Cashing in: pension freedom for public sector workers

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TaxPayers' Alliance

Introduction

Since 2010, the deficit has reduced from £181.5 billion to £23.3 billion[1] in constant prices. Part of the way in which this has been achieved is through reducing the public sector headcount and restraining pay. In the same period, the number of public sector workers has fallen from 6.4 million to 5.4 million[2] and public sector staff costs have fallen in real terms from £224.5 billion[3] in 2010-11 to £202.2 billion[4] by 2016-17. The latter was achieved by freezing public sector pay rates (as distinct from individuals' pay packets) for two years and then capping increases at 1 per cent. The government has since announced the end of the 1 per cent cap.

During the 2000s, public sector employees saw their pay increase far faster than their private sector counterparts. By 2010, the average public sector worker was paid 4.3 per cent more than the average private sector worker but the latest figures show this has now reversed and the average private sector worker earns 1 per cent more.[5]

The pensions landscape

This is, however, only part of the story. Despite some reforms proposed by the Independent Public Service Pensions Commission, which were vehemently opposed by trade unions, such as the move towards career averages rather than final salaries and changes to accrual rates, public sector pensions remain vastly more generous than those on offer in the private sector. Previous research has shown that in the private sector, a contribution rate of 30 per cent of their gross pay a year would be required for a worker to enjoy the same benefits as they would in the public sector.[6]

During the period of pay restraint, public sector pension liabilities increased from £1,157 billion in 2011-12[7] to £1,942 billion in 2016-17[8] in real terms. Despite increases in employer and employee contribution rates, HM Treasury is spending more than ever to plug the shortfall between contributions and expenditures – in 2018-19 it is expected to inject £12.6 billion into the main public sector schemes.[9]

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[1] OBR, *Public finances databank*, 25 March 2019, https://obr.uk/download/public-finances-databank/, (accessed 30 April 2019).
[2] ONS, *Public sector employment, UK: December 2018*, https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/publicsectorpersonnel/bulletins/publicsectoremployment/december2018, (accessed 25 April 2019).
[3] HM Treasury, *Whole of Government Accounts: year ended 31 March 2011*, October 2012, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/221560/whole_of_government_accounts_31-03-2011.pdf#page=129, (accessed 25 April 2019), p. 127.
[4] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, June 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720160/WGA_2016-17-print.pdf#page=72, (accessed 25 April 2019), p. 68.
[5] ONS, *Is pay higher in the public or private sector?*, 16 November 2017, https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/ispayhigherinthepublicorprivatesector/2017-11-16, (accessed 29 April 2019).
[6] Basey, P., *Pensions inequality,* TaxPayers' Alliance, 2018.
[7] HM Treasury, *Whole of Government Accounts: year ended 31 March 2012,* July 2013, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/223814/whole_of_government_accounts_year_ended_31_march_2012.pdf#page=107, (accessed 30 April 2019), p. 103.
[8] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, June 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720160/WGA_2016-17-print.pdf#page=137, (accessed 30 April 2019), p. 133.
[9] OBR, *March 2019 Economic and fiscal outlook fiscal supplementary tables: expenditure. Table 4.8,* 13 March 2019, https://obr.uk/download/march-2019-economic-and-fiscal-outlook-supplementary-fiscal-tables-expenditure/, (accessed 25 April 2019.

The increasing cost of public sector pension schemes will continue to increase costs for private sector employers. For example, the employer contribution rate for the Teachers' Pension Scheme is set to increase from 16.48 per cent to 23.6 per cent in September 2019. These increases are being driven by the government's belated but welcome moves toward using a more realistic discount rate, however the cost of these schemes to taxpayers remains disguised.

Proposals

Despite the end of the 1 per cent pay cap and the government's claims that "austerity is over"[10] the kinds of pay increases public sector workers became accustomed to in the 2000s will not be possible without very significant additional borrowing and/or significant increases in taxation.

The tax burden is at a 50-year-high.[11] Given this, and the government's reluctance to continue restraining public sector pay, it makes little sense for public sector workers to simultaneously accrue extremely generous pension rights, whilst also calling for significant pay increases. Instead, these rights could be exchange for generous pay increases. We therefore propose a pensions opt-out scheme for public sector employees:

- Public sector workers should be given the option to fully or partially opt-out of their pension at the beginning of each financial year.
- In return for sacrificing pension rights, employees would not be required to make contributions proportional to the size of their opt-out.
- They would then receive the corresponding share of the employer contributions as part of their salary.

Illustrative example of proposals:

- An NHS employee earning £25,000 in 2018-19, such as a staff nurse, had **take home pay of £18,960.88** after paying £2,275 income tax, £1,989.12 national insurance and £1,775 in pension contributions (7.1 per cent contribution rate).
- The employer currently pays £2,287.49 in national insurance and £3,575 in pension contributions, a total of £5,862.49 (14.3 per cent employer contribution rate).
- Under these proposals, the employee could choose to opt out of their pension for the year. In return for giving up 1 year of pension accrual, the employee would receive a **pre-tax salary of £28,575** (£25,000 + £3,575), **taking home £22,811.68** after paying £3,345 income tax and £2,418.12 national insurance.
- The employer would pay £2,780.84 national insurance.

Such a system could be readily applied across the public sector for a temporary period and at the request of the employee.

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[10] BBC, *Theresa May: People need to know austerity is* over, 3 October 2018, https://www.bbc.co.uk/news/av/uk-politics-45733098/theresa-may-people-need-to-know-austerity-is-over, (accessed 26 April 2019).
[11] TaxPayers' Alliance, *Briefing: five more years of historic-high tax burden*, 3 December 2018, https://www.taxpayersalliance.com/tax_burden_at_a_50_year_high_finds_taxpayers_alliance, (accessed 1 May 2019).

Sources and methodology

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