SEVEN MYTHS ABOUT PUBLIC SERVICE PENSIONS

There have been many attacks on our pension plan in the media recently. This document debunks those myths and provides some facts about the federal public service pension plan (superannuation).

Myth #1:

> Defined benefit pension plans such as the ones enjoyed by many public sector employees are overly generous.

Reality:

> Defined benefit plans offer good, stable and predictable retirement income. Because we pay for them.

In 2010 federal public sector workers will contribute 10.45% of every dollar they make under $47,200 and 8.4% of every dollar above $47,200 towards their pension, which is a combination of CPP and the federal public service pension plan.

The 10.45% will rise to 11.35% by 2013.

Defined contribution plans such as RRSPs have failed to provide stable, predictable retirement income. Politicians should be looking at ways to emulate rather than destroy the plans that are working.

Myth #2:

> Public sector pension costs are spiraling out of control.

Reality:

> The latest actuarial report tabled in Parliament in November 2009 shows the federal public service plan is adequately funded and has a surplus.

The CD Howe Institute, a right-wing think tank, claimed recently that the federal government is understating the actual cost of the pension plan for public service workers by costing it at a “going-concern” rate rather than using “solvency funding”.

Private pension plans and municipal pension plans are required to value their pension plans using both methods. The federal government, by law, is only required to use going-concern funding.

Private sector pension plans need to be valued using solvency funding because there is no guarantee that the employer will be around when their staff retire.

Solvency funding ensures that there's enough money to pay for pensions if the employer goes bankrupt.

The federal government, on the other hand, does not fund its pension for solvency since it's unlikely to go bankrupt.

Other attacks on public sector pensions give a huge number for the cost of future liabilities. But they rarely explain what this means.

Public sector pension liabilities go a long way into the future. Young people at work today building up a pension could well live for another eighty years. If you estimate the costs of all public sector pensions for decades into the future and then present it as a bill that has to be paid immediately, then you end up with a frighteningly big number.

But these figures do not mean very much. Because pensions are not paid out all at once - they're paid out over decades as more money comes into the plan.

Another way of looking at the cost of pensions is the “net public service pensions” cost. It is the difference between benefits paid out to today's pensioners and current contributions paid by current staff. In the most recent actuarial valuation for the fiscal year ending March 31, 2008, this difference was estimated to be $634 million.

This is eminently affordable, but the figure can change a lot from year to year. This is because it is the difference between two very big numbers:

1. The costs of pensions paid out each year – and pension levels are linked to the cost of living; and
2. The total contributions paid by staff and employers in the public sector, which is linked to the number of staff and yearly pay increases.

Over time earnings tend to go up more than prices so this will tend to reduce the net cost of pensions. But there can be sharp variations from year to year. For example, variations can occur when pay in the public

sector has been capped or frozen by politicians and then catches up later to respond to recruitment and retention problems caused by the freeze.

In 2008, for example, the increase in the cost of benefits was determined largely by the 2.3% increase in the cost of living (CPI), as of September 2007. But the increase in contribution income was largely determined by the size of pay increases in the public sector during 2008, which were capped at 1.5%. So when politicians freeze public sector pay below inflation it has the odd effect of appearing to make pensions more expensive, even though those extra costs are more than met by reduced expenditure on the wider wage bill.

Pension costs are also affected by other factors including:

how many people retire each year,

how long pensioners live

the number of current staff

what current staff are paid

But these change relatively slowly over time and don't produce the big changes between years that critics seize on.

Myth #3:

Defined benefit pension plans have been unfairly sheltered from the recession.

Reality:

Defined benefit plans are designed to withstand economic downturns.

Defined benefit plans pool everyone's risk. They accumulate surpluses in boom cycles and spend them in recessions. Defined benefit plans have not been allowed, by law, to accrue sufficient surpluses to allow them to offset major recessions and declining returns on investment.

The recession has had negative consequences for defined benefit plans, but these plans are still more able to provide stable income to participants during a down cycle than other retirement income vehicles. In RRSPs and DC schemes, individual take on investment risk on their own. When the

market drops, many savers in DC schemes see the value of their pension accounts drop too.

Myth #4:

The federal public service pension plan is rich relative to provincial public pension plans.

Reality:

The plan is very similar to what most provinces offer.

Provincial plans vary widely.

For example, public sector workers in Nova Scotia can retire without penalty based on a rule of 80 (years of service plus age), and PEI has a pension formula that is based on a best three-year earnings average.

Contribution rates also don't say much about the quality of the plan. Contribution rates reflect a number of factors:

demography (ages, marital status, etc. of plan members),

previous decisions related to funding (e.g. the federal government took $30 billion from the federal pension plans),

performance of investments,

administrative costs (e.g. it probably costs PEI more per participant to run its plan because it has fewer members).

Myth # 5:

Most public sector workers retire at 55 on a full pension.

Reality:

The majority of workers joining public sector pension schemes will retire near age 60 and they are paid nowhere near the "full pension" of 70% of their salary.

To retire from the federal public service at 55 with full pension, you need to have been working in the public service for 35 years or more. Very few people started in the public service as teenagers, even 35 years ago.

Public sector workers have always been eligible for an unreduced pension only at age 60.

In 2008 retired public service workers received on average $23,422. Those retiring in 2008 receive on average $33,519.

Myth #6:

> The discrepancy between private and public sector pensions needs to be addressed by punishing the public sector.

Reality:

> We should level up pensions – not level them down.

Around 82% of public sector employees are members of an employer-sponsored pension plan, most of which are defined benefit plans. In the private sector 24% of employees are members of an employer-sponsored pension plan but only 17% have a defined benefit plan.

Private sector employees have been hit hard by employers' retreat from good pensions. But this does not justify punishing public sector workers. Two wrongs do not make a right.

Public sector pensions provide distinct advantages to lower-paid and average-paid members of the workforce. Well-paid private sector employees are likely to get a decent pension on top of their pay, like their public sector counterparts.

The attack on public sector pensions may be wrapped in rhetoric about fat-cat public servants, but it is really an attack on the lower-paid workers in the public sector.

Myth #7:

> The private sector props up the public sector.

Reality:

> Canada depends on a strong public sector as well as a strong private sector.

Without an effective public sector, the private sector would be far less productive. It benefits from the public sector through transportation and information infrastructure and an educated workforce, whose social and health and welfare needs are attended to by the public sector.

And all workers pay for everyone's retirement income in one way or another. Private sector pensions are paid for through the price we all pay for goods and services. Public sector pensions are partly funded by the taxes that pay for public sector salaries (which allow employees to make contributions) and fund government contributions.

The public sector contributes significantly to our Gross Domestic Product (GDP) and it is entirely unfair to suggest that the public sector is any way a drain on the private sector.

Public pension funds also invest billions in the Canadian economy.

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