The politics of pensions

Steve Cushion examines the current moral panic around pensions and argues that unions must defend this 'deferred pay.'

Crisis? What crisis?

Prophets of doom in the government and their supporters in the press are currently issuing dire warnings that there is a crisis in the provision of pensions because we are all living longer. This, we are told, can only be resolved if pensionable age is raised, benefit levels curbed and contributions from employees are increased. Before considering our response to these threats, it is worth considering if there really is a crisis.

The recently published Green Paper states that life expectancy is 89 for men and 90 for women. This is strange because the Office for National Statistics gives life expectancy at state pension age, the important figure when calculating how much the provision of pensions will cost, as 82.4 for men and 85 for women and that it is levelling off. This last point is important, as it is often implied that life expectancy is constantly increasing and will continue to do so at the same rate. However, in 2009, pensioners represented 19% of total population, while it is predicted that by 2050 they will represent 21%. Hardly a change that warrants the current scaremongering. In fact, most of the increased average life expectancy that we have seen in the last hundred years is due to a dramatic fall in the infant mortality, which dragged the average figure down in previous centuries. This warns us to be very suspicious of statistics which, despite their air of scientific objectivity, can be selectively used to prove

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the writer's point. As Mark Twain commented, there are three kinds of lies: lies, damned lies and statistics.

There is considerable evidence, however, which links life expectancy to income. If they cut the pension, they will save money as many of us will then die earlier. We already have 2.5million pensioners whose income is below the poverty line, defined as 60% of average earnings, currently £178 before housing costs. Any deterioration in the basic state pension would add many more to that figure, as already 63% of pensioner households gain the majority of income from the state pension and other benefits.

State Pension

The existing basic state pension was set up in 1948 as part of the post war welfare reforms. It is funded by means of a National Insurance Fund. It was intended to be self funding, based on contributions of employees and employers. There are two ways in which pension provision can be organised, pre-funded and pay-as-you-go. Pre-funded schemes are started with a fund, which is increased by contributions and which generates investment income. Pay-as-you-go schemes operate such that the contributions of the economically active are more or less immediately paid out in pension benefits to the retired. All of the national schemes set up after the Second World War are pay-as-you-go, probably inevitably given the problems of starting them from scratch in economically difficult times. There was also strong pressure from the financial services industry who were afraid that a fully-funded scheme would represent competition and loss of business.

Right-wing ideologues associated with the banks and insurance companies mounted a campaign against any attempt to use the surplus in the National Insurance Fund for economic intervention in housing or job creation, condemning this possibility as 'state socialism' – if only. Such interventions from the financial services industry and its propagandists are a constant feature of the discussion of pensions. This is only to be expected, but what is unfortunate for the majority of us is their success in influencing policy. At the last valuation the National Insurance Fund was £41 billion in surplus, hardly a picture of a system in terminal crisis. This surplus, while it is reserved for its original intended purpose, is used to offset the government's borrowing requirement, and neither serves a useful economic purpose such as promoting industrialisation and job creation, nor does it grow through investment. Yet another case of the workers' money used by the state to reduce its debts and thereby lower

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taxes on the rich.

The Thatcher government started many processes that shifted the balance of national income from the poor to the rich, but her pension reforms have gone largely unnoticed. The most important of these from our point of view was the to change the indexation mechanism. Previously, pension increases were linked to the annual increase to wages or prices, whichever was the greater. Since 1980, pensions have been index linked to the retail price index (RPI) and, had this change not been made, the current £102 per week would be £165, still pathetic, but at least approaching the poverty level. By European standards, the British basic state pension is indeed pathetic, being a mere 30% of average earnings, compared to the EU average of 60%. Any suggestion that there is not enough money in the economy to guarantee all older citizens a reasonable standard of living is soon dispelled by examining the pension arrangements of the senior executives of the banks and finance houses. These make shocking headlines but are soon forgotten as the press prefers to concern itself with the minor peccadilloes of footballers and other celebrities. A truly investigative press would be less concerned with who is in bed with whom and more interested in who has got their already rich fingers in the public purse.

British employers' social contributions are the worst in Europe and the trade union response to this, rather than campaigning for a truly progressive taxation system that makes the rich pay at a level they can afford, has been to promote occupational pension schemes that cover the workers in single industries or individual companies.

Occupational pensions

Funded schemes are the more common form of occupational pension and represent a business opportunity for the banks and insurance companies, because they provide a constant stream of investment capital for big business with captive investors. There is an accountability deficit, with employees' ownership rights being usurped by the sponsoring management and their fund managers, who have more in common in both attitude and income with bankers than they do with the workers whose interests they are supposed to represent. Even those trade union representatives on boards of trustees find themselves with little or no influence on the day to day running of the scheme.

Occupational pension schemes were frequently a result of trade union action, for example the first such pension fund in the USA was set up

following the 1946 United Mine Workers national strike. Pensions are therefore best seen as a form of deferred wages. They take two forms, either ‘defined benefit’ schemes, from which benefits are paid according to a calculation based on the salary and the years of service of the retiring worker, or else ‘defined contribution’ (also called ‘money purchase’) schemes, in which the pensioner accumulates a ‘pot’ that is used to buy an annuity from which the benefits are paid. In the former case, the risk is taken by the sponsoring employer, in the latter the risk rests with the employee as the level of benefit is based upon circumstances such as stock market prices over which they have no control. Clearly the defined benefit approach is infinitely preferable from the employee’s point of view, which is why, in recent years, private employers have closed nearly 90% of such schemes or converted them to defined contribution, claiming that they cannot afford their contributions in times of economic difficulties. There is a lot of talk of ‘black holes’ in pension funds, completely ignoring the practice of taking ‘pension holidays’ in previously more profitable times or financing redundancies out of the pension fund. Between 1987 and 2001, British employers took pension holidays of £18.5 billion, which with proper investment would have done much to prevent the appearance of so-called black holes.

The majority of the remaining defined benefit schemes are now in the public sector, although privatisation and contracting-out has significantly reduced the number of final salary occupational pensions (or indeed any other kind). This has led to a government sponsored attack on public sector pensions with their supporters in the press headlining stories of

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the 'Fat cat pensions' of a few over-paid municipal chief executives and overlooking the fact that the average public sector pension was £68/week in 2006-7, as the wages of the majority of public sector workers are scandalously low. Let us look at one such public sector schemes to give us an idea of how the approach works in practice.

The Transport for London pension scheme is fully funded and has a large portfolio of capital investment. It has been the subject of considerable trade union activity, with a campaign in the late 1980s securing retirement at 60, equal treatment for same sex partners and other improvements. The fund has also been subject to a cycle of surplus and deficit but even in the current strained economic atmosphere, last year's contributions exceeded benefit payment by £55m and, when investment income is taken into account, the was a net increase of £1,268,856,000. Nevertheless, the actuarial report, done in 2009 at the bottom of the economic cycle, turns this surplus into a deficit of £107 million. This is because it is based on the proposition that there should be enough in the fund to buy annuities from an insurance company to fulfil all benefit obligations should the fund be wound up tomorrow.[1] We shall see when considering the private pension industry that this is a particularly absurd measure of financial stability.

Private pension schemes

Private pension funds represent a valuable source of business for the financial services industry, but represent a particularly poor return for the investor. Heavy expenses for marketing, administration, collection and individual tailoring result in heavy charges, as of course does the profit made by the banking or insurance institution managing the funds. The BBC programme Panorama found that some some such as HSBC take up to 80% of money deposited in charges.[2] A charge of 1% per annum may not seem much, but over 40 years would take 20% of your pot and 2%, 3% and even 4% charges are not uncommon. The Workplace Income Commission report in August this year, chaired by Lord McFall, made it clear that private pension schemes were poor value for money and that the scale of management charges were a major reason for the bad returns. 'If you take management fees down from 2% to 1% you could be talking about an increase in pension pot of 50%'.[3]

The charges levied by the financial services industry for administering private pensions adds up to a vast operation of 'skimming off the top'. Many teachers who have contributed to the Additional Voluntary Contributions scheme recommended by the TPS have come to the

[1] http://www.tfl.gov.uk/microsites/pensions/documents.asp

[2] BBC, Panorama (4 August 2010)

[3] http://wricommission.org.uk/wric/

conclusion that it would have been better advised to have put their money under the bed.

The exorbitant charges levied by the private pension sector are not compensated for by financial security. The mis-selling scandal of the 80s resulted in 1.5 million people being conned into taking a worse option, while those who invested in Equitable Life lost a considerable part of their life savings. It is worth noting in passing that the government was prepared to spend billions of pounds of tax-payers' money to save the city banks, but did not compensate those small investors who lost much of their savings at Equitable Life.

There has been a trend to 'financialisation' of public schemes, with the increasing involvement of financial services industry. This is a form of privatisation that is costly and inefficient, but which generates funds for the banks while undercutting social solidarity. The finance industry is lobbying to remove the competition from public pension funds and we see, for example, that the Teachers Pension Scheme is run by the investment house Capita, when it would be perfectly possible to run it as part of the education ministry, rather as the Transport for London scheme is run in-house by the Mayor's Office with considerably greater efficiency.

Private pension funds have become integral to global capitalism. Half of Britain's stocks and shares are owned by pension funds which are administered according to the ethos of the City of London: short termism, lack of interest in manufacturing industry and looking for a quick profit without investing for future development. In every respect they are part of the problem, rather than providing a solution to the question of financing old age.

Green Paper

So, why are they attacking our pensions? The simple answer is that they want to solve the banking crisis at the expense of pensioners and working people and that the recently published green paper on pensions is part of a process which will significantly transfer the balance of national wealth from labour to capital.

This green paper introduces the initially attractive idea of a single pension, but at a significantly lower rate than would be required to raise the majority of pensioners out of poverty. The end of 'contracting out' (the system which allows lower national insurance contributions for employers with occupational pension schemes) threatens to kill the remaining private sector pension schemes and place a further strain on public sector

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schemes. The end of the state second pension will also have worsening effect on remaining defined benefit pensions. The state second pension was targeted at those who were not in good occupational schemes, while those employers with adequate pension schemes could 'contract out' of contributions for of this state second pension. This meant that both employer and employee pay reduced National Insurance contributions. Those in both private and public sector occupational pension schemes will incur higher rates of National Insurance contributions in future. The green paper envisages a 3.4% increase in NI contributions for employers and 1.4% for employees. This will be the death knell for yet more private sector defined benefit schemes.

If this aspect of the proposed changes has gone largely unnoticed, the change in the basis for indexation of benefits from the Retail Price Index (RPI) to the Consumer Price Index (CPI) has been more widely commented and is clearly a fraudulent recalculation of the rate of inflation to the government and employer's advantage. This year alone it has resulted in an increase of 3.1% compared to the 4.6% it would have been if the RPI indexation had been maintained. Each succeeding year, the lower percentage will be calculated on an already lower base, in a form of reverse compound interest.

The real reason behind of the change in inflation indexation is clearly demonstrated by the case of British Telecom. 'Investors could benefit from a £100bn windfall over the next 15 years following a government switch to a lower measure of pensions inflation that has given BT a £4bn plus boost to its finances . . . a ruling that allows it to link pension payouts to the lower CPI measure of inflation'.[4] Again, a government move to shift the balance of national income away from labour towards capital. All of this will, of course, be aggravated by the raising of the the age of entitlement for the basic state pension to 68. Wait longer for less while paying more.

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[4] *Guardian* (13 May 2011)

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Teachers' Pensions

How will this affect the pensions that lecturers and academic related staff can expect to receive? There are two schemes covering the employment field in which the UCU organises, the Teachers Pension Scheme (TPS), covering Further Education and post-1992 universities, as well as school teachers, while the University Superannuation Scheme (USS) covers the pre-1992 university sector.

The Teachers Pension Scheme is run on a pay-as-you-go basis. In 2008 it had a £400m surplus, in 2009 a £200m deficit and in 2010 a £100m surplus. This would seem to indicate that the scheme is functioning quite nicely and makes one wonder what the fuss is about. The scheme undergoes a periodic actuarial evaluation and, as a result of the last one in 2007, the trade unions agreed to changes that included an increase in contribution and the capping of the employers' contribution, with changes to benefits. The fact that the next legitimate and agreed evaluation is soon due accounts for the unseemly haste with which the government is attempting to raise employee contributions from 6.4% to 9.5% and increase the retirement age from 60 to 65.[5] If they wait until the figures are published, it looks extremely likely that this will not indicate a problem severe enough to warrant such a draconian assault. In hindsight, the trade unions probably gave in too easily in 2007 and, as the old proverb goes, 'the blackmailer always comes back for more'. However, the response to the current attack has been considerably more robust with the teacher trade unions taking united strike action for the first time, recognising that the increase in contributions would just be a windfall for the exchequer. As Sally Hunt, general secretary of the University and Colleges Union, said recently: 'Any increase in contributions from members will not aid their retirement; they will raise funds for the Treasury. This is simply a tax on public sector workers'.

While the assault on the TPS can be seen as a simple cost cutting exercise by a government intent on reducing its budget deficit at the expense of working people, the proposed changes to the USS look more like an asset stripping operation. The employers are demanding a reduction in benefits claiming that pressures on the fund make this inevitable. The pressures they cite are increased longevity, larger salary increases than expected and lower investment returns leading to a possible funding deficit. The scheme management claim that 'rates of longevity will continue to improve', without saying by how much. We noted above that this increased life expectancy is levelling off for the general population and there is no

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[5] Teachers' Pension Scheme (England and Wales), *Resource Accounts 2009-10* (31 March 2010) www.official-documents.gov.uk/document/hc1011/hc02/0257/0257.pdf

reason to believe that university staff will not follow the general pattern so, while the matter needs to be addressed, it should not be seen as the 'time bomb' the scare mongers would have us believe. The argument that 'salary increases in the sector have been significantly greater than in the past' will come as a surprise to most academics, who have watched their salaries struggle to keep pace with inflation. In any case, as contributions are a percentage of salary, higher salaries would mean greater contributions, so what is the problem? [6]

There is clearly no problem with the fund's existing financial position.

The Report and Accounts show that contribution income has exceeded benefit payment for the last five years by an average of 200 million pounds a year. This means that the entire investment income, averaging 800 million pounds a year, increases the investment value of the fund and contributes to what is a very healthy surplus. It is true that there were substantial losses in investment value during the years 2008 and 2009, but the value of the fund never went below 200 billion pounds and has now recovered to be currently worth £30,131, 000, 000. While on the subject of the fund's accounts, it is worth noticing that the administration costs (excluding investment management costs) have risen from 11.8 million to 16.9 million pounds, an annual increase of nearly 10%; would that teachers salaries had kept pace with this rate of increase. Examining these figures indicates that there may be some argument for a minor adjustment in contributions to account for the slightly longer life expectancy of pensioners, but the scale of the reductions in benefit proposed is out of all proportion to this. The USS is, on their own figures, a healthy and wealthy pension fund.[7]

The most dangerous of the management proposals for benefit changes is to move new entrants from a final salary arrangement to a 'career average revalued earnings'. A career average scheme matches each year's benefit accrual to earnings in each year rather than the final years' earnings. The earnings figure will be uprated in line with prices rather than the actual increase in earnings. This is particularly detrimental to workers in a sector which has a salary scale based on annual increments. If this were not bad enough, the prices index used for indexation will not be the Retail Price Index (RPI) but the lower Consumer Price Index (CPI). Existing members will retain final salary benefits, albeit with some benefit reductions, but the fact that new members will have their benefits determined on a career average basis introduces a dangerous division and vastly reduces the

[6] USS, *Dealing with the funding challenges* (2011) www.uss.co.uk/SchemeGuide/FinalSalaryBenefitssection/publicationsandpresentations/memberreports/Pages/default.aspx

[7] USS, *Report and Accounts* (2011)

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potential for united resistance when the management came back for their next attack, as they surely will. The whole concept of pensions is based on intergenerational solidarity, a principal worth defending at all costs.

The alternative answer to any financial difficulties which may exist in the USS finances, or indeed those of any other scheme, is clearly spelled out in their own documentation: 'These pressures could be addressed simply by increasing the employer contribution rate . . .'.

The Way Forward

In the end, while it is important to understand the financial mechanism by which these different schemes operate, this should not be seen as the determining factor. Workers or pensioners have no control over the way the money is invested, they should take no responsibility for the outcome, which is why trade unions support the defined benefit approach.

Starting from the basis that pensions are deferred wages, an essential part of our remuneration that is paid out of contributions by employers and employees, it becomes an issue of naked class interest, a question of what proportion does each class pay. We need to insist that there be no cuts in benefit, no increase in workers' contribution, with benefits indexed to prices or wages, whichever is the higher, and the defence of the RPI as the basic measure of price inflation, not the CPI. To achieve this, we need to demand compulsory employer contribution to a second pension. Private employers, even the honest ones who do not pillage the pension fund as did Enron and Maxwell, can go out of business, so it would be better to