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Research Briefing

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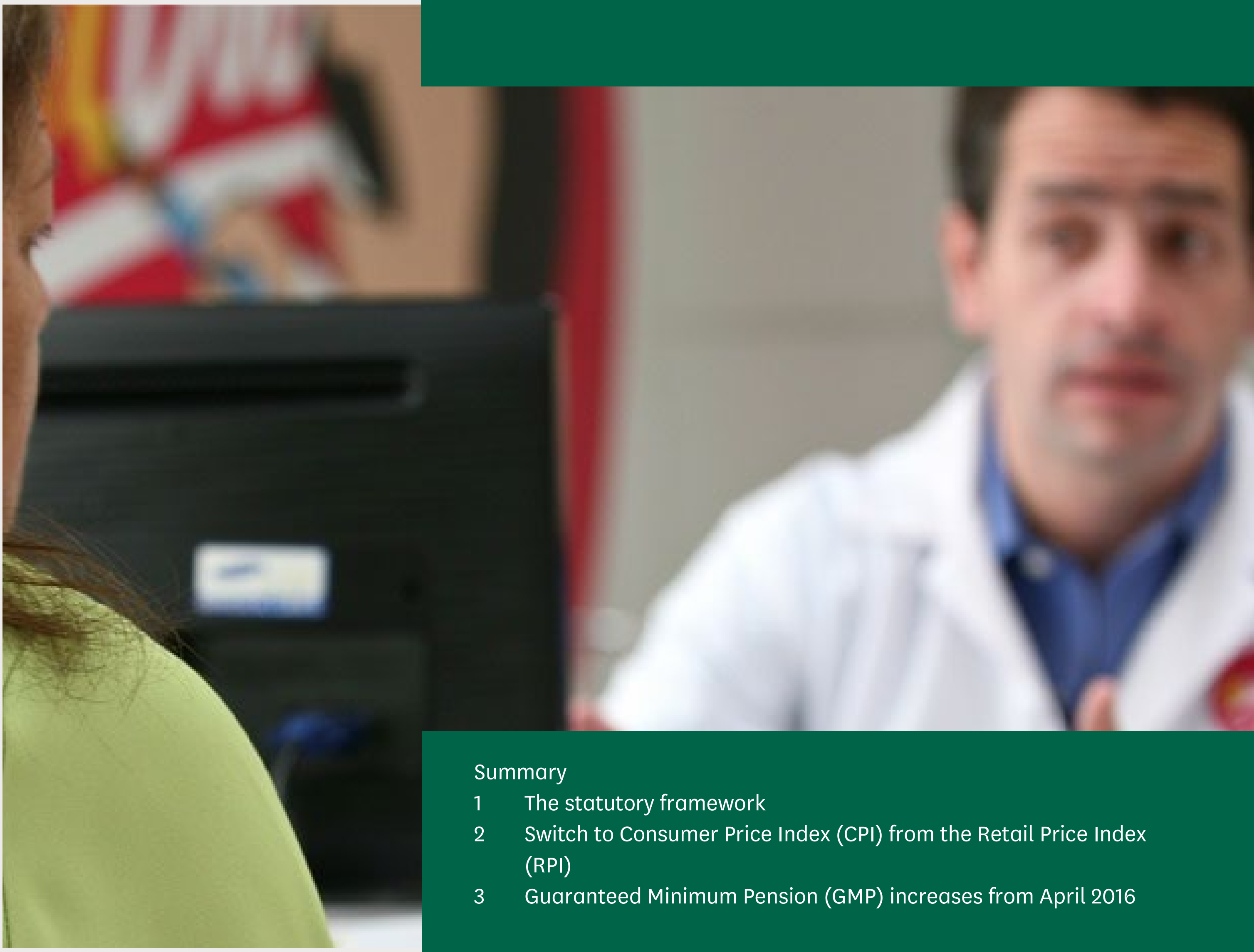
Public service pension increases



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Statutory requirement to increase public service pensions

There is a statutory requirement to increase the main public service pensions in payment each April in line with prices. The requirement is for the increase to be at the same rate as the additional State Pension, now measured according to the annual increase in the Consumer Prices Index (CPI) in the year to the preceding September.

Further information is available in the Library briefing on State Pension uprating.

Switch to CPI

Until April 2011, the measure of prices used was the Retail Prices Index (RPI). However, in the June 2010 Budget, the Coalition Government announced that it was switching to the Consumer Prices Index (CPI). The change to using CPI aimed to use "a better representation of the way consumers change their consumption patterns in response to price changes."

CPI generally increases less quickly than RPI, which meant that the change to using CPI was expected to reduce the generosity of public service pensions and the cost of providing them. The change was unsuccessfully challenged in the courts by public service trade unions. The Government estimated in July 2021 that the switch to CPI, along with increases in member contributions and structural reforms in 2014 and 2015, will save over £400 billion across the 50 years following their introduction (PDF).

RPI is still used by many defined benefit pension schemes in the private sector. In September 2019, the UK Statistics Authority said it intended to address shortcomings of the RPI by bringing the methodology for calculating it into line with that for CPIH (Consumer Price Inflation including owner occupier housing costs). Following consultation, HM Treasury announced in November 2020 that this would not happen before 2030.

Further information is available in the Library briefing Occupational pension increases.

Guaranteed Minimum Pension (GMP) increases

The basic and additional state pension

For people who reached State Pension age before 6 April 2016, the State Pension has two tiers:

- The basic State Pension – which is a contributory flat-rate benefit.
- The additional State Pension – which depends on someone's earnings during their working life since 1978.

When the additional State Pension was introduced, it was possible to contract-out of it. This meant that both the employer and employee paid a reduced rate of National Insurance and instead of the additional State Pension the employee received a workplace pension meeting certain requirements.

Contracting-out ended when the new single-tier State Pension replaced the basic and additional State Pensions in April 2016 as there was no longer an additional State Pension to contract-out from.

Guaranteed Minimum Pensions (GMP)

A Guaranteed Minimum Pension (GMP) is a minimum pension normally provided through a workplace pension scheme to people who contracted-out of the additional State Pension between 6 April 1978 and 5 April 1997.

Until April 2016, when the State Pension changed and contracting out ended, the main public service pension schemes were contracted-out of the additional State Pension.

Special arrangements for public service pensions

For public service pensions, there were special arrangements to ensure that public servants received increases (indexation) on their GMP, while preventing double increases.

With the introduction of the new State Pension in April 2016, the additional State Pension (which formed part of these arrangements) was removed. While it looked for a permanent solution, in November 2016 the Government put in place temporary arrangements, committing to full indexation of GMPs earned in public service for people who reach State Pension before April 2021. In March 2021, the Government said in a statement that it would make full indexation the permanent solution.

1 The statutory framework

1.1 Requirement to increase public service pensions

Public service pensions

Public service pension schemes are occupational pension schemes for employees of central or local government, a nationalised industry or other statutory body. There are over 200 public service schemes and most are established by statute.[1]

Which schemes does the requirement apply to?

There is a statutory requirement to increase "official pensions" outlined in the Pensions (Increase) Act 1971.[2] These include public service pension schemes covering:

- Ministerial and parliamentary
- Civil service
- Administration of justice
- Police and fire service
- Teachers
- NHS
- Armed forces
- Local government

Official pensions under the Act also includes the state pension (see section 1.2 below).

1 HM Treasury, Public service pension schemes: changes to the transitional arrangements to the 2015 schemes. Consultation, 16 July 2020, p69

2 Pensions (Increase) Act 1971, schedule 2

The public service pensions covered are all defined benefit schemes.[3] Defined benefit schemes pay a promised pension, which is usually an income for life and may also include a set lump sum. The amount the pension provides is based on factors such as salary and length of service. It is not based on how investments perform.[4]

The requirement to increase public service pensions applies to both deferred defined benefit pensions and those in payment.[5] A pension is deferred where someone is no longer building up a pension in the scheme but has not yet started to receive a pension (for example where they have left employment).

There are other public service pensions, such as older Armed Forces pensions and many non-departmental public bodies, where the increases are provided for under arrangements "by analogy" with (in the same way as) those for "official pensions."[6] HM Treasury produces guidance on the operation of increase legislation for public service pension schemes.[7]

1.2 Link to the State Pension

Requirement to increase with the additional State Pension

There is a statutory requirement for public service pensions in payment to be increased (uprated) by the same percentage as the additional State Pension.[8]

The additional State Pension

The additional State Pension was part of the State Pension system for people who reached State Pension age before 6 April 2016. It was provided through the State Earnings Related Pension Scheme (SERPS) between 1978 and 2002 and the State Second Pension (S2P) from 2002 to 2016.

The Secretary of State is required to increase the additional State Pension in April each year in line with the increase in the general level of prices over the preceding "review period" estimated in "such manner as the Secretary of

3 Pensions Increase Act 1971; Social Security Pensions Act 1975; Public Service Pensions Act 2013, s27 and Sch 8 added the 2015 schemes to the list of official pensions
4 The other main type of scheme is defined contribution in which contributions are made to a fund that is invested and used to provide an income in retirement.
5 HM Treasury, Guidance on the operation of increase legislation for public service pension schemes, April 2016, para 1.4
6 HM Treasury, Guidance on the operation of increase legislation for public service pension schemes, April 2016 (updated April 2021), para 1.3
7 HM Treasury, Guidance on the operation of increase legislation for public service pension schemes, April 2016
8 Social Security Pensions Act 1975, s59 (1)

State thinks fit."[9] In practice this is the increase in the year to the preceding September as measured by the Consumer Price Index (CPI).

Deferred pensions

The Treasury explained in 2021 that public service pensions, deferred pensions and lump sums should be increased annually so that they maintain their purchasing power in line with increases in the cost of living.[10]

When prices fall (inflation is negative)

In the event of inflation being negative, as in September 2009, the statutory requirement is to protect the nominal (cash) value of payments. This means to keep payments the same and not to reduce them on account of deflation.[11]

1.3 Annual pensions increase review order

Procedure

The annual public service pension increase is legislated for by means of a statutory instrument, the Pensions Increase (Review) Order, made under the Social Security Pensions Act 1975 as amended.[12] They are subject to the negative resolution procedure in Parliament, which means that they become law on the date stated on them but will be annulled if the House passes a motion calling for their annulment within a certain time.

HM Treasury produces tables each year to help scheme administrators correctly apply the increase, taking into account increases from previous years.[13]

Latest increase

In April 2024, public services pensions increased by 6.7%, in line with the annual increase in the Consumer Prices Index up to September 2023 (except for those public service pensions which had been in payment for less than a year, received a pro-rata increase).[14]

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9 Social Security Administration Act 1992 (section 150 (1) (c) and (3) (b))

10 Pensions Increase (Review) Order 2021 (SI 2021/275) – Explanatory Memorandum (PDF)

11 HM Treasury, Pre-Budget Report 2008, Cm 7484, November 2018, Box 5.1; HC Deb, 19 Jan 2010, c 203W; To ensure the full increase was paid the following year when prices rose again, an amendment was needed to the definition of 'base period' - Pensions Increase (Modification) Regulations 2011 (2011 No. 826)

12 Orders from previous years can be found on GOV.UK.

13 HM Treasury, Public service pensions increases, 2 February 2024

14 HCWS566 20 February 2023

2 Switch to Consumer Price Index (CPI) from the Retail Price Index (RPI)

2.1 Background

From 1988 to 2011, the measure used to increase the additional State Pension and public service pensions was the annual movement in the September RPI. Since 1987, the actual increases have taken place in April, from the first Monday of the tax year.[15]

The Conservative-Liberal Democrat Coalition Government announced in the June 2010 Budget that it would instead adopt CPI for the price indexation of the additional State Pension and public service pensions (as well as benefits and tax credits). The Coalition Government said that CPI was a more appropriate measure of benefit and pensions recipients' inflation experiences. This is because CPI excludes most housing costs faced by homeowners. This was considered relevant because low-income households may receive separate support for housing costs through benefits. Furthermore, most pensioners own their home outright.[16] The Coalition Government also noted that this would create consistency with the Bank of England, who use CPI for monetary policy.[17]

The Coalition Government said this change did not represent an interference with accrued pension rights: they continue to be increased by the same percentage as the additional State Pension.[18] It was prepared to consider changes in the light of new arguments or evidence (for example, the inclusion of owner-occupier housing costs, if an appropriate means of doing this was found).[19]

15 HM Treasury, Guidance on the operation of increase legislation for public service pension schemes, (Updated April 2021), Annex D; Independent Public Service Pensions Commission: Interim Report (PDF), October 2010, Box 2B
16 HM Treasury, Budget 2010, HC 61, June 2010, para 1.106-7
17 As above
18 HC Deb, 17 February 2011, c1182-3; See also, c1179
19 Pensions Bill Committee debate, 14 July 2011, c303

2.2 Reaction to the proposal

The switch to CPI was controversial because, in general, inflation as measured by CPI tends to be lower than that measured by RPI.[20]

Calls for a temporary switch

The Opposition supported the switch to CPI on a temporary basis only "as a means to reduce the deficit" but did not believe that "on a permanent basis, it is the right way to uprate pensions or other benefits."[21] The then Leader of the Opposition, Ed Miliband, tabled an Early Day Motion to the effect that Pensions Increase (Review) Order 2011 should be withdrawn on grounds that it required the uprating of public sector pensions using CPI, which the government had indicated would be a permanent change. The Opposition argued that a temporary change would be fair, but that a permanent change would disadvantage public sector workers and the poorest in society.[22]

Petitions

A petition on the Downing Street website, calling for the RPI measure to be re-introduced for public and private pensions, got over 100,000 signatures. It argued that CPI would "mean a steady reduction in spending power for pensioners as they progress into their retirement."[23]

An further e-petition in 2012 similarly called for the RPI measure to be reintroduced to ensure that the spending power of public and private pensioners is maintained.[24] This resulted in a debate in the House of Commons on 1 March 2012, and a motion in the name of Labour MP, John McDonnell, called on the Government to revert to the RPI. The motion was defeated on division by 232 votes to 33.[25]

2.3 Legal Challenge

On 18 April 2011, a group of organisations representing public service pension scheme members (the FDA, Prospect, the GMB, the Civil Service Pensioners'

20 GOV.UK, Blog: Actuaries in government, Measures of Price Inflation: RPI, CPI and CPIH, 23 August 2021

21 Pensions Bill Committee debate, 14 July 2011, c296 [Rachel Reeves]; HC Deb, 23 February 2012, c1050 [Stephen Timms]; EDM 1629 in name of Leader of the Opposition, Ed Miliband

22 See also EDM 1625 in the name of John McDonnell

23 Public and private pensions - change from RPI to CPI, e-petition to HM Government, closing date 8 May 2010

24 Public and private pension increases – change from RPI to CPI, e-petition to HM Government, closed 8 May 2012

25 HC Deb, 1 March 2012, c452-91

Alliance and the National Association of Retired Police Officers) applied for judicial review of the decision to switch to CPI for increasing public service pensions.[26]

There were four distinct grounds of challenge:

- CPI was not an index which the Secretary of State was entitled to adopt in compliance with sections 150 (1) and (2) of the Social Security Administration Act 1992 (section 150 (1) (c) and (3) (b)). The obligation was to compare prices directly;
- The decision to switch from RPI to CPI was in any event taken having regard to irrelevant considerations or for an improper purpose – the need to make economic savings;
- There had been a series of representations to the trade unions to the effect that the RPI would continue to be used, establishing a legitimate expectation that this would be the case;
- The Secretary of State did not comply with the public sector sex equality duty, failing to have regard to the fact that the effect of the changes would have a particularly marked adverse impact upon women, who constitute a significant proportion of pensioners.[27]

The High Court decided, by a majority of 2 to 1, to reject the application for judicial review of the decision to switch to CPI.[28]

The three judges agreed in rejecting the first, third and fourth grounds of challenge but disagreed on the second - that the Secretary of State had "erred in having regard to economic considerations when deciding to switch to the CPI index".[29]

Lord Justice Elias and Mr Justice Sales recognised the force of this argument but were not ultimately persuaded by it.[30] They said that in their judgement the Secretary of State can decide upon a fair and genuine method for calculating inflation to achieve the objective of protecting the purchasing power of the relevant benefits and pensions.[31] They stated that the Secretary of State can adopt a particular method that achieves this objective, even if the reason for preferring it over other methods is that it "draws less on the public purse."[32] They also stated that even if the Secretary of State was wrong

26 See, for example, Prospect Press Release, 15 April 2011, 'Unions launch legal challenge to CPI switch'; See also FDA Press Release, 19 April 2011, 'Union challenges legality of Government's pension decision'

27 As above, para 38-42

28 R v Staff Side of Police Negotiating Board and Others ; [2011] EWHC 3175 (Admin)

29 As above, para 52

30 As above, para 56-67

31 As above, para 59

32 As above, para 59

to have taken account of economic considerations in deciding which of the two inflation measures to use, they were satisfied he would still have chosen the CPI measure.[33]

Mr Justice McCombe dissented from this judgement. He agreed with the claimants in the judicial review that it was impermissible to use public expenditure considerations as the primary reason for selecting an inflation measure.[34] In his view, there was no indication that the Secretary of State had asked the following simple, "stand alone" question:

> How can we determine appropriately, for the purposes of the review under section 150(1), whether benefits/pensions have retained their value in relation to the general level of prices obtaining in Great Britain?[35]

He could not conclude that the same decision would be made if budget considerations were not included when selecting an inflation measure.

Trade Union Congress General Secretary, Brendan Barber expressed disappointment with the judgement, saying:

> This is a disappointing judgement for pensioners and scheme members whether they draw a private, public or state second pension. But we take great heart that the court accepted the argument that the government did this to cut the deficit rather than carry out a proper consideration of the best way of measuring the cost of living for pensioners, even if only one judge said that it was unlawful.[36]

The unions appealed the decision to the Court of Appeal.[37]

On 20 March 2012, the Court of Appeal announced its decision to uphold the High Court ruling in favour of the Government's switch from the RPI to the CPI for uprating public sector pensions.[38] The FDA described the decision as a "blow to public sector workers".[39] On 19 April, the FDA, Prospect, the GMB, National Union of Teachers and Civil Service Pensioners' Alliance announced that they had decided not to progress an appeal to the Supreme Court.[40]

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33 R v Staff Side of Police Negotiating Board and Others ; [2011] EWHC 3175 (Admin), para 118

34 As above, para 118

35 As above, para 133

36 Community Care, Unions lose public sector pensions legal ruling, 2 December 2011

37 FDA press release, FDA appeals High Court decision, 12 January 2012

38 FDA & Ors, R (on the application of) v Secretary of State for Work and Pensions & Anor [2012] EWCA Civ 332 (20 March 2012)

39 FDA press release, Court's rejection of appeal against RPI-CPI decision is 'another blow to public sector employees', says FDA, 20 March 2012

40 FDA press release, Unions' RPI-CPI legal challenge to end,19 April 2012

2.4 Impact

The switch to CPI preceded other reforms to public service pension schemes. From 2015 (or 2014 for local government), there was an increase in member contribution rates and new schemes were introduced. There was also a change to pension benefits based on career average revalued earnings (CARE) rather than final salary and higher pension ages. These reforms were based on the recommendations of the Independent Public Service Pensions Commission, chaired by former Labour Work and Pensions Secretary Lord Hutton of Furness. The Commission's interim report, published in October 2010, cited analysis by the Pensions Policy Institute (PPI) which suggested that the "change in the indexation measure may have reduced the value of benefits to scheme members by around 15 per cent on average."[41]

In 2012, the Institute for Fiscal Studies (IFS) commented that the reform reduced the generosity of schemes owing to the fact that CPI was expected to increase less quickly than RPI. They noted that:

> This reform has a more immediate impact on costs than the last Labour government's reform since it did not only apply to new entrants: current members will receive lower pensions, with future accrual and pensions paid relating to past service both being made less generous, and deferred members will receive lower pensions in relation to their accrued service.[42]

The Government in July 2020 estimated that a combination of the switch to CPI, increases in member contribution rates; and structural reforms under the Public Service Pensions Act 2013 had combined to reduce "the forecast cost of public service pensions to the taxpayer by approximately £400 billion over 50 years."[43]

The 2013 Act reforms are discussed in the Library Briefing Paper Public service pensions – the 2015 reforms.

[41] Independent Public Service Pensions Commission, Independent Public Service Pensions Commission: interim report (PDF), 7 October 2010, Ex11, para 2.15

[42] Institute for Fiscal Studies, Green Budget 2012, 1 February 2012, chapter 5

[43] HM Treasury, Public service pension schemes: changes to the transitional arrangemetns to the 2015 schemes: Consultation (PDF), July 2020, para 1.9

3 Guaranteed Minimum Pension (GMP) increases from April 2016

3.1 Guaranteed Minimum Pensions

The basic and additional State Pension

For people who reached State Pension age before 6 April 2016, the State Pension has two tiers:

- The basic State Pension (BSP) – which is a contributory flat-rate benefit.
- The additional State Pension – which depends on someone's earnings during their working life since 1978.[44]

When the additional State Pension was introduced in 1978, employers could contract-out their employees.[45] This meant that both the employer and employee paid a reduced rate of National Insurance and instead the employee received a workplace pension which meet certain requirements.

What is a Guaranteed Minimum Pension?

A Guaranteed Minimum Pension (GMP) is a minimum pension normally provided through a workplace pension scheme to people who contracted-out of the additional state pension between 6 April 1978 and 5 April 1997.[46]

After 1997 there were still minimum pension benefits which employers needed to provide in order to contract out, but these were met through a reference scheme test instead of GMP.[47]

Further information is available in the Library briefing Guaranteed Minimum Pension (GMP) increases.

The new State Pension

The new State Pension was introduced for people reaching the State Pension age on or after 6 April 2016.[48] Unlike the previous system, the new State

44 Social Security Contributions and Benefits Act 1992
45 Social Security Pensions Act 1975
46 Pensions Act 1995
47 Pensions Act 1995

Pension is single-tiered.[49] It is not possible to contract-out of the new State Pension.

Until April 2016, when the State Pension changed and contracting out ended, the main public service pension schemes were contracted-out of the additional State Pension.

3.2 Special arrangements for public service pensions

There were special arrangements to ensure that public servants received increases (indexation) on their GMP, while preventing double increases. The Treasury explained removing the mechanism to provide public servants with fully indexed and equalised benefits overall would impact on public service pension schemes in two ways:

- they would no longer effectively receive indexation on their GMP through the additional state pension.
- the mechanism designed to avoid unequal payments based on gender would no longer apply.[50]

In March 2016, the government announced that those reaching State Pension age between 6 April 2016 and 6 December 2018 would receive a fully-indexed public service pension for life. They said that this would "ensure public service pension payments to these individuals continue to be equal between men and women."[51]

In November 2016, the government launched a consultation on how to address this issue in the longer term.[52] It said an estimated two million members of public service schemes with GMPs, reaching their State Pension age up until 2040 might be affected by the State Pension reforms. In extreme cases, cumulative losses could have an estimated value of £18,000, although for the majority of those who lose, the government expected the impact to be lower.[53]

48 Pensions Act 2014
49 Pensions Act 2014
50 HM Treasury, Consultation on indexation and equalisation of GMP in public service pension schemes, Updated 22 January 2018, para 2.4
51 HM Treasury, Government one step closer to introducing new State Pension this year, 1 March 2016; HM Treasury, Guidance on the operation of pensions increase legislation for public service pension schemes, April 2016
52 HM Treasury, Consultation on indexation and equalisation of GMP in public service pension schemes, 22 January 2018
53 As above

On 22 January 2018, the Government said that it had decided to extend the interim solution for a further two years.[54] In October 2020, the government consulted on a further extension of the full indexation policy.[55]

In March 2021, the Government said that it would make full GMP indexation the permanent solution for public service pension schemes. Schemes would be directed to provide full indexation to those public servants with a GMP reaching State Pension age beyond 5 April 2021.[56]

54 HM Treasury, Consultation on indexation and equalisation of GMP in public service pension schemes, 22 January 2018

55 HM Treasury, Public Service Pensions: GMP indexation consultation: Proposal to extend full indexation, October 2020

56 HM Treasury, Public service pensions: Guaranteed Minimum Pension indexation consultation: Government response to consultation, updated March 2021