The Fire Brigades Union

Pension Schemes in the Fire Service and the Independent Public Service Pensions Commission

A Critical Analysis by
Tony Cutler and Barbara Waine

Foreword

Matt Wrack, FBU general secretary

The FBU is stepping up our campaign to defend firefighter pensions. The union has been building up solid arguments and evidence so that we can knock down the case put by government against us.

It is therefore with great pleasure that I commend this report to you. Tony Cutler and Barbara Waine have already written some excellent papers on pensions – most recently on the Hutton report.

The FBU asked the authors to apply their expertise specifically to firefighters' pension schemes and to provide an independent assessment of the government's case. They have written an excellent analysis and come to their own conclusions.

The FBU believes that the arguments in this paper should be discussed by all stakeholders in the fire and rescue service. We believe it broadly supports our arguments against the government.

I would ask you to read the report carefully and to use it to raise the level of discussion on pensions.

The authors

As independent academic researchers, Tony Cutler and Barbara Waine originally wrote two Working Papers (Nos 80 and 100) on public sector pensions for the Centre for Research on Socio Cultural Change (www.cresc.ac.uk/publications). They have, at the request of the Fire Brigades Union, developed the framework used in those working papers so that it is applied to pensions in the Fire Service.

This report for the Fire Brigades Union aims to encourage informed debate on the issue of public sector pensions which engages critically with the relevant evidence. The views expressed in this report are those of the authors and not those of the Centre for Research on Socio Cultural Change or its funder the Economic and Social Research Council.

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FBU summary of key points

The FBU believes the following points made by Cutler and Waine are very important.

Sustainability

- Firefighter pensions (with the exception of the Local Government Scheme) are paid out of a combination of employee contributions and government expenditure. If membership of public sector schemes falls significantly, the contribution income will fall and government will be required to meet a larger share of the costs of public sector schemes.
- The Hutton report in October 2010 estimated that **the cost of public sector pensions will fall** as a percentage of GDP over the next fifty years. The Office for Budget Responsibility issued a report in July 2011, which estimates that the projected gross cost of public sector pensions will *fall* from 2% of GDP in 2015-16 to 1.4% in 2060-61.
- The long term costs of the firefighters' pension schemes may have been overestimated. The Government Actuary assumes that only 4% of serving firefighters were members of the less expensive NFPS scheme. However, 16% of regular firefighters are NFPS members.
- The change in the distribution of firefighters across schemes combined with the continuation of the trend to reduction in ill-health retirement would suggest that no decisions on structural changes to the schemes should be considered until a further valuation has been done.

Fairness

- The Hutton report gives no definition of how **'fairness'** between public and private sector pension provision should be defined.
- Government spokespersons and Hutton commit the same logical error. They describe a contrast between relative contribution rates of employers and employers (taxpayers) *at given points in time*. But it is impossible to infer from this what ***should*** be the case.
- The FPS has a member contribution rate of 11% which is over **double** the private sector weighted average member contribution in defined benefit schemes of 5.2%.
- The FPS scheme operates with an employer to employee contribution ratio of 2.2: 1. The NFPS scheme operates with a ratio of 1.4: 1. In the private sector, employer contributions to defined benefit schemes have been consistently in excess of **three times employee contributions** (>3: 1).

Employee contributions

- A central issue in pensions policy is to prevent poverty in old age - to ensure retired people have **an 'adequate' income**.
- It is difficult to see how the Treasury could state that the opt-out rate, following the increase in contributions, was likely to equate to a 1% fall in contributions as a percentage of the pay bill.
- Treasury estimates obtained under the Freedom of Information Act show that the percentages of **workers likely to opt out** of public sector schemes at 6% of those earning under £25,000 per year and 8% for those earning under £21,000.
- The number of workers opting out from the Greater Manchester Pension Fund (part of the LGPS) has risen by more than 50% in the past year, even *before* the effect of higher contribution rates take effect.
- The Secretary of State for Health, Andrew Lansley in a letter leaked to the *Daily Telegraph* (24 July 2011) warned of the "risk that lower-paid staff…will simply opt out leaving [the Treasury] with reduced

receipts in the short term while still having to pay for past pension promises".

Career average schemes

- In a career average scheme the final pension is based on a percentage of salary earned in each year of the working life. As some of the qualifying earnings may be forty years or more before the pension thus their **real value will have been eroded** by subsequent inflation.
- It is difficult to see how *both* a career average (CARE) scheme *and* tiered contributions could be justified. A combination of tiered contributions and a CARE scheme means that benefits for 'high flyers' are being reduced while they may be asked to substantially increase their contributions.
- In the leaked letter by Andrew Lansley, there is reference to an official government paper suggesting **an accrual rate of 1/100th** for public sector schemes. Such accrual rates are literally 'off the radar', there are no private sector defined benefit schemes with accrual rates worse than 1/80th.

Normal pension age

- The requirement to work longer reflects an implicit view that the only obstacle to higher retirement ages is expectations about retirement ages, ignoring any potential constraints from lack of **employment *opportunities***. Long term historical experience suggests that relatively buoyant economic conditions are crucial to such patterns.
- There is a substantially higher incidence of **part-time working** amongst older workers and this raises the question of whether such employment could generate an 'adequate' income.
- There are problems relating to the **health status of older workers** and the extent to which it constitutes a barrier to employment. Thus 47% of those economically inactive between the ages of 50 and 64 in 2004 cited long term sickness as the reason for their economic inactivity.
- One argument for a higher normal pension age in the fire service is that scheme members need not remain in an operational role but could be redeployed in **non-operational roles**, which make fewer physical demands. The trend has been for local authorities to increasingly employ non-uniformed staff in such roles under different terms and conditions.
- The CLG operational statistics bulletin shows that on a full-time equivalent basis, the number of wholetime firefighters in England fell by 4% over the period 2005-10 while non-uniformed staff increased by 26%.

Conclusion

The overall conclusion of this report is that there is **no substantial case for major structural changes to public sector pension schemes** in general or in the Fire Service in particular. Proposed changes are unnecessary and create major dangers to schemes, which are a crucial part of occupational pension saving in the United Kingdom.

Introduction

In this paper the aim is to discuss some major issues in the current debate on structural changes to public sector pensions and to apply this discussion to the pension schemes operating in the Fire Service. The argument uses the framework developed for the Centre for Research on Socio-Cultural Change (University of Manchester) Working Paper, *In Defence of Public Sector Pensions: A Critique of the Independent Public Service Pensions Commission* (Cutler and Waine, 2011).

Thus each section is structured so that the general argument on the issue is analysed and then the discussion is developed with respect to pension schemes operating in the fire service. A major point of reference in the discussion is the reports of the Independent Public Service Pensions Commission (referred to henceforth as the IPSPC). The IPSPC was chaired by the former Cabinet minister Lord John Hutton and produced two reports, an Interim Report (referred to henceforth as IR) was published in October 2010 and a Final Report (referred to henceforth as FR) in March 2011.

The paper is structured around five major issues. The first is the question of the long term cost of public sector pensions and the argument that major structural changes in public sector pension schemes are essential because cost increases are 'unsustainable' in the long term. With reference to this issue it is necessary to remember that major structural changes to public sector pensions were introduced under the last Labour government and these, as will be discussed in the section on 'sustainability', will significantly reduce the long term costs both of public sector schemes in general and those applicable to the Fire Service. The second section is concerned with a further issue which has played a salient role in the case for structural changes to public sector pensions, that they are in some sense 'unfair'. In the section discussing 'fairness' two ways in which this term is used are critically discussed, fairness with respect to pension provision in the private sector and in relation to taxpayers.

One of the undisputed strengths of public sector pensions is their coverage with over four fifths of public sector workers being scheme members. This has two principal advantages, it means that workers with a significant record of continuous employment in the public sector can look forward to a reasonable income in retirement and it follows from that there is a financial benefit to the public sector because they have no need to draw means tested benefits. This position has, however, been put under threat by Coalition policies on employee contributions to public sector pension schemes.

In the Comprehensive Spending Review of 2010 the Coalition announced a target for 'savings' to public spending through substantial increases in average employee contributions to public sector schemes. In the third section the discussion focuses on the possible impact of such contribution increases on membership levels in public sector schemes, whether such increases will encourage substantial numbers of existing members to opt-out and for new members not to join. The discussion also covers an important related financial issue. Public sector pensions (the principal exception is the Local Government Scheme) operate on a 'pay-as-you-go' basis i.e. current pensions are paid out of a combination of employee contributions and government expenditure. It thus follows that, if membership of public sector schemes fall significantly, the contribution income will fall and government will be required to meet a larger share of the costs of public sector schemes.

The IPSPC recommended a major structural change to public sector pensions. Currently the overwhelming majority of such schemes operate on a 'final salary' basis i.e. pensions are based on earnings at the end of working life. The IPSPC was critical of such schemes

on the grounds that they give disproportionate benefits to scheme members who either experience significant promotions and/or major increases in salary at the end of their working life. It recommended that public sector schemes should change to a career average basis. In the fourth section the discussion focuses on some of the problems arising from this recommendation.

A final important issue refers to the Normal Pension Age (NPA) in public sector schemes. This refers to the age at which members can retire without suffering any actuarial reduction in their pension. The IPSPC has recommended a policy of increasing the NPA and the potential problems with this policy are explored in this section.

Pension Schemes in the Fire Service

As was indicated above the aim of the paper is to discuss the general policy issues relating to public sector pensions in the context of schemes operating in the Fire Service so it is necessary to briefly outline the major features of these schemes. There are three relevant schemes, the Firefighters' Pension Scheme (FPS), the New Firefighters' Pension Scheme (NFPS) and the Local Government Pension Scheme (LGPS). The FPS is open to all firefighters appointed before the 6th April 2006. It has an NPA of 55, this is lower than the general run of public and private sector pension schemes but firefighting is, of course, a highly physically demanding job and the issue of need for a substantially lower NPS in firefighting is discussed in the section on NPA. Like most public sector schemes the FPS is a final salary scheme and thus operates on what is termed a defined benefit (DB) basis. DB schemes mean that the member can broadly predict the pension level. This is derived from a combination of the length of the member's pensionable service and the scheme *accrual rate*.

This latter aspect is a central feature of final salary DB schemes and links the pensionable service with the pension as a fraction of income at the end of working life. Thus an accrual rate of 1/60th means that the scheme member will accrue (earn) the entitlement to a pension of 1/60th of final salary for each year of pensionable service. In the FPS there is a 1/60th accrual rate for each year of service for the first 20 years and 2/60ths for service after 20 years with a maximum entitlement of 40/60ths after 30 years. An ill health retirement pension is payable from any age if the scheme member is permanently disabled for the performance of duties in his or her role and a lower tier award of this pension is payable where the member is assessed as capable of regular employment other than as a firefighter.

The NFPS is open to all firefighters regardless of duty system or hours of employment. It has an NPA of 60 and an accrual rate of 1/60th. It follows, therefore, a broad pattern resulting from the Labour 'reforms' to public sector pension schemes. These operated so that entry to older schemes like the FPS were closed to new members (firefighters appointed after 6th April 2006 are ineligible for the FPS) and the terms of the new schemes are less advantageous than the older scheme. This can clearly be seen in the comparison of FPS and NFPS with the latter having a later NPA and an inferior accrual rate. This has important implications for the long term costs of public sector schemes. Over time a larger proportion of the occupational group will be members of the less generous (and less expensive) new scheme and trends of this type can already be clearly seen in the two firefighters' schemes as will be discussed in the section on sustainability.

The third relevant scheme for the Fire Service is the Local Government Pension Scheme (LGPS). This is a very large scheme and covers members of the Fire Service working in fire control duties. It is also the only large scheme not operating on a pay-as-you-go basis. The LGPS is a funded scheme. This means that contributions (from

employer and employee) are invested to generate a return contributing to the funding of pensions to retired staff. The issue of whether all public sector schemes should operate on a 'funded' basis was discussed by the IPSPC which rejected such a course (Hutton, 2011a: 114). It outlined a number of objections to moving to a funded basis (Ibid.: 79-80) but one is of particular significance to the question of the financing of public sector pensions. This is the question of 'transitional' costs.

A move to a 'funded' basis would mean that the contributions of new members of a 'funded' scheme would be invested and hence could not be used to help finance current pensions; this would mean that the requirement to finance the latter from general public expenditure would increase in the short to medium term. The LGPS scheme operates with an NPA of 65 though the Labour reforms resulted in abolishing the 'rule of 85' where it was possible for employees to retire at 60 with an unreduced pension if their service plus their age added to 85. The reformed scheme has an improved accrual rate but contributions are now 'tiered' meaning that those on higher incomes pay higher contribution rates.

In the first section the discussion examines evidence on the long term costs of both public sector schemes generally and those in the fire service.

Long Term Costs: the Issue of 'Sustainability'

A major issue in the debate on public sector pensions concerns their long term costs. The most relevant starting point for the analysis of this issue is the IPSPC's discussion of 'sustainability'. The FR states that 'in order to be sustainable, a scheme must be able to manage and share risks effectively, *without dramatic increases in costs*' (Hutton 2011a: 31, our emphasis). Thus a 'sustainable' public sector pension scheme is one which is able to operate 'without dramatic increases in costs'. The definition of 'sustainability' includes no specific time reference but it is, arguably, implicit in the notion that *long term* costs should be controlled. Furthermore, the discussion of sustainability in the IR is set in the context of estimates of public sector pension costs over a fifty year period (Hutton 2010: 64).

Measuring 'Sustainability'

If a 'sustainable' public sector pension scheme is one which does not involve 'dramatic increases in cost' this raises the issue of how such costs should be measured. An important measure is the expected annual cost of public sector pensions as a percentage of national income. One of the key reasons why this measure is particularly relevant is its connection to the way in which public sector pensions are financed. As UK public sector pension schemes are mainly 'pay as you go' schemes they meet the current liability of having to pay pensions out of current income. Thus the expected cost of public sector pensions as a share of national income has the advantage that it reflects the demands on government to meet the liabilities of public sector pension schemes in a given fiscal year; and that their capacity to do this will naturally be related to national income.

Perhaps reflecting such considerations the IPSPC supports pension costs as a share of national income as the best way to measure 'sustainability'. The IR argues, '…the Commission's view is that the projected public service payments as a percentage of estimated GDP is an *effective* measure of the future cost of public Service pension provision…' (Hutton 2010: 63, our emphasis). The FR goes further stating that 'the Commission's *preferred* measure of the cost of public service pensions is the level of benefit payments as a percentage of GDP' (Hutton 2011a: 28, our emphasis).

Long Term Trends in Public Sector Pension Costs

Given its status as the Commission's 'preferred measure' of the long run costs of public sector pensions it is necessary to review the principal estimates of such costs. However, this discussion requires reference to a major change in the treatment of indexation of pensions introduced by the Coalition government. In his budget speech of 22nd June 2010 the Chancellor announced that from April 2011 the Consumer Price Index (CPI) would replace Retail Price Index (RPI) for the indexation of public sector pensions (HM Treasury 2010: 17). While this change has a technical aspect relating to both the composition of the indices and the method of averaging (for a lucid account see Davies 2010) it is has major practical consequences because CPI is expected to rise more slowly than RPI hence indexing benefits (including public sector pensions) by CPI will result in lower benefits than if RPI were used (for discussion see Ibid. and the Pensions Policy Institute (PPI) 2011: 1).

The first estimate considered is that produced by the Pensions Policy Institute (PPI) (Adams et al.2010). This is particularly useful because it compares the effects of using RPI and CPI inflation measures. Public sector pension payments as a percentage of Gross Domestic Product can be measured on a gross basis (i.e. without deducing employee contributions to public sector pension schemes) or a net basis (making such deductions), The PPI estimate (Table 1 below) is on a net expenditure basis; and they are for pay as you go public sector schemes and thus exclude the Local Government Scheme.

In the IR the Commission presents estimates from the National Audit Office (NAO) and the Office for Budget Responsibility (OBR), these estimates (Table 2 below) are presented on a gross expenditure basis thus accounting for the higher figures when contrasted to the PPI estimate given in Table 1.

Table 1: Projected Future (Net) Annual Cost of Unfunded Public Sector Pensions as a Proportion of Gross Domestic Product

	2010	2020	2030	2040	2050
CPI indexation	1.2	1.2	1.1	1.1	1.0
RPI indexation	1.2	1.3	1.3	1.2	1.2

Source: Adams *et al.*(2010)

Table 2: Projected Future (Gross) Annual Cost of Unfunded Public Sector Pensions as a Proportion of Gross Domestic Product

	2009/10	2019/20	2029/30	2039/40	2049/50	2059/60
NAO	1.7	1.9	1.9	1.8	1.7	1.7
OBR	1.8	1.9	1.9	1.8	1.7	N.A.

Source: *Hutton* (2010)

The IR also commissioned an estimate of long term public sector pension costs from the Government Actuary's Department (GAD). This was designed to update the NAO and OBR figures (Hutton 2010: 63-4). This estimate was that, on a gross basis, total public service pension benefit payments would peak at 1.9% of GDP in 2011 falling to 1.4% by 2059-60; on a net basis the peak would also be in 2010/11 falling to 1.1% by 2059/60 (Ibid.: 64). Since the publication of the FR, the OBR issued a report in July 2011 on long term fiscal sustainability. This estimates that the projected gross cost of public sector pensions will *fall* from 2 per cent of GDP in 2015-16 to 1.4 per cent in 2060-61 (OBR 2011: 63).

What is clear is how far all these estimates indicate a broad trend. In no case is the long term estimate of public sector service costs as share of national income higher than the current figure. In three cases (the PPI calculation based on RPI indexation; the NAO and OBR calculations, used by the IPSPC, the long term cost is at the same level as the current); in three other cases (the PPI calculation based on CPI indexation, the GAD updating for the Commission and the OBR report of July 2011) the share of national income accounted for by public service pension costs is *lower* than the current level. Such trends hardly indicate 'a dramatic increase in costs'.

The decision of the Coalition government to impose a change from indexation of public sector pensions by CPI rather than RPI is currently subject to judicial review which was launched by 5 trade unions in April 2011 with a hearing likely in October 2011. However, what is clear is even if the Coalition were obliged to abandon this change the PPI calculation suggests that there would be no long term trend to public sector pension costs absorbing an increased share of national income in the long term.

The Fire Service schemes are also likely to be equally 'sustainable'. The IR suggests that savings from the Labour government's public pension reforms within the uniformed services are likely to be much more marked in the firefighters' scheme. The IR states (Hutton, 2010: 42) 'over the next 30 years, expected savings under the reforms of the uniformed service schemes range from under a tenth of the overall cost for the armed forces to about a fifth for the police and a third for firefighters'. This conclusion appears broadly in line with the PPI's estimates of the effect of the reforms on the effective employee benefit rates in the uniformed schemes in its evidence to the IPSPC. These suggested that while the fall in effective employee benefit rate would be from 39 to 38 per cent in the armed forces scheme (a fall of 2.5 per cent), from 35 to 29 per cent in the police scheme (a fall of 17 per cent), it would fall from 35 to 24 per cent in the firefighters' scheme (a fall of 31 per cent) (PPI 2010: 4).

The Government Actuary's Department estimated an even larger fall in its actuarial valuation of the firefighters' schemes as of 31st March 2007. Pension benefits in the FPS scheme were assessed at 37.7 per cent of pay and 23.7 per cent in NFPS (a fall of 37 per cent) (GAD 2009: 4). It is also worth pointing out, as the FBU did in its submission to the first call for evidence from the ICPSC, that GAD operated with assumptions on levels of ill-health retirement which are, arguably, excessive. The FBU's evidence showed a fall in ill-health retirements in the scheme from17.8 per 100,000 in 2001/2 to 3.8 in 2006/7 (FBU, 2010:6). It also referred to evidence from the Department of Communities and Local Government (DCLG) that the levels of ill-health retirement of 2006/7 had been maintained in 2008/9 and 2009/10.

However, in explaining its assumptions in the 2007 valuation, the GAD stated 'it is not known whether the downward trend of ill health retirements between 2003 and 2007 will continue…DCLG have reported that ill health retirements were less than 3 per thousand employees during 2007/8 indicating

a continuation of this observed trend. I have made some allowance for improving ill health retirements but without going as far as the level observed in 2006/7…*nine ill health retirements per* 1,000 F*irefighters* [is] *a reasonable fit for the average experience*' (GAD, 2009: 14, our emphasis). Put together with the communication to the FBU from the DCLG this would suggest that a level of ill health retirement roughly one third of that assumed by the GAD has applied for four successive years equally therefore suggesting that, in this respect, the long term costs of the scheme may have been overestimated.

A further reason to suggest that the GAD estimate, based on the situation in March 2007, might exaggerate the long term costs of the schemes for firefighters relate to the changing composition of the membership in the two schemes. As has been indicated the Labour 'reforms' to public sector pensions had closed what were usually more expensive schemes to new members who were obliged to join cheaper new schemes and over time this operates as a mechanism to control (and generally reduce) scheme costs. At the time of the GAD survey only 4 % of serving firefighters were members of the less expensive NFPS scheme (GAD, 2009:7).

However, the FBU, in response to the second call for evidence from the IPSPC, indicated that 16 per cent of regular firefighters were NFPS members (FBU 2011a: 4). The change in the distribution of firefighters across schemes combined with the apparent continuation of the trend to reduction in ill-health retirement would suggest that the FBU's argument that no decisions on structural changes to the schemes should be considered until a further GAD valuation has taken place (due to produce an estimate for the situation at 31st March 2011) is sound (Ibid.: 2).

It is more difficult to produce a comparable analysis for the LGPS since estimates depend on assumptions regarding investment returns in a funded scheme. However, the PPI evidence to the IPSPC suggests that changes introduced under Labour are likely to leave the employee benefit rate unchanged thus suggesting that this would not be a source of increase in long term costs (PPI, 2010:3).

The Labour public sector pension 'reforms' included a further mechanism termed 'cap and share'. The basic concept is that if, for example, pensioner longevity increases to an extent not anticipated in actuarial predictions, then costs will be 'shared' between employers and scheme members (Thurley, 2009: 8). The 'capping' aspect refers to a ceiling on employer contributions (Labour unsuccessfully sought to interest private sector employers in cost sharing and capping, (see Department for Work and Pensions (DWP) 2008).

Thus, if following periodic review of the actuarial assumptions, increased scheme costs are identified then the employer liability is linked to an agreed cap (the level of the caps for employer contributions can be found in Thurley 2009). Identified cost increases above the cap would thus have to be met by increased *employee* contributions, revisions to scheme benefits or a combination of both. The Coalition has apparently decided to suspend these arrangements. In a letter to Brendan Barber of the 18th July 2011 the Chief Secretary to the Treasury, Danny Alexander states that consultations over projected scheme savings are to shortly commence. Consultations on individual schemes will replace 'cap and share' which is to be suspended and scheme specific proposals will be put forward (HM Treasury 2011a).

The broad evidence from public sector schemes in general and the schemes in the Fire Service suggest that, in the ICPSC's terms these schemes are 'sustainable'. It equally follows that there is no case for further structural changes to such schemes on 'sustainability' grounds. In the next section the aim is to consider the case for structural changes to public sector pensions on 'fairness' grounds.

The Question of 'Fairness'

In this section the aim is to discuss two aspects of 'fairness', between provision in the private and public sectors; and between members of public sector schemes and taxpayers.

'Fairness' between public and private sectors

The IPSPC gives no definition of how 'fairness' between public and private sector pension provision should be defined. However, in the IR (Hutton 2010: 92), the Commission presents a chart showing a wide and increasing gap in average pension benefits as a percentage of pay. In 2001 the mean value of such benefits in the public sector was 23.7 per cent as against 8.7 per cent in the private sector and the respective figures for 2005 were, respectively 25.1 per cent and 8.2 per cent.

In its discussion of the inter-sectoral data the Commission (Hutton 2010: 92-3) points out that 'The fall in the private sector is entirely due to a composition effect, rather than a reduction in generosity of particular schemes in the private sector. This composition effect is as a result of falling membership of more generous DB schemes in the private sector; and increase in membership amongst less generous DC [defined contribution] schemes; and an overall fall in membership of pension schemes in the private sector'. This raises a very important point with respect to comparisons between sectors. Provision in the private sector varies enormously. The majority of private sector workers, nearly two thirds in 2010, are *not* members of occupational pension schemes (ONS 2011a). However a significant minority are members of final salary DB schemes which are structurally similar to the dominant pattern of provision in the public sector.

The last annual survey of occupational pension provision by the Office of National Statistics (ONS) showed that there were 2.4 million 'active' members of private sector DB pension schemes, i.e. they were accruing pension benefits in a DB scheme (ONS 2010: 9). This contrasts with the frequently implied view that DB schemes have effectively disappeared from the private sector. A key reason why such a view is misleading is that, while there has been a significant trend for private sector firms to close their DB schemes, the dominant pattern of closure has been to *new* members. This pattern is shown in figures on private sector DB schemes from the Pension Protection Fund. Its survey of private sector DB schemes in 2010 found that just over 34 per cent of members were in schemes that were still open, and just over 60 per cent were in schemes closed to new members, only 5 per cent were closed to all future accruals (Pension Protection Fund 2010: 38). This means that even where schemes are closed to new members existing members can continue to accrue pension benefits up to retirement.

Thus, if we want to compare provision on a 'like for like' basis it is necessary to look at comparisons of DB schemes across sectors. This issue was examined by the IPSPC which argued that 'where DB schemes are still open in the private sector they provide *similar* levels of benefit to the reformed public sector schemes' (Hutton 2010: 93, our emphasis). This conclusion is broadly similar to a detailed analysis of this issue by the Pensions Policy Institute (PPI). This contrasted three stylised private sector DB schemes with 'low', 'medium' and 'high' benefits.

Thus the most generous private sector schemes were characterised by features such an earlier normal pension age, a better accrual rate and a lower member contribution rate. The PPI takes these stylised variants to calculate an 'effective employee benefit rate' for each type and then to compare this with a corresponding calculation of the benefit from different public sector DB schemes. The PPI

estimated (Steventon 2008: 37) an effective employee rate for a 40 year old man was 9 per cent of salary in the low benefit, 19 per cent in the medium benefit and 32 per cent in the high benefit private sector DB scheme and that (post reform) the four largest public sector schemes (Local Government, NHS, Teachers' and Civil Service) have an effective employee rate of 19 per cent of salary, at a comparable level to 'medium' private sector DB benefits.

However even if public sector DB schemes are not 'generous' when generally contrasted with their private sector counterparts it is important to discuss the issue of whether the Fire Service schemes offers particularly good terms for members when contrasted with private sector DB provision. Two features of the Fire Service schemes might appear particularly generous, the normal pension age in the FPS scheme which the FBU wishes to apply to the NFPS; and the accrual rate in the FPS. The NPA for the FPS scheme is 55.

In contrast it is often assumed that the NPA in private sector DB schemes is universally set at 65. This is not the case as just over 20 per cent of members are in private sector schemes with an NPA of 60 (ONS 2010: 17), nevertheless the most recent ONS survey (Ibid.) suggests that NPAs earlier than 60 are effectively absent from the private sector. The accrual rate in the FPS scheme is effectively 1/45th. The ONS 2009 survey shows that around 4 per cent of private sector DB scheme members were in schemes with accrual rates of 1/50th or better (Ibid.: 32) so while comparable accrual rates to the FPS can be found in private sector DB schemes it is fair to say that these only apply to a small minority of private sector DB members.

However, there are two important points to stress with respect to these comparisons. The first is that the NPA of 55 and the accrual rate are integrally related to the specific demands of the job which are discussed in the section of this document on the pension age. If the condition of an effective and efficient fire service is a retirement age of 55 then it is clearly inequitable to impose an actuarial penalty for such a retirement age. It is equally necessary, if a reasonable pension is to be achieved, that a better accrual rate apply since the effective period over which the pension can be built up will necessarily be shorter.

The second key point is that FPS has a member contribution rate of 11 per cent which is over double the private sector weighted average member contribution in DB schemes in 2009 of 5.2 per cent (Ibid.: 23). Thus FPS scheme members are making member contributions well in excess of norms in private sector schemes. With respect to the NFPS the PPI's inter-sectoral comparison did not classify the fire scheme as comparable to the most generous private sector DB schemes. It was said to have (along with the police scheme) 'average effective employee benefit rates that are *between the medium and high benefit private sector schemes*' (Steventon, 2008: 38, our emphasis).

Again it is important to note that the NFPS which, as has been indicated, offers considerably reduced benefits relative to the FPS, has a member contribution of 8.5%, roughly 70 per cent higher than the private sector weighted average. As was noted above effective employee benefit rates in the LGPS are in line with 'medium' DB schemes in the private sector.

Of course it is possible to take the view that 'inter-sectoral' fairness requires that pension benefits as a percentage of pay should be equalised across sectors. The IPSPC does not advocate this course as it would endorse a 'race to the bottom' in pension provision bearing in mind that the de facto private sector 'norm' is absence of occupational provision. In his foreword to the IR Lord Hutton explicitly rejects such an

approach: 'The downward drift in pension provision in the private sector does not…provide sufficient support or justification in my view for the argument that pensions in the public sector must automatically follow the same course. I *regard this as a counsel of despair.*' (Hutton 2010: 4, our emphasis).

Furthermore the logic of the 'race to the bottom' would effectively be to wind up occupational pension provision in the public sector while protecting accrued rights. This would have a number of paradoxical effects. Winding up such schemes would, of course, end the income stream to government from employee contributions thus increasing the net cost of public sector pensions as pensions to retired staff would have to be paid by virtue of the guarantee to accrued rights. Furthermore it would provide a disincentive to pension saving contrary to the Commission's desire to at least maintain if not increase the coverage of occupational pension provision in the public sector.

'Fairness' between Taxpayer and Scheme Member

In its discussion of this dimension of 'fairness' the IR (Hutton 2010: 99) points out that public sector schemes in the past exhibited either equality or relatively small differences (when contrasted with current practice) between employer and employee contributions. Thus for example (Ibid.) whereas, in 1925, employer and employee contributions in the Teachers' Pension Scheme were equal at 5 per cent, in the current scheme employee contributions are 6.4 per cent and employer contributions at 14.1 per cent; in the NHS scheme in 1948 employee contributions were 5 per cent and employer contributions varied from 6 to 8 per cent according to different categories of worker, in contrast in 2008 employee contributions varied from 5 to 8.5 per cent whereas employer contributions were 14 per cent (Ibid.).

This approach was replicated by the Chief Secretary to the Treasury in his speech to the Institute for Public Policy Research (IPPR) on the 17th June 2011. He stated 'when the Teachers' Pension Scheme began, employee and taxpayer contributions were equal at 5%. Today however current scheme members pay around 6% with taxpayers contributing more than double at 14% (HM Treasury, 2011b). Both the IPSPC and the Chief Secretary commit the same logical error. What they describe is a contrast between relative contribution rates *at given points in time* but it is impossible to infer from such contrasts what is 'fair', i.e. what *should* be the case.

The Chief Secretary's statement appears to express the view that there is something somehow 'unfair' about employer contribution rates more than double those of scheme members. However an obvious point of comparison in this respect is private sector DB schemes. Table 3 (on the next page) shows relative employer and employee contribution rates in private sector DB schemes over the period in which the Office for National Statistics has conducted an annual survey of occupational schemes (earlier studies were undertaken in a different format by the Government Actuary's Department).

Table 3: Weighted Average Employer and Employee Contributions to Private Sector Defined Benefit Schemes 2006-2009

	Employer Contribution (% of salary) (1)	Employee Contribution (% of salary) (2)	Ratio 1:2
2009	16.5	5.2	3.2
2008	16.6	4.9	3.4
2007	15.6	4.9	3.2
2006	14.6	4.7	3.1

Source: *Office for National Statistics* (2007); (2008); (2009); (2010)

There are two clear implications of the data in the Table. The notion of a norm of employer and employee contributions operating with a ratio of under two to one is spurious. In the private sector employer contributions to DB schemes have been consistently in excess of three times employee contributions. Secondly this makes the examples cited by the Commission and the Chief Secretary even more anomalous. The discussion of the NHS scheme in the IPSPC suggested that employer contributions were effectively excessive relative to employee contributions.

However in the example given employer contributions to the NHS scheme were 2.8 times employee contributions in the case of the lowest contributory rate (14 per cent as against 5 per cent) and 1.6 times in the case of the highest rate (14 per cent as against 8.5 per cent). The Teachers' scheme ratio, discussed by the Chief Secretary operates with a ratio of employer contributions 2.3 times those of members.

By the same token relative employer and employee contributions in the fire schemes are well below those in the private sector. The FPS scheme operates with an employer contribution of 26.5% of salary and an employee contribution of 11% (Hutton, 2010: 137), a ratio of 2.4: 1. The NFPS scheme operates with respective rates of 14.2 and 8.5 per cent (Ibid.) a ratio of 1.7. Another way of seeing the same contrast was that if 2009 private sector DB average ratio of employer to employee contributions (3.2:1) were applied to the fire schemes then employee contributions would be 8.3% in the FPS scheme and 4.4% in the NFPS.

The LGPS operates with an employer contribution of 18% and employee contributions of between 5.5 and 7.5% ratios of 3.2 and 2.4 respectively. At the lowest tier the LGPS ratio is the same as the weighted average of private sector DB schemes at the highest level substantially lower. Schemes in the Fire Service thus reflect the general public sector pattern that the ratio of employer to employee contributions is generally well below those prevailing in private sector DB schemes.

With respect to inter-sectoral comparisons and the relative contributions of employee and taxpayer there is thus no substantial case for structural changes to either public sector schemes in general nor those operating in the Fire Service. In the next section the implications of the Coalition's policy of substantially raising employee contributions in public sector schemes is discussed.

The Question of Employee Contributions

Defining an 'Adequate' Pension

A central issue in pensions policy is to prevent poverty in old age by ensuring that pension levels are sufficient to allow retired people an 'adequate' income. This was a key consideration for the IPSPC. An important standard for defining 'adequacy' was that provided by the 2004 Pensions Commission (henceforth referred to as the Turner Commission), these are reproduced in Table 4.

Table 4: Turner Commission Benchmark Replacement Rates

Gross Income	Benchmark Gross Replacement Rate
Less than £9,500	80%
£9,500-17,499	70%
£17,500-24,999	67%
£25,000-49,999	60%
£50,000 and above	50%

Source: *Hutton* (2010)

In this approach an adequate pension is defined in terms of the proportion of income while in work replaced by the pension. As the IR notes (Hutton 2010: 86-7), replacement rates are set below 100 per cent for a number of reasons. These include lower taxation levels in retirement, the likelihood of lower housing costs (due to paying off of mortgages), that work expenses may no longer be incurred and that saving for retirement is not required. In the IR the IPSPC noted that the 'Turner' replacement rates had been 'widely accepted' (Ibid.: 87). In the call for evidence for the FR responses were requested on 'how the Commission should think about the issue of adequacy and whether a full state and public service pension should ensure people reach an adequate level of income' (Hutton 2011a: 38). The FR noted that there was a 'broad consensus that the benchmark replacement rates set out by the Turner Commission…were the appropriate way of thinking about adequacy' (Ibid.) a view which the Commission endorsed stating that 'the Commission agrees with this view' (Ibid.).

There also appeared to be a similar consensus on the role of public sector pensions in underpinning 'adequate' retirement incomes. Thus the Commission reported that 'most respondents felt that a full public service pension, in conjunction with a full state pension, should deliver at least an income at these [Turner] levels' (Ibid.). This view also had the imprimatur of the Commission and the FR states 'the Commission agrees with these views and believes that the Government should ensure future public service pensions schemes (in conjunction with a full state pension) deliver at least the minimum level in retirement recommended by the Turner Commission' (Ibid.).

'Adequacy' and Public Sector Pensions

Given its endorsement of the importance of public pensions for underpinning an 'adequate' pension for public sector workers the IPSPC stated that it was important to maintain and improve public sector scheme participation rates 'especially below median income levels' (Hutton 2011a:39). Currently

20 per cent of those in the public sector earning less than £18,000 are not scheme members (Ibid.: 78). The IPSPC emphasis on maintaining and improving scheme participation levels at lower incomes is linked to the likelihood that individuals on such incomes will have fewer additional resources to fall back on in retirement and hence will be less likely to have an 'adequate' income.

The objective of maintaining and improving scheme participation has, however, been rendered problematic by the Coalition government's decision to introduce a 3.2 per cent average increase in employee contributions to public sector schemes by 2014-2015 in order to deliver savings of £2.8 billion required by the Spending Review. The IPSPC suggested that participation of the lower paid could be encouraged by lower contribution increases than for other income groups (Hutton 2011a:79) and this concern was consistent with the Coalition Government's claim that increases in contribution rates would 'provide protections for the low paid' (HM Treasury, DWP and HM Revenue and Customs 2010: 18).

Since the publication of the FR the Government has proposed that those earning less than £15,000 will not have their contributions increased while those earning less than £18,000 will have their contribution increase capped at 1.5 per cent (HM Treasury 2011b). However suggested contribution increases have only been announced for one year which will account for only part of the target 'savings'. These changes this may also mean that many employees earning substantially less than the median income (£25,900 in April 2010 ONS 2010) could be paying an additional 3 per cent in employee contributions by 2014-2015. Lord Hutton has returned to this issue in his talk at the IPPR on 23rd June 2011 where he stated that there was a need for 'careful examination of any possible increase in opt out rates…' from higher employee contributions (Hutton, 2011b). This raises the question of whether higher employee contributions even with the announced 'protections' are likely to prove a threat to maintaining, let alone enhancing, levels of scheme membership in the public sector.

An initial estimate on this issue, given in the Spending Review Policy Costings was sanguine (HM Treasury, DWP and HM Revenue and Customs 2010:18). It stated that the effect of contribution increases on opt-outs would be no more than 'one per cent of the…pay bill'. However, it is difficult to place reliance on this figure. In evidence to the Public Accounts Committee, the Treasury stated that earlier estimates of possible opt out following the Labour reforms to public sector pensions in 2007-8 suffered from the lack of a 'huge evidence base'. Equally while, as was indicated, opt out was expected to have the effect of reducing contributions by 1 per cent of workforce costs it was not possible to translate this figure into a percentage of the workforce likely to opt out as the contribution rates at particular pay levels (the 'progressivity') had not yet been settled (Public Accounts Committee 2011 Ev 19-21).

Lacking a significant 'evidence base' it is difficult to see how the Treasury could state that the opt-out rate, following the increase in contributions, was likely to equate to a 1% fall in contributions as a percentage of the pay bill. Concerns regarding the reliability of this estimate also arise from papers obtained by the GMB (under the Freedom of Information Act). These show Treasury estimates of the percentages of workers likely to opt out of public sector schemes at 6 percent of those earning under £25,000 per year and 8 per cent for those earning under £21,000. It is also worth noting that the later Treasury estimates of expected levels of opt out from the workforce are regarded as too low by a pensions consultant who advised the Hutton Commission (Timmins 2011). The number of workers opting out from the Greater Manchester Pension Fund (part of the LGPS)

has risen by more than 50% in the past year, even *before* the effect of higher contribution rates take effect (Cohen 2011).

The issue of the effect on opt out and refusal to join public sector schemes has been subject to a very weak and unsatisfactory discussion in the consultation documents on the major public sector schemes. In the document on the Civil Service scheme there is no discussion linking proposed increases to possible levels of opting-out (Cabinet Office 2011). However in a separate document it is stated that opting-out will mean giving up the employer contribution and death in service benefits. In addition any saving would need to be set against the requirement to pay a higher national insurance contribution. It concludes that even with the increased contribution the civil service scheme will still remain 'one of the best schemes available' (Ibid.).

There is also no discussion linking proposed increases to opting-out in the NHS consultation document (Department of Health 2011). Again it is stated that even with the increases the scheme will still give 'an excellent return on investment' and will remain 'amongst best schemes available'. These treatments are open to a number of objections. Firstly, as will be discussed in detail in the next section, the IPSPC did not recommend an accrual rate for its favoured career average scheme and the Coalition has not put forward public proposals on the accrual rate (in the next section some rather disturbing indications of government thinking on accrual rates from a leaked letter by a cabinet Minister are discussed). The absence of certainty on this issue literally means it is impossible to decide how 'good' an 'investment' public sector scheme membership will be as the likely pension return is indeterminate. A second objection is that public sector workers could opt out or refuse to join public sector schemes even if they do perceive them as 'good investments' because of the combined pressures of falling real wages in the public sector with substantial increases in employee contributions.

There is a more serious attempt to link the impact of the proposed increase to opting-out in the consultation for the Teachers' scheme (Department for Education 2011). It proposes extending the 0.6% increase in 2012-2013 to all those earning less than £26,000 arguing that this would protect teachers in their early years in the profession as opt out usually occurs in the first two years. In the next band (£26,000-£31,999) the increase would be 0.9%, slightly less than the average in order to encourage increased participation in the scheme. However, no attempt is made to suggest likely levels of opt-out or refusal to join if these policies on contribution levels were adopted. However, if a given target for increased contribution income is maintained then reductions in contributions at lower income levels would have to be compensated for by significantly higher contributions at higher income levels.

The FBU (2011b) commissioned YouGov to undertake a survey on opt-out rates if contributions were increased. 43,000 members were contacted and there was an 18 per cent response rate to the survey, 90% of respondents being members of the FPS, 10% members of the NFPS. The opposition to the proposed average increase of 3 percentage points was uniform across the different schemes, with 75% strongly opposed and 15% tending to oppose. If the pension contributions were increased 12% said they were 'very likely' and 15% 'likely' to opt-out. The proposed increases would have also appear to have an impact not only on continued scheme membership but on continuing to work in the service, with 13% 'seriously considering' and 45% 'considering' leaving the Service, with the latter being highest among those with most experience.

While the precise impact of contribution increases is difficult to forecast there are major reasons for concern regarding the

likely impact of the impact of Coalition policy on participation levels in public schemes. The initial estimate given in the Policy Review Costings was concerned with the financial impact of reduced contributions but appeared to imply that the proportion of the workforce opting out as a result of increased contributions would be relatively small.

However, the later estimates acquired by the GMB indicate an expectation that overall 6 per cent of the workforce could be expected to opt with 8 per cent at lower incomes, an estimate which we noted was regarded as too low by a pensions consultant who advised Hutton. The FBU survey suggests opt-out rates could be much higher than these Treasury estimates. Naturally this carries the serious threat that the role of public sector pensions in underpinning an 'adequate' income in retirement for public sector workers as envisaged in the FR could be threatened by the Coalition planned increases in employee contribution rates.

There is a further important implication of this threat. A major objective of the planned increase in contributions is to reduce the public sector financial deficit. With respect to the firefighters' pensions the DCLG suggested that the increases to employee contributions would save £13.2 million in 2012, £26.4 million in 2013 and £33million by 2014- a total of £72 million over the three years. This was based on an opt out rate equivalent to 1% of the pay bill as in the insecure estimate in the Policy Review Costings discussed above .The Government Actuary's Department provided figures for a meeting of the Firefighters' Pension Committee in January 2011 which estimated that every 1% opt out would cost the scheme £3.5 million in lost contributions. Thus the FBU briefing argues that taking account of these figures plus their survey data on opt outs any potential savings from increased contributions could be wiped out. Thus a 12% opt out (corresponding to those 'very likely' to opt out would cost £42 million p.a. or £126 million over 3 years, while an opt out of 27% (combining those 'likely' and 'very likely' to opt out would cost £94.5 million p.a. or £ 283.5 million over a three year period. An opt our rate as low as 7% would wipe out any short term savings from the contribution increase (FBU 2011c).

Such concerns were also raised by the Secretary of State for Health, Andrew Lansley in a letter leaked to the *Daily Telegraph*. He referred to the 'risk that lower-paid staff…will simply opt-out leaving [the Treasury] with reduced receipts in the short term while still having to pay for past pension promises (Stanley 2011a). He also raised concerns regarding opting-out by better paid staff. Referring to the NHS schemes he suggests 'if it appears that we intend to significantly reduce' the value of future pensions then 'we also face the risk of opt-out from higher-paid staff' (Ibid.). Thus employee contributions create a paradox, if they trigger substantially increased opt-outs from public sector schemes or the refusal of new employees to join then they will contribute to a deterioration in the public sector financial deficit. They also create the potential for a major long-term problem.

The IPSPC was clear that current public sector pension provision (combined with the basic state pension) meets the 'Turner' target for 'adequate' pension provision in retirement (Hutton, 2011a: 39). A high level of opt-outs/refusal to join public sector schemes would undercut this provision leading to the stark choice of tolerance of widespread poverty in old age or increasing reliance of the retired population on means tested benefits. In the next section the argument analyses some potential problems with the IPSPC's support for a shift in public sector pensions to a career average basis.

Career Average Schemes and Tiered Contributions

The IPSPC recommended that a fundamental change should be made in the design of public sector pension schemes moving them from a final salary to a career average basis. Final salary schemes are often criticised on the basis that high flyers (those people who receive late promotions or large increases in salaries) receive far higher effective pension benefits than those who have few or no salary increases' (Hutton 2010: 94). In the FR, for example, an analysis of the Local Government scheme shows that median annual pension payouts for employees retiring on a salary in the highest quintile are 'almost 30 per cent higher than the pension payout' for employees retiring with a salary in the lowest quintile (Hutton 2011a: 23).

In a career average scheme the final pension is based on a percentage of salary earned in each year of the working life. As some of the qualifying earnings may be forty years or more before the pension thus their real value will have been eroded by subsequent inflation. This was a reason why career average schemes were increasingly rejected by trade unions in the 1950s (Hannah 1986) Thus there has to be a mechanism for revaluing pensionable earnings if the pension is to be adequate at the point it is drawn.

The Commission proposes a career average scheme with the accrued pension being revalued in line with earnings (CARE) (Hutton, 2011a: 71). However, the IPSPC does *not* recommend an accrual rate. The FR does contain a discussion (Ibid.: 66-70) of the trade off between accrual rates and indexation making the point that more generous indexation (earnings rather than prices) allows broadly comparable benefits to be achieved with a lower accrual rate. However, there is no recommended accrual rate attached to this section and no recommended accrual rate appears at any point in the FR. Thus, as various commentators have noted (Cooke 2011; Emmerson 2011) it is impossible to envisage how the recommended CARE scheme could operate because key parameters such as the accrual rate are not specified.

There are also some rather disturbing signs in this respect. In the leaked letter by Andrew Lansley, discussed above there is reference to an official government paper suggesting an accrual rate of 1/100th for public sector schemes (Stanley, 2011b). This contrasts with the modelling commissioned for the IPSPC from the PPI which indicated that a CARE public sector pension comparable with post-reform final salary schemes, where earnings were revalued by reference to changes in average earnings, would require a 1/61st accrual rate. Equally the suggestion that a 1/100th accrual rate is in any way comparable with private sector DB schemes is absurd. The ONS survey of occupational pension schemes in 2009 showed (ONS 2010: 32) that such accrual rates are literally 'off the radar' as no private sector DB schemes with accrual rates worse than 1/80th are identified.

Tiered contributions, as Hutton notes, were originally introduced into the local government and NHS schemes to reflect the fact that 'high flyers' receive proportionately more from final salary schemes than lower earners, per £ of contributions. However, if the rationale for a CARE scheme is that it substantially removes such 'high flyer' benefits it is difficult to see how *both* a CARE scheme *and* tiered contributions could be justified.

One argument (Hutton 2011a: 78) is that participation in pension schemes increases with salary so lower rates for lower earners is likely to encourage participation. However, a combination of tiered contributions and a CARE scheme means that benefits for 'high flyers' are being reduced while they may be asked to substantially increase their contributions. This raises the potential problem of opting out or refusal to join public sector schemes by higher paid workers, in line with the argument advanced

by Andrew Lansley, with important implications for scheme finance.

There is also the question of the relevance of the 'fairness' rationale for different public sector schemes, an issue of particular relevance for the Firefighters' Pension Scheme.

The evidence submitted by the FBU (2011a) to the IPSPC final report pointed out that the fire service has a flat career structure. Thus the salary range for a firefighter is £21,000 to £28,000. 90% of members of both the FPS and the NFPS are classified as firefighters, with the remaining 10% being station/group/area/brigade manager (Ibid.). Of the former group because of the low turnover (7%, Ibid.) the majority are on the maximum salary. There are few opportunities for promotion to the higher paid roles which are few in number and where the financial rewards are considerably less than in other areas of the public sector.

While the case for a CARE scheme was made by the IPSPC on the grounds of greater fairness the Commission failed to recommend an accrual rate and the Coalition has made no public statements on this issue. It is thus unclear whether a CARE scheme would provide comparable benefits to those operating in current public sector schemes. The leaked letter from Andrew Lansley suggests that the Coalition is considering accrual rates greatly inferior to those currently operating in the public sector and to the assumed rates used in the modelling for the CARE scheme discussed in the FR. There would appear to be little rationale for tiered contributions *in* a CARE scheme and if they were applied they risk a further increase in opt outs from higher paid staff, again an issue identified in the leaked Lansley letter. In the final section the argument looks at problems in increasing the NPA.

Normal Pension Age

A vital aspect of policy on public sector pensions concerns the Normal Pension Age (NPA). In the FR one of the Commission's recommendations is that 'the Government should increase *the member's Normal Pension Age* (NPA) *in most schemes so that it is in line with their State Pension Age* (SPA)' (Hutton 2011a: 94, emphasis in the original). The recommendation is qualified by the caveat that 'the link between the SPA and the NPA should be regularly reviewed to make sure it is still appropriate' (Ibid.). However, in line with the overall recommendation the Commission wants any review of the SPA-NPA link to be undertaken 'with a preference for keeping the two pension ages linked' (Ibid.).

In a speech to the IPPR on 17th June 2011 the Chief Secretary to the Treasury indicated that the Coalition was proposing the implementation of such a link across the public sector with the exception of the uniformed services which are discussed below (HM Treasury 2011b) This implies a significant increase in the NPA in public sector schemes. In the Pensions Bill, introduced by the Coalition in January 2011, it is proposed to raise the SPA for men and women from 65 to 66 by April 2020. The previous Labour government had proposed to raise the SPA but the Pensions Act 2007 provided for SPA to rise to 66 between 2024 and 2026.

If the NPA in public sector schemes rises in line with an increasing SPA it follows that scheme members will be expected to work longer and that they will either be completely dependent on their income from work during this extended working life, or that, if they do have an income from an occupational pension, this will, necessarily, fall short of a *full* occupational pension. This, in turn, assumes that the relevant employment opportunities for older workers will be forthcoming.

In effect the Commission treats the employment implications of such longer working lives as unproblematic. A clue to the

underlying assumptions behind this sanguine treatment of the issue can be found in Table 4A of the FR. In that Table the Commission outlines its 'assessment of longevity management' options against the 'principles' which inform the structure of the Commission's reports. The FR discusses the option of setting the NPA in public sector schemes at 65 and thus, in the light of plans to raise SPA discussed above, allowing NPA to remain below SPA. It comments that this would have the effect of creating 'no cultural expectation for continued working beyond NPA even though SPA would be increasing' (Hutton 2011a: 93).

Conversely the course recommended by the Commission (linking NPA and SPA subject to review) is treated positively because it 'should assist in creating a cultural expectation of changes in working life in response to changes in longevity' (Ibid.). However, this reflects an implicit view that the only obstacle to higher retirement ages is expectations about retirement ages thus ignoring any potential constraints from lack of employment *opportunities*. This lack of concern with whether employment opportunities will be forthcoming for older workers expected to extend their working lives is also reflected in the Chief Secretary's 17th June 2011 speech which makes no reference to employment conditions.

In an important article Macnicol (2008) has explored some of the problems with this view of extending working lives. He points out that optimism regarding the employment of older workers stems from employment patterns between the early 1990s and the onset of the 2008 economic crisis. Currently economic activity rates are highest for those aged 25-34 (85.3 per cent) and 35-49 (85.7 per cent) (ONS 2011b). Between the spring of 1994 and the second quarter of 2007 employment rates for those aged between 50 and the SPA increased from 62.4 per cent to 71.7 per cent (Macnicol, 2008: 582). An examination of the long term historical experience suggests that relatively buoyant economic conditions are crucial to such patterns (Ibid.). However, it has now become a virtual commonplace of post 2008 economic crisis discourse to question whether the economic conditions applying from the early 90s to the onset of the 2008 crisis are sustainable (see the discussion in Ibid.: 582).

This approach also presupposes that it can be implemented across the national economy. However this fails to appreciate the significance of marked regional differences in employment rates for older people (Ibid.: 587). Thus, in the second quarter of 2010, employment rates for those between the ages of 50 and 64 varied from 58.3 per cent in Wales, 59.7 per cent in North East England to 70.2 per cent in South East England (Department for Work and Pensions 2010).

A further reason for concern over this pattern relates to analysis of patterns of job creation in the public and private sectors from the late 1990s. As Buchanan et al (2009: 22) have demonstrated, areas with lower employment rates for older workers were heavily dependent on direct state and 'para-state' employment, the latter referring to employment financed by the state but outsourced to primarily private sector providers. In the North of England such state and para state employment accounted for 64 per cent of new job creation between 1998 and 2007 and in Wales for 55 per cent of such job creation (Ibid.).

However, current Coalition policy is designed to undercut the sources of such job creation by substantial cuts in public expenditure. The Coalition claims that this should not damage long term employment prospects because it is part of a process of 'rebalancing' the economy away from what it perceives as excessive reliance on public sector employment (Cutler and Waine, 2011). However, the experience of areas where significant deindustrialisation has occurred suggests that there are severe doubts on the viability of such 'rebalancing' and, if so this also suggests the need for scepticism with respect to prospects for employment of older workers.

Two additional problems in respect of employment for older workers can be identified. Firstly there is a substantially higher incidence of part-time working amongst older workers and this raises the question of whether such employment could generate an 'adequate' income (Macnicol, 2008: 588). Secondly there are problems relating to the health status of older workers and the extent to which it constitutes a barrier to employment (Macnicol 2008: 584). Thus 47.4 per cent of those economically inactive between the ages of 50 and 64 in 2004 cited long term sickness as the reason for their economic inactivity (Whiting 2005: 292).

As was discussed above, the IPSPC recommended a distinct policy on NPA for the uniformed (armed services, police and firefighters). In this respect it is worth noting a piece of sleight of hand on the part of the Chief Secretary. In his speech of 17th June 2011 he stated 'we accept Lord Hutton's recommendations in this area that 60 should be the benchmark Normal Pension Age for the uniformed services' (HM Treasury 2011b). In fact the IPSPC is more ambiguous on this point. The FR does state that is the 'Commission's view' that an NPA of 60 'should be seen as a benchmark for the uniformed services' (Hutton, 2011a: 112). However this is *not* embodied in the formal recommendation of the IPSPC on this point. The recommendation reads as follows that the government 'should *consider* setting a new NPA of 60 across the uniformed services where the NPA is currently below this level' (Ibid.: our emphasis).

The extension of the NPA both in general and in the case of the uniformed services has been discussed in the context of adapting public sector pensions to increases in life expectancy. In the case of the uniformed services, however, both the IPSPC and the Chief Secretary have given some recognition to the physical demands of jobs in the uniformed services by suggesting a lower NPA. The FBU has, however, questioned whether an NPA of 60 is suitable in the fire service. It points out, for example, that firefighters experience a major injury rate over 40 per cent higher than the all industry average and a three day injury rate over four times the all industry average (FBU 2010: 9).

Equally the assumption that an NPA of 60 can operate in the Fire Service without damaging service efficiency is untested. This suggests that an excessive focus on issues relating to life expectancy as a justification for a higher NPA could compromise service efficiency and hence public safety. Furthermore there are also potential problems with the extent of savings from such a source. In the section on long term costs reference was made to the sharp decline in ill health retirements of firefighters. An excessive NPA runs the risk of reversing this trend and hence compromising the expected level of 'savings' from a higher NPA.

One argument for a higher NPA in the fire service is that scheme members need not remain in an operational role but could be redeployed in non-operational roles which make fewer physical demands. However, the FBU has pointed out that the trend has been for local authorities to increasingly employ non-uniformed staff in such roles under different terms and conditions (FBU 2010: 4). Such arguments would appear to be supported by trends identified in the DCLG operational statistics bulletin which shows that (on a full-time equivalent basis) the number of wholetime firefighters in England *fell* by 4.4 per cent over the period 2005-10 while non-uniformed staff increased by 25.8 per cent (DCLG, 2010: 7).

Thus the official discussion of the NPA both by the IPSPC and the Coalition is problematic. It is uncritically assumed that relevant employment opportunities will be forthcoming. Equally in 'uniformed services' such as the Fire Service there is a failure to seriously consider the potential threat to service efficiency posed by such proposed extensions to working life.

Conclusion

In this concluding section the aim is to briefly bring together the principal themes discussed in this report. A major issue in debates on public sector pensions concerns the long term costs of such schemes. However estimates from the authoritative sources, the Government Actuary's Department, the National Audit Office, the Office of Budget Responsibility and the Pensions Policy Institute have all come to broadly the same conclusion. This is that the long term costs of unfunded public sector pensions over roughly the next half century will not exceed the current cost as a share of national income. This latter measure is the 'preferred measure' of public sector pensions costs of the IPSPC. This general pattern is likely to be replicated in the Fire Service. Over time the relative significance of the NFPS where pension benefit levels are around a third lower than the FPS will increase and this will reduce the overall cost of providing pension benefits in the Service.

It is also argued that a case for major structural changes to public sector pensions can be made on the grounds that they are 'unfair' to private sector workers, and to taxpayers. However, once these arguments are examined they fall apart. The private sector is highly diverse stretching from very good defined benefit final salary schemes to the two thirds of employees with no occupational pension provision. If the comparison is made in 'like for like' terms then it is impossible to make a case for 'unfairness'.

The major public sector schemes, including the Local Government scheme covering those Fire Service staff in control functions, have, according to the Pensions Policy Institute (PPI), pension benefit levels comparable to 'medium' schemes in the private sector. The FPS does have a low Normal Pension Age by private sector standards but this has to be understood in the context of the risks and demands for physical fitness in the job. NFPS is not classified, by the PPI, as providing pension benefits equivalent to the best schemes in the private sector.

A 'race to the bottom' levelling down to the de facto private sector 'norm' of no provision is rightly rejected by the IPSPC. It would have the perverse effect of destroying one of the major remaining areas of occupationally based pension saving and, by cutting off the income stream to government from employee contributions, would increase the costs to the Exchequer of providing public sector pensions.

The notion that public sector pensions are 'unfair' to taxpayers is based, in the work of the IPSPC, on the assumption that 'fairness' is represented by either equality of near equality between employer and employee contributions. However this is based on the logical error, replicated by the Chief Secretary to the Treasury, that the situation at a given point in time in the past is in some sense an indicator of what ought to be the case. If, again, comparison with private sector DB schemes is made what is striking is that employers generally contribute a much larger multiple of employee contributions in the private sector and this conclusion holds good for the schemes covering the Fire Service.

A major structural change advocated by the IPSPC is to shift public sector schemes from a predominantly final salary basis to a career average. However, it is impossible to know how such a change would work because the IPSPC did not recommend an accrual rate for its favoured career average scheme. A 'fairness' argument was also advanced in respect of this change with the suggestion that such a move would equalise proportional pension benefits between 'high flyers', who enjoyed late promotions or substantial salary increases, and other public sector workers who did not have such a career trajectory.

However, the IPSPC wants to combine such a change with tiered contributions where higher paid workers pay higher pension contributions. Such a combined change runs

the risk, recognised by the Secretary of State for Health in a leaked letter, of opting out of public sector schemes by higher paid workers with a damaging impact on the finances of public sector schemes. In the Fire Service the case that current schemes are 'unfair' because of disproportionate benefits to 'high flyers' is particularly weak because of the generally flat career structure in the Service with the bulk of members in operational roles and a small minority in management and with a very compressed salary range.

A strong point of current public sector pension schemes is the high level of coverage and the corollary that public sector pensions for staff with reasonable service levels combined with their state pension generate an 'adequate' income in retirement by the standards of the Pensions Commission, chaired by Lord Turner. The latter was the standard of 'adequacy' used by the IPSPC. This achievement is, however, threatened by the increases in employee contributions to public sector schemes planned by the Coalition.

The estimates implying a very low reduction in scheme membership advanced at the time of the Comprehensive Spending Review appear to have very little evidential basis and later Treasury estimates of opt-out and refusal to join are much higher. The FBU's own survey suggests that even these higher estimates are likely to be too low. This has two damaging implications: it means that in the short and medium term attempts to increase employee contributions may have a negative impact on public finances as contribution income falls; in the longer term this de facto assault on a major area of occupational pension saving is likely to increase the need for retired people to claim means tested benefits.

A further important structural change in public sector schemes is to raise the Normal Pension Age or the age at which it is possible to claim a public sector pension without suffering any actuarial penalty. Arguments for such a course rest on reference to increasing life expectancy. However, what is problematic about such arguments is that they fail to seriously consider constraints on the employment of older workers stemming from labour demand and health status. Optimistic notions regarding higher employment rates for older workers tend to extrapolate from the relatively benign economic conditions from the early 1990s to the 2008 financial crisis but it is at the very least unclear whether such assumptions can still be confidently relied on.

Furthermore employment rates for older workers vary considerably from region to region and already tend to be lower in areas heavily dependent on direct and indirect state employment, employment threatened by the Coalition retrenchment programme. Health status is not only an issue of general importance but one particularly crucial in the Fire Service. Increasing the NPA runs a number of risks in the Service. That the Service will be less efficient with an ageing workforce. That the trend to reduced ill health retirements will be reduced with significant cost implications. Finally scope for redeployment of older workers to non-operational roles is at best limited and contrasts with a strong trend to local authorities substantially increasing use of non-uniformed staff while cutting employment of uniformed staff.

The overall conclusion of this report is thus that there is no substantial case for major structural changes to public sector pension schemes in general or in the Fire Service in particular. Proposed changes are unnecessary and create major dangers to schemes which are a crucial part of occupational pension saving in the United Kingdom.

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