPI);

(v) The reduction in the revaluation mechanism for the career-average NUVOS scheme (the move from RPI to CPI);

(vi) The redundancies in the civil service; and

(vii) The ongoing pay freeze.

45. It is simply unacceptable and unfair to expect that FDA members will see the value of their pensions cut by a series of salami-slicing measures, without the ability to negotiate freely on all the changes the Government is proposing, and for the Government to fail to even articulate its overall objective.

46. The FDA recognises the scale of the fiscal crisis facing the Government, but the union has already agreed measures to bring down the costs of the civil service pension schemes. The FDA is willing to negotiate openly and freely on maintaining the continued sustainability of the scheme, but that should be on the basis that further changes to pension arrangements are made by agreement, not by Government diktat.