

This article appeared on www.butterworth.co.uk March 2004

Are public sector pensions sustainable?

By David Farmer, Solicitor

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A study published by a former Bank of England economist questions whether using future taxation to fund index-linked risk-free pensions for millions of public sector workers is sustainable. David Farmer, solicitor with niche pensions specialists Sacker and Partners, talks to Stephen Ward about the issue...

According to Neil Record of Record Currency Management, the cost over future decades of providing pensions promised to public-sector workers in 2002, the year he used for his research, was greater than all Government expenditure that year. And he points out that tens of thousands of extra public sector jobs, each with the same pension entitlement, have been created since 2002. David Farmer, solicitor with niche pensions specialists Sacker and Partners, says the added liability to pension funds is stemming partly from the fact that the proportion of the population which is of pensionable age is increasing, through people living longer.

“It remains to be seen whether these public sector pensions are sustainable,” he admits.

He says: “There is increasing pressure on the Government as regards the changing demographic profile of schemes and it may be they would need to look at the issue of funding (when the payment is made into the funds) and the issue of scheme liability (the entitlement of future pensioners)”.

It is wrong to say the entire public sector pensions are funded out of future taxation, he points out. Although this is the way some 8.8m members’ benefits are funded, for several million local government employee members there is pre-payment by scheme employers (which may ultimately mean the taxpayer) and by members.

He says neither is it true that the Government has not taken note of the future cost implications of public sector pensions. “It would be wrong to say they have closed their eyes to the generosity of such schemes. They are looking at cost issues,” he says. But historically, he says, final salary schemes have been seen as an important facet of the employment benefits associated with working in the public sector. Many see these as compensation for the higher salaries usually paid in the private sector.

Record has called on the Government to ‘come clean about the enormous hidden cost’ of public-sector pensions and for these to be brought into line with those in the private sector.

But Farmer says the picture of the entire private sector winding up final salary schemes while the public sector retains them is not the full picture. He says: “There are parallels with the private sector which is making more effort at looking at how to provide final salary pension benefits. And there have been high profile cases recently of the private sector standing behind their schemes and putting money in because these final salary benefits are still regarded as valuable benefits.”

He cites recent press reports on Marks and Spencer's £400m bond issue last month which was largely used to top up the final salary pension scheme. And the Local Government Pension Scheme is currently undergoing a 'stocktaking' review, he says.

He says whether public sector pensions are pre-funded like the Local Government Pension Scheme, or 'pay as you go' is largely a question of timing; pension promises have to be financed at some point, whether on the pay-as-you-go basis or by funding. But switching to pre-funding may well be politically painful, because it would mean higher spending now for a benefit in the future.