But is it ‘Fair’? The UK Coalition Government, ‘Fairness’ and the ‘Reform’ of Public Sector Pensions

Tony Cutler and Barbara Waine

Centre for Research on Socio-Cultural Change, University of Manchester, UK

Abstract

The article analyses arguments for reform of public sector pension schemes by the UK Coalition government on the grounds that existing provision is ‘unfair’. Three dimensions of ‘fairness’ are discussed. That between public and private sector provision; between the costs to public sector employees and other taxpayers; and between members of public sector schemes. The article argues that there are serious weaknesses in the Coalition position on each of these dimensions of ‘fairness’. It suggests that these weaknesses are rooted in the discussion of public sector pensions in isolation from the overall pattern of occupational pension provision in the UK and that a more satisfactory analysis requires reference to principles of distributive justice.

Keywords

Public pensions; UK; Coalition; Reform; Distributive justice

Introduction

Public sector pensions are a central part of occupational pension provision in the UK. In 2010, public sector schemes had 12.5 million members (ONS 2011: 16), with the largest individual schemes being those of the Civil Service, local government, the National Health Service (NHS) and teachers’ (Hutton 2010: 24). However, as Brunsdon and May (2011: 103) have observed, such pension schemes are ‘under considerable pressure’ (for similar trends internationally, see Ponds et al. 2011: 3–4; Stewart 2011). A first major instalment of public sector pensions reform in the UK occurred under Labour. The ‘Normal Pension Age’ (NPA), the age at which a scheme member can retire without any actuarial reduction in pension entitlement, was increased from 60 to 65 for new members of the Civil Service, NHS and teachers’ schemes (the local
government schemes already operated with an NPA of 65% (Steventon 2008: 12). Labour also introduced ‘cost capping and sharing’ so that the costs of pensioner longevity, not anticipated in actuarial predictions, would be ‘shared’ between employers and scheme members with a ‘cap’ or ceiling on employer contributions (Thurley 2011: 5); Labour also introduced ‘tiered’ employee contributions, which vary with employee income, to the NHS and local government schemes (Steventon 2008: 12). In its 2010 manifesto (Labour Party 2010: 14), Labour indicated that it was not intending to take the reform of public sector pensions any further.

Notwithstanding these major changes to public service pensions, the UK Coalition government has embarked upon a further instalment in the reform of public sector pensions. A major concern of such reforms has been the long-term costs of public sector pensions. However, another important strand of criticism is that current forms of provision are ‘unfair’ and it is this issue of ‘fairness’ which is the focus of this article. A variety of major official publications are used in the analysis. These include the last major available statement of the Coalition’s ‘preferred’ approach to public sector pension reform, Public Sector Pensions – Good Pensions that Last (henceforth, GP) (HM Treasury 2011a), the reports of the Independent Public Service Pensions Commission (IPSPC) appointed by the Coalition (Hutton 2010, 2011a), and specific proposals of the Coalition on employee contribution rates (Thurley 2012a). While the IPSPC produced two substantial reports, in these reports and in key Coalition policy statements, there is a lack of precise definitions either of ‘fairness’ in occupational pensions in general or with respect to particular dimensions of ‘fairness’. Thus the analysis aims to use these key sources to construct an account of how the Coalition conceives ‘fairness’ in this policy area.

The article is divided into five parts. The first discusses the background in Coalition policy to the dimensions of ‘fairness’ in public sector pensions discussed in later sections. Subsequent sections discuss three key dimensions of ‘fairness’. The second section examines the issue of how far the proposed changes to public sector pensions could be seen as creating greater ‘fairness’ in occupational pension provision between workers in the public and private sectors. The third considers ‘fairness’ between scheme members – who generally, whether in work or retirement, pay tax – and ‘other taxpayers’. The fourth section discusses ‘fairness’ between public sector scheme members particularly between those who experience substantial increases in pay particularly at the end of their working life and those who do not. A fifth concluding section draws the argument together, examines the limitations of the critique advanced in the argument and suggests questions which would have to be addressed to provide a more complete analysis of ‘fairness’ in occupational pension provision. It considers a number of facets of the Coalition/IPSPC reform programme in relation to the major theories of distributive justice of Nozick and Rawls. The issues discussed in this context are the protection of accrued pension rights, the framing of the reforms to protect in particular the interests of lower paid workers and the problems of the limited remit of the IPSPC to consider only pension provision in the public sector.

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‘Fairness’ in Public Sector Pensions: The Coalition Policy Context

The aim in this section is to explore the background to the three dimensions of ‘fairness’ in public sector pensions which will be discussed in detail in the subsequent three sections. Unlike other areas of Coalition social policy (most notably tuition fees in higher education), policy on public sector pensions did not raise major problems in reconciling the views of Conservative and Liberal Democrat wings of the Coalition. This was because both parties believed that a further significant instalment of public sector pension reform was required. This was reflected in the party manifestos which identified two of the key dimensions of ‘fairness’ with respect to public sector pensions which will be discussed below, that between public and private sectors and ‘for taxpayers’ (Conservative Party 2010: 12; Liberal Democrat Party 2010: 16).

Both Conservative (for David Cameron’s views, see Chapman 2008) and Liberal Democrat (e.g. Cable 2009: 42) senior politicians were convinced that the relationship between public and private sector pension provision was ‘unfair’. A crucial point of reference for such criticisms was the divergent trends between public and private sector pension provision. In the public sector the dominant form of occupational pension provision is the defined benefit (DB) final salary scheme, where scheme members receive a pension based on earnings at the end of their working life calculated on the basis of years of service and an ‘accrual rate’ which gives the member a fraction of the final pension for each year of service. This form of pension provision had been dominant in the private sector but there has been a pronounced trend to ‘closure’ of DB schemes. This is salient to the argument on inter-sectoral ‘fairness’ because it is generally recognized that DB schemes offer more generous and secure pensions (though they are open to criticism on the grounds that they penalize ‘early leavers’ and, see below, favour higher paid workers). The issue of ‘unfairness’ arising from defined benefit final salary schemes remaining dominant in the public sector but declining in the private sector was raised explicitly by Cable (2009: 42) and, during the period 2006–10, membership of DB schemes in the private sector declined by 30 per cent while membership of public sector schemes increased by 10 per cent (ONS 2007, 2011), though it should be noted that the public sector increase reflected expanding public sector employment which has been sharply reversed by Coalition retrenchment policies (for relevant data, see Office for Budget Responsibility 2011).

The Liberal Democrat Manifesto 2010 (Liberal Democrat Party 2010: 16) indicated that part of the rationale for further public sector pension reform was to create a public sector pension settlement which was ‘fair for taxpayers as well as for public servants’. Discussing this issue prior to the 2010 general election, Vince Cable (2009: 43) suggested that it would not be unreasonable to expect higher contributions from public sector workers. He did not give any indication of the possible levels of such increase but, in the 2010 Comprehensive Spending Review, it was stated that the Coalition government would progressively change the level of employee contributions to public sector pension schemes which were expected to involve an average 3 per cent increase in employee contributions to be phased in from 2012 (HM Treasury 2010: 37).
The Liberal Democrat Manifesto 2010 (Liberal Democrat Party 2010: 16) called for an ‘independent review’ of public sector pensions and the Coalition government programme (HM Government 2010: 26) included a commitment to establish an ‘independent commission’ to investigate public sector pensions. On 20 June 2010 the Coalition announced that John Hutton, a Labour Peer and former Cabinet minister, had accepted an invitation from the Chancellor of the Exchequer to chair an Independent Public Service Pensions Commission. The terms of reference of the Hutton commission on public sector pensions were ‘to conduct a fundamental structural review of public service pension provision and to make recommendations to the Chancellor and Chief Secretary on pension arrangements that are sustainable and affordable in the long term, fair to both the public service workforce and the tax payer and consistent with the fiscal challenges ahead, while protecting accrued rights’ (Hutton 2010: 133).

The Commission published an Interim Report (henceforth, IR) on 7 October 2010 and its focus was on ‘the landscape around public service pensions and . . . the case for reform’. The Final Report (henceforth, FR) which recommended structural changes to public sector pensions was published on 10 March 2011. These changes have been opposed by many public sector trade unions, which took strike action on 30 November 2011 and 10 May 2012, but the Coalition government is proposing to introduce legislation designed to implement these changes in the next parliamentary session.

These reports were significant for increasing the salience of a third dimension of ‘fairness’ in public sector pensions, ‘between scheme members’. Hutton argued that final salary schemes favoured public sector employees who experienced significant promotions and/or substantial increases in pay at the end of their working life and disadvantaged employees who experienced only pay increases in line with general increases in average earnings. Hutton (2010: 126) rejected moving public sector provision to a Defined Contribution (DC) basis. The latter give no predictable pension level as the eventual pension is determined by contributions, investment returns (net of administrative costs) and annuity rates which turn the ‘pension pot’ into an income stream. Hutton was concerned that a shift to DC provision would expose lower paid employees to the risk of low investment returns (see Brunsdon and May 2011: 113–4 for discussion of the advantages of DC schemes). The Commission thus recommended a major design change to shift public sector pensions to a defined benefit Career Average Revalued Earnings (CARE) basis (Hutton 2011a: 58). A CARE scheme operates by basing the pension on average earnings over a working life which are revalued by reference to an index rather than earnings at the end of working life as in a final salary scheme. In the next three sections the distinct dimensions of ‘fairness’ in occupational pension provision are analyzed in turn.

‘Fairness’ between the Public and Private Sectors
As was discussed in the previous section, prior to the 2010 general election, senior Conservative and Liberal Democrat politicians developed a critique of public service pensions which asserted that public service workers received
significantly more generous pensions than their private sector counterparts. However, in such arguments the basis of the inter-sectoral comparison was not clear. This issue is the focus of the analysis in this section. However, before discussing this question it is worth considering an objection to limiting the discussion to pension provision. The basis of this objection is that pensions must be considered in the context of inter-sectoral pay differences and that better public sector pension provision is a means of compensating public sector workers for lower pay relative to private sector counterparts. In a valuable commentary, Income Data Services (IDS 2011) show that there is some basis for this argument with evidence of lower pay levels in the civil service when contrasted with private sector counterparts undertaking jobs with comparable demands. However, the same study (IDS 2011) points to difficulties in drawing general conclusions that public sector pay is lower than private sector pay for comparable work because of large inter-sectoral variations in the types of work undertaken.

Given this limitation it seems reasonable to consider inter-sectoral comparisons of occupational pension provision and three distinct criteria for comparison are analyzed. The first considers measures of the average level of occupational pension benefits across sectors. The second is a ‘like with like’ comparison of a similar type of occupational pension provision in the two sectors. Lastly, the argument discusses a conception of inter-sectoral ‘fairness’ where the public sector follows the dominant pattern in the private sector. A key method in the valuation of occupational pension benefits is to use modelling techniques to estimate a value for such benefits as a percentage of pay. The IR (Hutton 2010: 92) cites an estimate from the Institute for Fiscal Studies (IFS) of the mean value of total pension benefits across all employees (the original source is Crawford et al. 2010: 15).

In 2001, the estimated 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 25.1 per cent and 8.2 per cent (Hutton 2010: 92; Crawford et al. 2010: 15). The IFS estimate, cited in the IR, did not take into account the impact of the Labour reforms to public sector pensions most notably the increase in NPA. The IFS study modelled the effects of a ‘simulated reform’ and concluded that, had the Labour reforms applied during the 2001–05 period, mean public sector occupational pension benefits would have fallen from 23.7 per cent to 20.7 per cent (Crawford et al. 2010: 22).

However, while it has been generally agreed that the major changes to public sector pensions introduced by Labour will result in reductions in the value of public sector pensions (see e.g. Steventon 2008: 15–16), the ‘simulated reform’ estimate, cited above, still puts average benefits in the public sector at over double the private sector level. Nevertheless, there is a difficulty in using average pension benefits as a basis of inter-sectoral comparison. In its discussion of the inter-sectoral data, the IR considers the reasons for the trend to a growing inter-sectoral difference in pensions benefits. The key mechanism identified is a ‘composition effect’ (Hutton 2010: 92) which, in turn, has two components. The first is the relative decline of more generous DB schemes and the growth of less generous DC schemes in the private sector. The IFS study (Crawford et al. 2010: 13) estimated that, in 2005, private sector DB
pension benefits averaged 24 per cent of pay as against 9.3 per cent for private sector DC schemes. Occupational pension coverage is inversely related to income across sectors, but the much higher coverage of DB schemes in the public sector means that, even at most earnings bands below the median, a substantial majority of public sector workers have DB coverage while this is restricted to a small proportion of private sector workers with similar earnings levels (for the relevant data, see ONS 2012).

The second key mechanism was the fall in membership of pension schemes in the private sector (Hutton 2010: 92–3) and the IR cites figures from 2009 showing that while 85 per cent of public sector workers had employer-sponsored pension provision, the corresponding figure in the private sector was 35 per cent (Hutton 2010: 93).

The heterogeneity of private sector provision ranging from DB schemes to no provision suggests a second alternative basis of comparison on a ‘like-with-like’ basis. In effect, given the dominance of DB schemes in the public sector, this becomes a comparison of private and public sector DB provision. However, before discussing estimates of DB pension benefit levels across sectors it is important to deal with a potential objection. As was indicated above, an important theme in the pre-2010 general election discussion of occupational pensions was the contrast between the survival of DB pension provision in the public sector and its decline in the private sector. This might suggest that there is, in effect, no basis of comparison because there is no DB provision in the private sector. However, it is important to distinguish two forms of ‘closure’: to ‘future accruals’, which means that no further DB pension benefits can be earned; and to ‘new members’, which means that no new members can join the scheme but existing members continue to enhance their DB pension entitlements. The regular survey of private sector DB schemes by the Pensions Regulator shows that, by 2011, 84 per cent of DB schemes had closed but of these 24 per cent were closed to future accruals and 58 per cent to new members, with 2 per cent winding up (Pensions Regulator 2012: 32). The effects of this pattern of closure can be seen in membership figures. ‘Active’ members of occupational pension schemes are defined as accruing pension benefits. The 2010 ONS survey of occupational pensions found that there were 2.1 million active members of private sector DB schemes. One million were in ‘open’ schemes which accepted new members but the other 1.1 million were in schemes ‘closed’ to new members where existing members continued the accrue DB benefits schemes (ONS 2011: 18). An emphasis on scheme closure also exaggerates the impact on the coverage of open defined benefit schemes since there has been a trend towards closure of smaller schemes. Thus the Pensions Regulator (2012: 32, 34) shows that while 16 per cent of defined benefit schemes were open, these covered 31 per cent of members (for academic research showing similar cross national trends, see Turner and Hughes 2008: 24). Thus as a significant minority of employees in the private sector continue to accrue pension rights in DB schemes, an inter-sectoral comparison is not inappropriate.

Discussing the comparison between DB provision across sectors, the IR concludes that it is broadly similar stating 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). This conclusion is in line with two detailed studies from the Pensions Policy Institute (PPI) (Steventon 2008: 37–8) and a more recent one from the IFS (Emmerson and Wenchao 2012: 104–6).

A third possible interpretation of ‘inter-sectoral’ fairness is that public sector pensions should follow the predominant pattern in the private sector. However, as the data on coverage of occupational pensions in the private sector would suggest, the predominant pattern in the private sector is the absence of provision with around two thirds of private sector workers without occupational pension coverage. The possibility that the public sector should effectively follow the dominant pattern in the private sector was considered in the IR. In his foreword to that report, Lord Hutton explicitly rejected 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, emphasis added). The logic of such a ‘race to the bottom’ would effectively be to wind up occupational pension provision in the public sector while protecting accrued rights. However, winding up such schemes would 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. The Coalition government has also rejected a ‘race to the bottom’ with respect to private sector provision and, in its joint programme (HM Government 2010: 26), committed itself to ‘reinvigorate occupational pensions by encouraging companies to offer high quality pensions’. Steve Webb, the current Pensions Minister, has recently written that the government is looking to investigate options for a new pensions model where risks are shared more evenly employer and employee, what he terms the ‘defined ambition’ pension (Webb 2012).

Thus inter-sectoral comparison is a problematic exercise. Average benefit comparisons involve comparing a certain degree of homogeneity, at least of scheme type, in the public sector but radical heterogeneity in the private sector. Like-for-like comparisons of DB schemes show broad inter-sectoral similarity. A norm where the public sector adopts the dominant pattern in the private sector leads to a race to the bottom repudiated by the IPSPC and at variance with Coalition policy on improving private sector occupational pension provision.

‘Fairness’ between Public Sector Scheme Members and Other Taxpayers

In this section the Coalition’s stance on ‘fairness’ between public sector pension scheme members and other taxpayers is discussed. The argument focuses on two aspects of this issue, the relative contributions to public sector pension schemes of employers/taxpayers and employees; and the possible impact of planned increases in employee contributions. GP (HM Treasury 2011a: 8) states that an important objective of any reform of public service pensions should be to provide a fair balance of costs and benefits between public service workers and other taxpayers. However,
the document neither provides any indication of how this dimension of ‘fairness’ should be defined nor does it explicitly spell out the policy implications of effecting such a ‘balance’. If, however, Coalition policy on the relative levels of employer and employee contributions is compared with the work of the IPSPC, then it is possible to construct an arguably plausible account of the Coalition’s assumptions on this issue.

In the IR (Hutton 2010: 99) it is argued 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 (Hutton 2010) in 1925, employer and employee contributions in the teachers’ pension scheme were equal at 5 per cent; in the NHS scheme in 1948 employee contributions were 5 per cent and employer contributions varied from 6 per cent to 8 per cent according to different categories of worker. It is then observed that pensioner longevity and hence costs of occupational pension provision in the public sector have increased markedly since these reference dates (Hutton 2010). These relative employer and employee contributions are then contrasted with current employer and employee contribution levels in the two schemes. Tiered employee contributions in the NHS vary according to employee pay levels from 5 per cent to 8.5 per cent while employer contributions are 14 per cent (Hutton 2010). Discussing relative contribution levels in the teachers’ scheme, the IR states ‘current membership pay 6.4 per cent with employers paying over twice as much at 14.1 per cent’ (Hutton 2010: emphasis added). The IR goes on to argue that, as increases in employee contributions have been ‘marginal’ then ‘the taxpayer has met most increases in cost’ (Hutton 2010).

Two related conclusions could be drawn from this discussion. The first is that the early pattern of relative contribution levels in the two schemes cited could be seen as a norm, suggesting that rough equality between employer and employee contributions could be regarded as a ‘fair balance’ between workers and other taxpayers. The second is, in line with the comments on the teachers’ scheme, that relative contributions of employers in excess of twice those of members are treated as a benchmark for an ‘unfair’ balance.

As the argument above indicated, GP neither provides a definition of what would constitute a ‘fair balance’ of costs and benefits between public sector workers and other taxpayers or an operational guide to how this might be related to relative contribution rates. However, it does outline suggested ‘cost ceilings’ within which it is envisaged public sector pension schemes would operate. The ‘ceilings’ (HM Treasury 2011a: 13) are combined employer and employee contributions. They are also broken down into the relative contribution levels envisaged for employers (the ‘taxpayer’ contribution) and for employees. Table 1 shows the relative contribution levels anticipated for the two schemes discussed above (teachers’ and NHS) and contrasts the employer to employee ratios currently applicable in those schemes.

The pattern indicated in the table suggests that Coalition policy is consistent with the *de facto* norm outlined in the IR and discussed above. As table 1 suggests, there is an attempt to move from a putative ‘unfair’ ratio where taxpayer/employer contribution frequently exceeds 2:1 to virtual parity of contribution levels between employer/taxpayer and employee – a similar
pattern can be seen in proposed contribution levels for the local government (HM Treasury 2011a: 13) and firefighters’ schemes (Thurley 2012d: 33).

However, there is a problem with such a *de facto* criteria of this dimension of ‘fairness’. The observations in the IR refer to a ratio of employer to employee contributions at given points in time in public sector schemes; there is no warrant to conclude that such ratios are ‘fair’ or ‘unfair’ and the IR reflects this by suggesting that there may be a case for rebalancing the split of costs in the future (Hutton 2010: 99). The notion of an ‘unfair’ burden on taxpayers would, however, be strengthened if public sector schemes could be shown to be notably more ‘generous’ in the sense that employer contributions were a much higher multiple of employee contributions than those applying in the private sector. Table 2 shows weighted average employer and employee contributions to private sector DB schemes during the period 2007–10.

The data in the table undermines the notion of public sector ‘generosity’ with respect to private sector practice since, far from operating with employer: employee contribution ratios of under 2:1, they are consistently over 3:1. DC

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**Table 1**

NHS and teachers’ pension schemes employer/taxpayer and employee contributions (as a percentage of pensionable pay) in anticipated cost ceilings and in current schemes

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Current employer/taxpayer contribution (%)</th>
<th>Current employee contribution (%)</th>
<th>Ratio 1:2</th>
<th>Anticipated employer/taxpayer contribution (%)</th>
<th>Anticipated employee contribution (%)</th>
<th>Ratio 3:4</th>
</tr>
</thead>
<tbody>
<tr>
<td>NHS</td>
<td>14%</td>
<td>5%–8.5% (tiered)</td>
<td>2.8–1.6:1</td>
<td>12.1%</td>
<td>9.8%</td>
<td>1.2:1</td>
</tr>
<tr>
<td>Teachers’</td>
<td>14.1%</td>
<td>6.4%</td>
<td>2.2:1</td>
<td>12.1%</td>
<td>9.6%</td>
<td>1.2:1</td>
</tr>
</tbody>
</table>

*Source:* Adapted from HM Treasury 2011a; Thurley 2012b, 2012c.

**Table 2**

Weighted average employer and employee contributions to private sector defined benefit schemes 2007–10

<table>
<thead>
<tr>
<th>Year</th>
<th>Employer contribution (% of salary)</th>
<th>Employee contribution (% of salary)</th>
<th>Ratio 1:2</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>15.8</td>
<td>5.1</td>
<td>3.1</td>
</tr>
<tr>
<td>2009</td>
<td>16.5</td>
<td>5.2</td>
<td>3.2</td>
</tr>
<tr>
<td>2008</td>
<td>16.6</td>
<td>4.9</td>
<td>3.4</td>
</tr>
<tr>
<td>2007</td>
<td>15.6</td>
<td>4.9</td>
<td>3.2</td>
</tr>
</tbody>
</table>

schemes are less generous and employer contributions in such schemes fluctuated from 6.1 per cent to 6.5 per cent of pensionable pay during the period 2007–10 (ONS 2008, 2009, 2010, 2011). However, even in private sector DC schemes, the employer to employee contribution ratios were 2:1 or more during the 2007–10 period, varying from 2.0 in 2008 to 2.4 in 2007 (ONS 2008, 2009, 2010, 2011).

The second key issue to be addressed in this section is the potential impact on public sector scheme membership of the increases in employee contributions planned by the Coalition. Since 1988 (Social Security Act 1986), all occupational pension schemes have operated on a voluntary basis and membership cannot be made a condition of employment. Thus increases in employee contributions could lead to the rejection of public pension scheme membership either through an unwillingness to join or a decision to opt out. This problem was recognized in the FR (Hutton 2011a: 80). Lord Hutton returned to the issue in a talk at the Institute of Public Policy Research where he stated that there was a need for ‘careful examination of any possible increase in opt-out rates . . .’ from higher contributions (Hutton 2011b) and his concern was reiterated in a radio interview (Hutton 2011c). The Coalition has sought to guard against this by excluding those earning less than £15,000 per annum from planned increases in contributions in the Civil Service, NHS and teachers’ schemes. It has also limited the planned contribution increase to no more than 1.5 per cent of pay in total, during the period to 2014–15, for those earning up to £21,000 (Thurley 2012a: 1).

It is difficult to know what will be the implications for scheme participation rates of the planned contribution increases, especially for women who, on average earn less than men in the public sector (Unison 2011). The government provided an initial estimate on opting out in the Spending Review Policy Costings which was sanguine. It stated (HM Treasury, DWP and HM Revenue and Customs 2010: 18–19) that the effect of contribution increases on opt outs would be no more than ‘one per cent of the . . . paybill’. Concerns regarding the reliability of this estimate arise from papers obtained by the GMB union (under the Freedom of Information Act 2000). These show Treasury estimates of the percentages of workers likely to opt out of public sector schemes at 6 per cent 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 are regarded as too low by a pensions consultant who advised the IPSPC (Timmins 2011). Indeed, the Spending Review Policy Costings (HM Treasury, DWP and HM Revenue and Customs 2010: 19) admitted that ‘assumptions about opt-out behaviour are inherently uncertain’ (for evidence that opting out may be much higher than the Treasury anticipates, see Cohen 2011; NUT 2011; Unite 2011; NASUWT 2011; FBU 2011a).

An important implication of threats to opt out of pension schemes could be that the Treasury is left with reduced receipts while having to pay for past pensions. Figures from the Fire Brigades Union (FBU 2011b) illustrate this point. Using data from the Government Actuary’s Department, the Fire Brigades Union estimated an opt out rate as low as 7 per cent from the firefighters’ scheme would wipe out any expected short-term saving for the
taxpayer. The government has responded to these estimates by arguing that opting out would mean that employees would lose the employer contribution and a number of benefits which have to be purchased separately, for example death-inSERVICE. However, whatever the validity or otherwise of such an argument, there is the difficulty that decisions to opt out may be driven by the effects of falling real pay levels which lead members to regard contributions as unaffordable. In the 2011 Autumn Statement (HM Treasury 2011b: 23, 37), the Chancellor announced that public sector pay awards were to be set at an average of 1 per cent for the two years after the current freeze comes to an end and proposals for local variations in public sector pay raise the possibility of further cuts in real pay levels in the public sector.

Thus the issue of ‘fairness’ between public sector workers and other taxpayers raises two different problematic issues for the Coalition analysis. The argument showed that the Coalition appears to have adopted a de facto norm that something close to equality of contribution between employer and employee is a ‘fair’ balance. However, there is no justification for such an assumption and such an implicit norm is at variance with the experience of private sector DB and DC schemes. Further, if the Coalition’s notion of a ‘fair balance’ is to be sustained this would have to rest on the assumption that the level of occupational pension coverage will not be significantly reduced in the public sector. The effects of the planned contribution increases are, at the time of writing, unclear but the Coalition’s operational assumptions on maintenance of scheme membership sit uneasily with the initial sketchy Treasury assumption regarding reductions in coverage and the questionable view that scheme membership will be driven predominantly by assessments of such membership as a long-term ‘investment’.

‘Fairness’ between Public Sector Scheme Members

One of the major changes to UK public service pensions advocated by the Coalition is to shift the principal form of pension scheme operating in the public sector from a DB final salary type to a DB Career Average Revalued Earnings (CARE) form (HM Treasury 2011a: 16). The principal argument advanced by the Coalition is that CARE schemes will establish greater fairness in pension provision between members of public sector schemes. Thus it is argued, in GP, that ‘the predominantly final salary scheme designs currently in place mean that lower-paid public service workers are subsidizing the pensions of the highest paid’ (HM Treasury 2011a: 7). The proposed switch in the form of public sector pension scheme is related to a finding of the IPSPC, cited in GP, that ‘those who retire on a higher salary in a final salary pension scheme receive a significantly higher pension per £100 of employee contributions’ (HM Treasury 2011a: 10–11). The cited source for this argument is an analysis of the local government scheme, in the FR, which shows that median annual pension payments (per £100 of employee contributions) for those 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).
The IPSPC also commissioned an analysis by the PPI which compared a proxy final salary scheme with the two CARE options. The proxy scheme used by the PPI was broadly based on the terms offered to new entrants to the local government and NHS schemes (Hutton 2011a: 171–2). The PPI analysis concluded that ‘high flyers’ (defined as those who, in addition to ‘standard’ promotions and earnings increases in line with general wage inflation, experienced additional earnings growth of 1 per cent per annum over their career) could expect a return on their contributions 50 per cent higher than ‘low flyers’ whose earnings growth was just in line with general wage inflation (Hutton 2011a: 180). In contrast, the returns for these groups with radically different earnings trajectories over their working life in the CARE schemes modelled were ‘very similar’ (Hutton 2011a).

GP does not discuss how ‘fairness’ between scheme members should be defined but, in effect, the document follows the definition outlined in the IR that ‘a benchmark for fairness within a scheme could be that effective benefits from scheme membership, net of employee contributions, are roughly equal as a proportion of salary (at least over someone’s career – since effective benefit rates will vary with age’ (Hutton 2010: 94). The reference, cited above, to ‘the predominantly final salary scheme designs currently in place’ (HM Treasury 2011a: 7) in the public sector is ambiguous. The statement could be read as either suggesting that all final salary schemes have these ‘unfair’ characteristics; or that the form they take in the public sector makes them particularly regressive.

The reason for suggesting that all final salary schemes have potentially regressive effects is straightforward. Under final salary schemes, if a given individual experiences significant promotions/and or salary increases late in their career then their pension will be inflated since it is based on substantially higher earnings at the end of working life. The higher ‘return’ on employee contributions will follow from the payment of employee contributions on the higher salary only for a limited period. Naturally, employees whose pay only rises with general wage inflation (the ‘low flyer’) will not obtain such a boost from late salary increases. This regressive mechanism is thus a function of the scheme type not the sector in which the scheme operates.

However, if regressive effects are to be anticipated from final salary schemes, could it be suggested that such effects are likely to be worse in the public sector? There are various difficulties with this argument. The first is that the regressive effects of final salary schemes can be and are modified by the operation of tiered contributions and this was demonstrated, with respect to the NHS scheme, in the IR (Hutton 2010: 95). However, tiered contributions would appear to be currently confined to the local government and NHS schemes. Thus in their most recent annual survey of occupational pensions the Office for National Statistics does refer to the tiered contributions in these schemes (ONS 2011: 38) but makes no reference to tiered contributions applying at all in private sector schemes (ONS 2011: 33). Thus this mechanism for mitigating the regressive effects of final salary schemes is present in certain public sector schemes but does not appear to be present in private sector DB schemes.

The second problem is that, in a final salary scheme, rapid growth of earnings drives higher pension entitlement. If, therefore, public sector final
salary schemes were to be more regressive than their private sector counterparts, a key mechanism should be that pay increases for senior managers and officials have been more rapid in the public sector than for their counterparts in the private sector. This issue was investigated in a review of fair pay in the public sector undertaken, for the Coalition, by Will Hutton. Hutton’s Interim Report, published in December 2010, concluded that ‘pay disparity has grown in the private sector in recent years’ and ‘for larger companies this has been much greater than the public sector’ (Hutton, W. 2010: 49, original emphasis). The caveat on large companies should be noted so that the trends in, for example, FTSE 100 companies are not reflected in pay levels in medium sized private companies (see Hutton, W. 2010: 50). The implications for pensions can be seen if comparisons are made between retirement pension levels at the apex of the public and private sectors. Comparing remuneration levels, Will Hutton (2010: 54) uses as a public sector benchmark the earnings of the Cabinet Secretary (then Sir Gus O’Donnell) which is contrasted with median (basic) salaries of chief executive officers in FTSE 100 and 250 companies. To investigate pension provision for senior personnel across sectors, the authors of this article compared the pension entitlement of the Cabinet Secretary with accrued pension levels in FTSE 100 companies offering defined benefit pensions to executive directors.

The research used the Lane Clark and Peacock (2011) survey of pension provision for executive directors in FTSE 100 companies as a starting point. This survey identified 15 FTSE 100 companies which offered defined benefit pension provision to all their executive directors. The FTSE 100 companies were defined as those in the index on 30 June 2011, and the companies offering DB provision for all directors were identified on the basis of published accounts for 2010. In order to ensure comparability, one company was excluded on the grounds that it offered a career average scheme unlike the final salary pattern dominant in the UK public sector. The analysis was also limited to the overwhelming majority of executive directors who were members of UK-based schemes (some provision for executive directors included final salary schemes administered in other jurisdictions, most commonly the USA). As the companies concerned were identified in the survey it was possible to derive data on the accrued pension entitlements of executive directors from remuneration reports in the published accounts. Accrued pension benefits refer to what the executive director would be entitled to as an annual pension and table 3 shows the range of such entitlements.

The Cabinet Secretary’s accrued pension in 2011 was recorded in the Cabinet Office Annual Report and Accounts 2010/11, as £105,000–£110,000 (Cabinet Office 2011: 154). It is thus clear from table 3 that pension entitlements for senior corporate managers in private sector DB final salary schemes are substantially higher than for senior managers and officials in the public sector. Just under 70 per cent of the executive directors had accumulated an annual pension entitlement at least roughly double that of the Cabinet Secretary and over half at least three times that level. Furthermore, it is important to note that the above figures do not reflect the completed pension entitlements of the executive directors concerned. Age data was available for 75 per cent of the directors, and 38 per cent of executive directors whose ages were...
known were under 50 thus allowing them considerable potential scope to enhance their pension entitlements.

The pattern of closure of private sector schemes to predominantly to new members rather than to all accruals discussed above has a significant effect on the continued relevance of DB provision for executive directors. Thus the Lane Clark and Peacock survey (2011: 10) points out that ‘defined benefit pensions are still the most common form of pension provision with 43 per cent of FTSE 100 executives earning these pensions’ (the higher percentage of directors than companies reflects the fact that some directors will remain personally covered by DB final salaries even though the company does not offer them to all executive directors). Thus the discussion of ‘fairness’ between scheme members has a somewhat attenuated character. The Coalition can point to evidence that final salary schemes in the public sector do confer advantages in terms of the return on their pension contributions for ‘high flyers’ relative to scheme members who experience earnings increases in line with average earnings increases. However, the sharper trajectory of pay increases for senior private sector managers suggests that the ‘fairness’ problem is worse in the private sector and this is supported by the research undertaken for this article on pension relativities between executive directors and those available at the apex of the UK public sector.

**Conclusion**

The conclusion has two principal aims, to draw the argument together and to explore the limitations of the critical analysis and the kinds of questions which would need to be addressed if a more satisfactory treatment of ‘fairness’ in occupational pension provision is to be provided.

The object of the article has been to explore the weaknesses in the Coalition/IPSPC analysis of whether current occupational pension provision in the public sector is ‘fair’. Broadly, these weaknesses were reflected in a lack
of conceptual rigour and in omissions in the range of evidence considered. The lack of conceptual rigour can be seen in the IPSPC’s failure to specify what it considered an appropriate basis for inter-sectoral comparison in its discussion of ‘fairness’ between public and private sector workers. It was also a feature of the lack of a justification for the de facto norm that employer and employee contributions to public sector occupational pensions should be roughly equal. Important omissions included the absence of any investigation of the regressive effects of final salary schemes in the private sector. This omission could be seen as particularly problematic in the context of the rapid increase in rewards of senior corporate managers a significant proportion of whom remain DB scheme members.

However, the analysis has the key limitation that it is negative. What the article has sought to show is how and why the Coalition/IPSPC has failed to provide a satisfactory case that current occupational provision in the public sector is ‘unfair’. A reasonable starting point for the exploration of a more ‘positive’ conception of ‘fairness’ in occupational pension provision would be to consider the two central theories of distributive justice in contemporary debate (Powell 2002: 20). These are the ‘entitlement’ approach stemming from the work of Nozick (1974) and the ‘justice as fairness’ approach identified with the work of Rawls (1972, 2001).

For Nozick, entitlement to a ‘holding’ relates ‘justice’ in ‘acquisition’ and in ‘transfer’ (Nozick 1974: 150). The theory is ‘historical’ since whether an entitlement is just depends on ‘how it came about’ (Nozick 1974: 153) and, for example, acquisitions/transfers through theft or fraud are unjust (Nozick 1974: 152). Nozick’s approach is radically different from theories (such as utilitarianism) which use ‘structural principles’ to determine whether a given distribution of resources is just. In such theories it is the assessment of the distribution which matters, not how it came about (Nozick 1974: 154). The logic of Nozick’s position is a rejection of redistribution which involves a ‘violation of people’s rights’ (Nozick 1974: 168; for a critical discussion of this view, see Plant et al. 1980: 89–93). A preferred distribution of resources according to the relevant structural principle will not involve a correspondence with the ‘historical’ pattern of holdings but a shift to the preferred distribution involves, for Nozick, depriving people of their just ‘entitlement’.

Rawls seeks to ground his concept of justice on a hypothetical social contract undertaken in conditions of a ‘veil of ignorance’ where individuals do not know the social position which they will occupy (Rawls 1972: 12; 2001: 15). Rawls (1972: 302) argues that the ‘contractors’ would agree to a ‘principle’ whereby social and economic inequalities are to be ‘arranged’ ‘to the greatest benefit of the least advantaged’ (the ‘difference’ principle, Rawls 2001: 43) and ‘attached to offices and positions open to all under conditions of fair equality of opportunity’ (Rawls 1972: 302). Rawls (1972: 313; 2001: 64) supports a conception of ‘entitlement’ which is not ‘historical’. A just distribution in Nozick’s sense would be problematic because any inequalities would not be based on an expected benefit for the least advantaged but rather on the pattern of just acquisitions and transfers. Nozick (1974: 230–1) does allow for ‘rectification’ with respect to ‘unjust’ holdings but the scope of the latter is very limited (see Plant et al. 1980: 87).
Applying such abstract conceptions to a policy area like pensions is not unproblematic (in the indexes to Nozick 1974, Rawls 1972 and 2001 there is no reference to pensions). In the case of Nozick, occupational pensions should, arguably, be seen as a form of property which is justly held if it has resulted from an acquisition not falling under the unjust acquisitions or transfers discussed above. Since current public sector pensions involve a voluntary exchange (terms offered by the employer which can be accepted or rejected), the ‘holding’ would be legitimate. Equally, as a party to the exchange the employer would be free to change the terms on which the benefit is offered or withdraw it altogether. What the employer would not be free to do is to infringe accrued pension rights since this would be a violation of a ‘just’ holding.

The difficulties of applying the Rawls approach are possibly greater. One reason for this is that Rawls (1972: 86) claims that he is using ‘pure procedural justice ‘where there is no independent criteria for the right result’ but only a ‘correct or fair procedure’. However Miller (1976: 45) has criticized Rawls on the grounds that, for example, the ‘difference’ principle does prescribe ‘a certain outcome’. In this respect the IPSPC proposal to move from a final salary to a CARE scheme could appear to have echoes of the ‘difference principle’ since the object is to benefit the ‘least advantaged’. However, the ‘difference principle’ does not enjoin a reduction in inequality per se but only in those inequalities which engender no benefits to the ‘least advantaged’. There is, however, another clear implication of Rawls’s treatment. The proposal to shift from a final salary to a CARE scheme is only relevant to public sector scheme members and hence confers no benefits on the ‘least advantaged’ in the private sector. This is at variance with the use of Rawls’s concept (2001: 59) of the ‘least advantaged’ who are ‘not identifiable apart from, or independently of their income and wealth’. In this respect any treatment of ‘fairness’ in occupational pension provision which is limited to the public sector is problematic (Brunsdon and May 2011: 121). If the difference principle is read as prescribing a given outcome then there are also, arguably, implications for the form of pension provision. The IPSPC supported a shift from one form of DB scheme (final salary) to another (CARE) and this would be consistent with pursuit of a given distributional outcome since the characteristic of DB schemes, as their designation suggests, is that they give a predictable result. Again, however, this would raise issues about the support for DB provision only in the public sector.

The approach of the Coalition/IPSPC to ‘fairness’ in occupational pension provision is seriously flawed, an alternative approach would require an exploration of both the key principles which ought to be applied in judging the ‘fairness’ of occupational pension provision and applying them to the whole sphere of occupational pension provision.

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