

Forecasting Public Service Pensions

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The Context: Why Do OBR and HMT Care

Managing the public finances

- It is important that the Government demonstrate the ability to manage its finances:

Overall Objective:

Return the public finances to balance in the middle of the next decade

Deficit Rule:

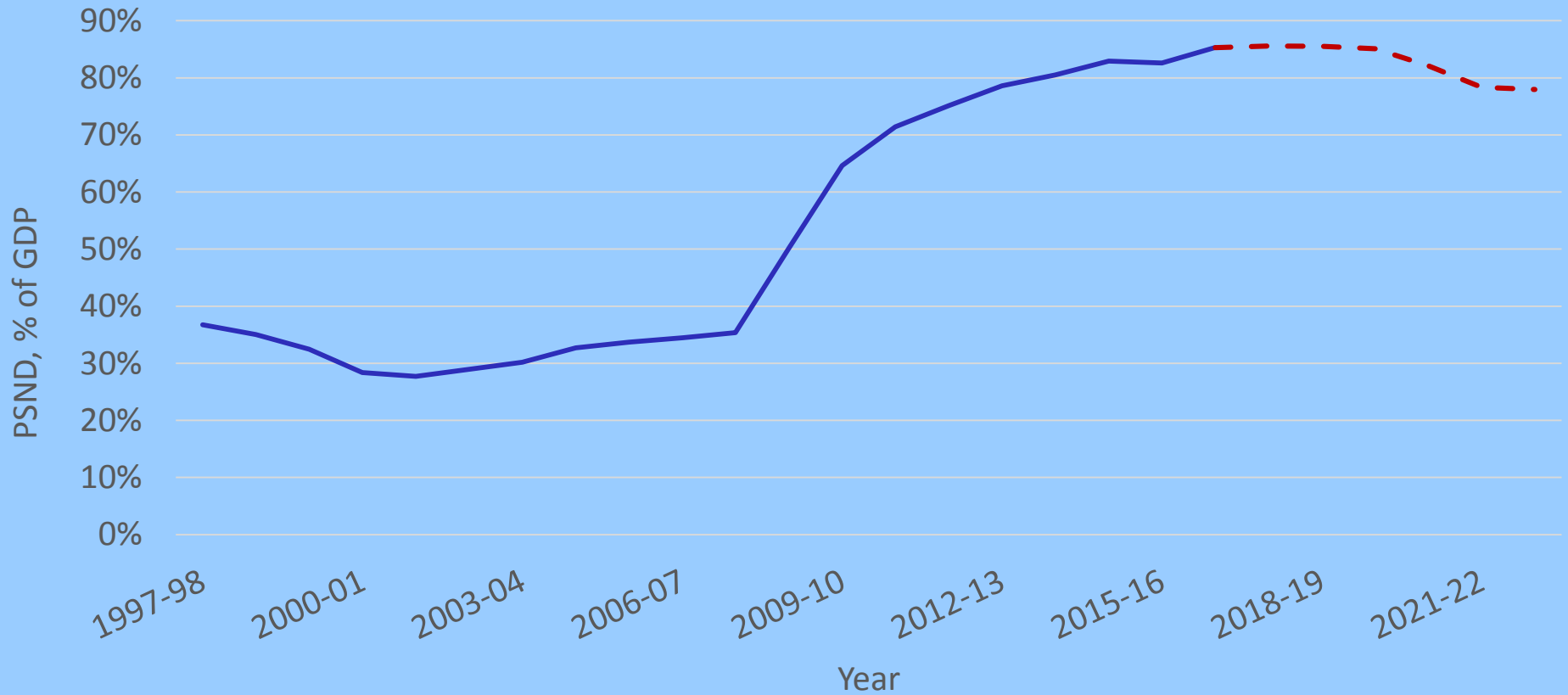
Reduce cyclically adjusted public sector net borrowing to below 2% of GDP by 2020-21

Debt Rule:

Public sector net debt as a percentage of GDP to be falling in 2020-21

- Debt is at its highest for 50 years; at over 85% of GDP (£1.8trn) we spend c.£50bn a year on debt interest.
- Debt is set to fall by a fine margin in 2018/19, and fiscal objectives remain challenging to achieve.

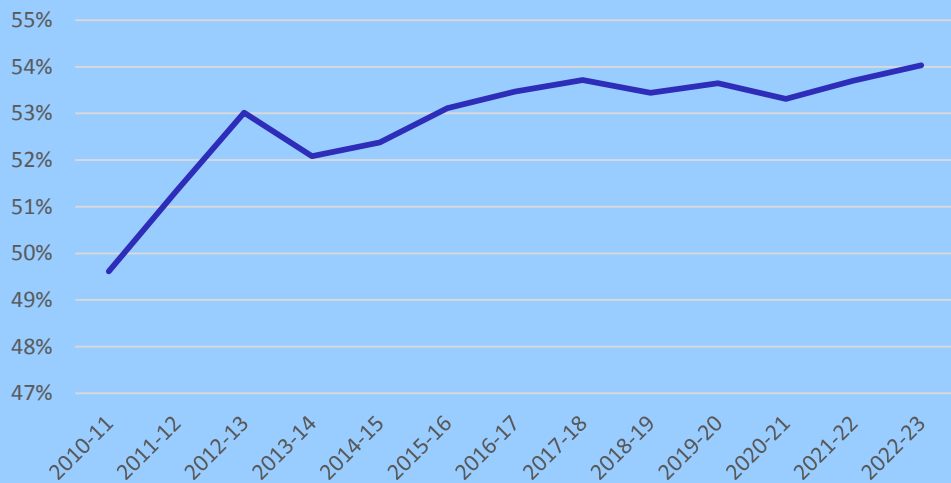
Public sector net debt as of Spring Statement 2018



AME squeezes DEL within the spending envelope

- Treasury controls public spending via two totals:
 - Departmental Expenditure Limits (DELs) – public services and day-to-day running of the Government;
 - Annually Managed Expenditure (AME) – spending that is less easily controlled and often driven by economic conditions , e.g. social security payments
- AME makes up an increasing proportion of total expenditure (see chart).
- In terms of delivering spending plans, increases in AME could imply squeezes elsewhere (potential pressures in DEL)
- The AME forecast has been increasing in real terms, while DEL has been squeezed since 2010

AME % Total Expenditure (17/18 Prices)

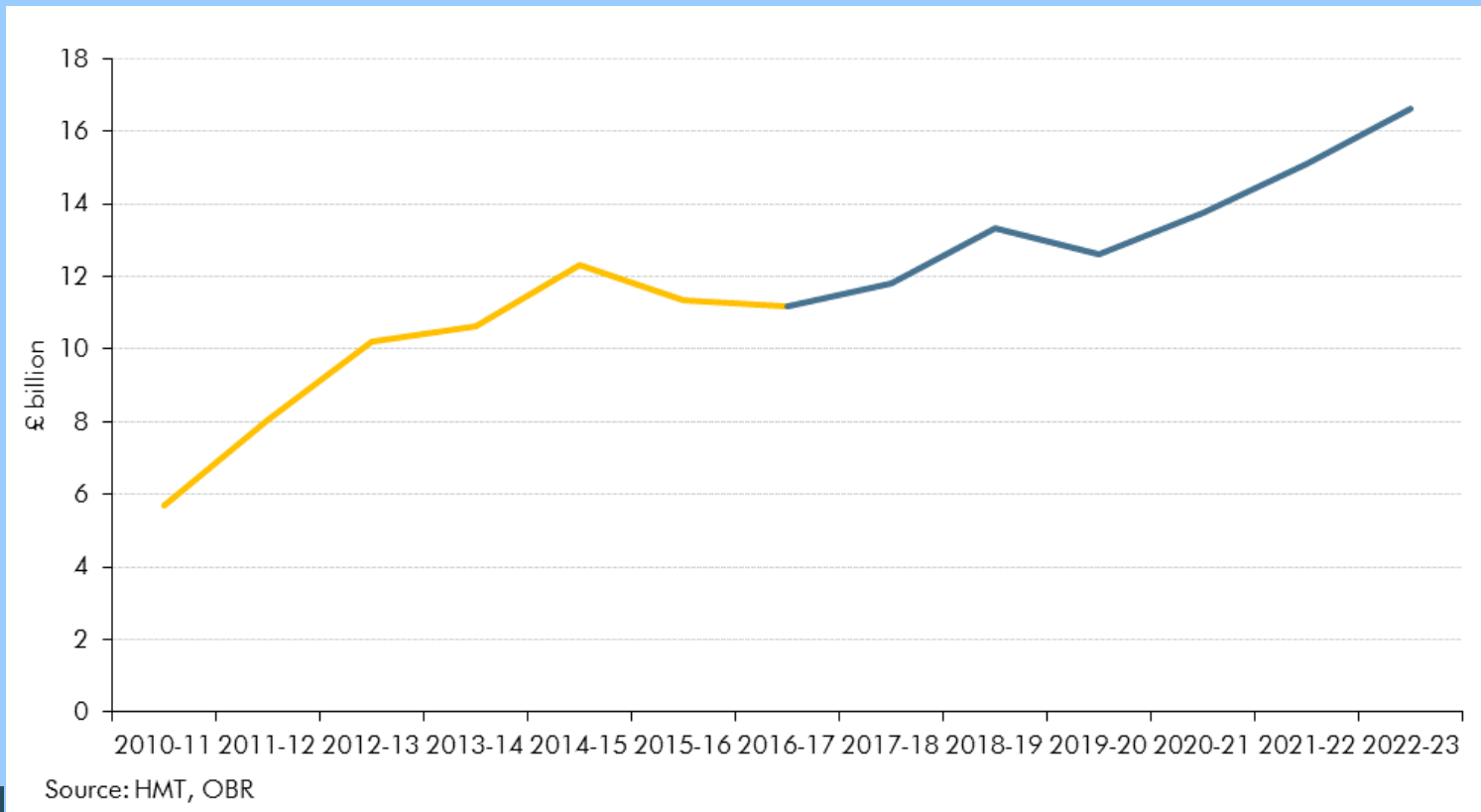


- Changes in AME will affect the level of borrowing and the government's achievement of its fiscal strategy and it is important that this expenditure is controlled.
- The accuracy of the AME forecast is also important for setting overall spending assumptions going into the next Spending Review.

Source: HMT analysis

Net public service pensions payments as a key part of the AME forecast

- Net public service pension payments forecast to rise by more than 40% over the next five years, or triple since 2010.



Source: HMT, OBR

Why does the OBR care about the profile of spending?

- The OBR's forecasts provide the foundation on which the Government bases its fiscal and economic policy decisions as part of the bi-annual *Economic and Fiscal Outlook*.
- The OBR is legally required to assess if the Government is meeting its fiscal targets.
- The forecast and subsequent policy decisions are subject to public and parliamentary scrutiny.
- So we need to explain the profile of spending (and receipts, borrowing, net lending, etc) over the forecast period.
- It is crucial that **the forecast is as central as possible** and informed by reliable data.

	£ billion					
	Forecast					
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Net public service pensions						
November forecast	11.9	13.2	12.5	13.6	15.0	16.6
March forecast	11.8	13.3	12.6	13.8	15.1	16.6
Change	-0.1	0.1	0.1	0.1	0.0	0.0
Expenditure						
November forecast	41.1	43.2	45.0	46.7	48.7	50.8
March forecast	41.1	43.3	45.2	47.0	49.0	51.1
Change	0.0	0.1	0.2	0.3	0.3	0.3
<i>of which:</i>						
CPI inflation	0.0	0.0	0.1	0.1	0.1	0.1
Armed forces pension scheme	0.0	0.1	0.1	0.2	0.3	0.3
Other	-0.1	0.0	0.0	0.0	-0.1	-0.1
Income						
November forecast	-29.2	-30.0	-32.5	-33.0	-33.6	-34.2
March forecast	-29.3	-29.9	-32.6	-33.2	-33.9	-34.5
Change	-0.1	0.0	-0.1	-0.2	-0.3	-0.3
<i>of which:</i>						
NHS paybill growth	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4
Armed forces paybill growth	0.0	0.1	0.1	0.1	0.1	0.1
CSPS paybill growth	0.1	0.1	0.1	0.1	0.1	0.1
Other	0.0	0.1	0.1	0.0	-0.1	-0.1

Source: Economic and Fiscal Outlook, OBR, March 2018

Practical Issues

Forecast process: reminder of the central basis for the forecast

- OBR forecasts, and pension schemes' forecasts supplied to the OBR, must be central and unbiased, with equal risk of outturns being above or below forecasts.
- This is different from what's required for plans, or final provision, or Spring Supplementaries.
- In-year OBR forecasts must reflect best forecasts of underspends (or overspends): do not be too cautious (or too optimistic).

Forecast process: timing and commissioning

- The government is required to give the OBR ten weeks' notice of a fiscal event, for which it requires a forecast.
- Not long enough for pension schemes' forecasts! So we have to ask for pension schemes' forecasts ahead of time, on a contingency basis.
- Timings are always indicative, so it's important to ensure that the forecasts are submitted on time, to allow for any change in the timetable and the appropriate scrutiny.

Forecast shape and likely drivers

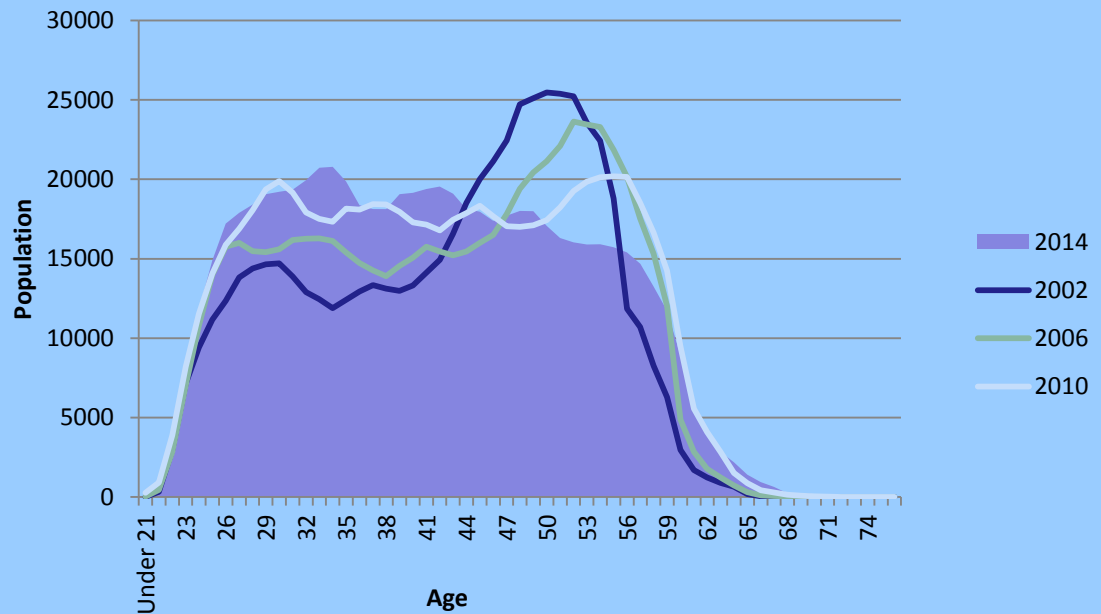
- Why OBR want more detail on forecast shape:
 - to explain the movement in the forecast over the forecast period;
 - to quality assure the forecast (to spot odd results and prevent repeated errors);
 - we aim to separate out ‘caseload’ from ‘effective rates’.
- So we need information on the drivers of the forecast shape: (demographics, mortality rates, etc).

Demographics

- Changes in demographics are key for future cash expenditure and receipts streams;
- Latest data and modelling is needed to take account of demographics.
- **OBR need information on demographics** in order to:
 - understand and QA the drivers and shape of pension forecasts;
 - separate out underlying caseloads from effective rates (e.g., changes in generosity or levels of each payment and receipt).

Demographics affect the level of retired staff and active workforce

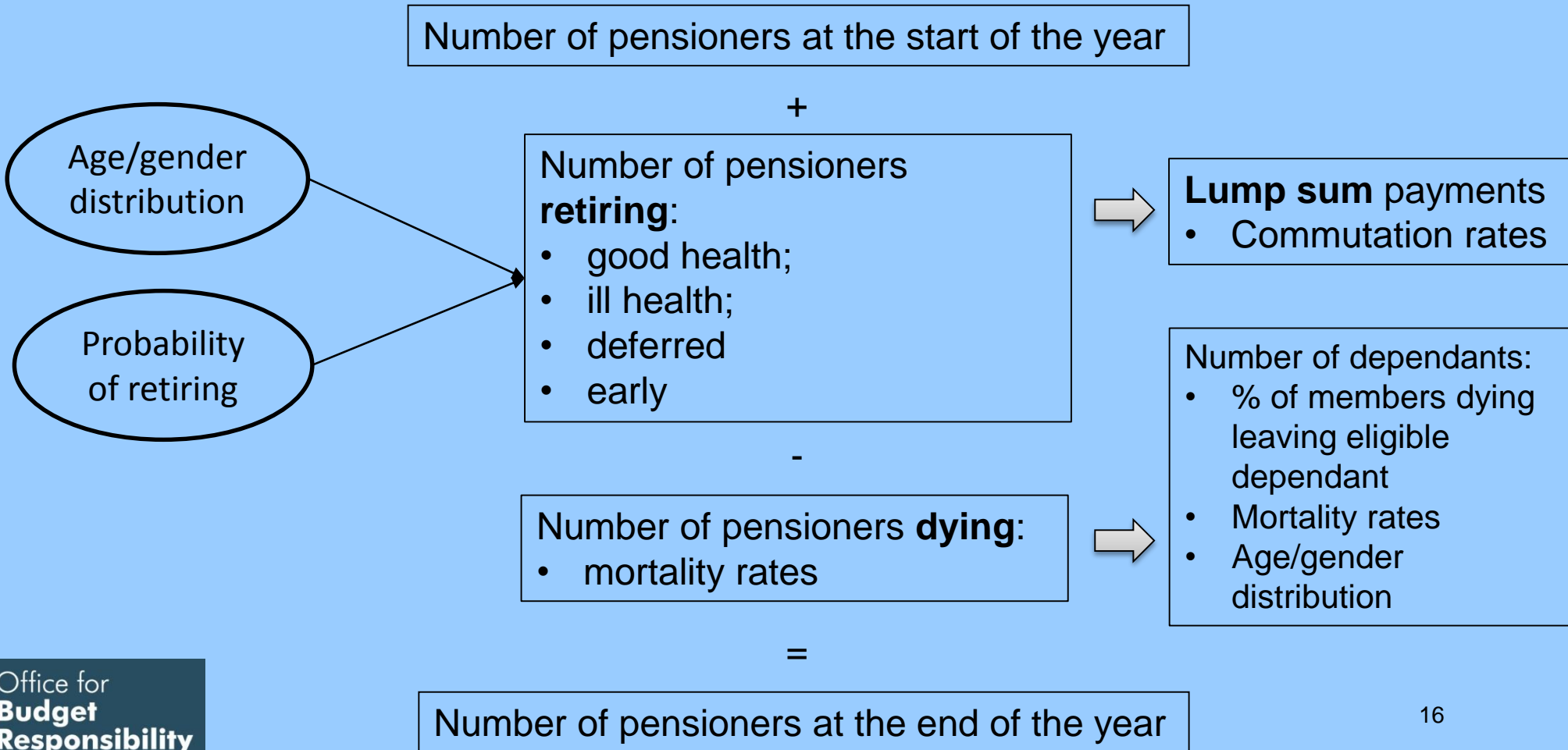
Active Members Profile 2002-2014



- The post-war baby boom (and other cohorts) will be reflected in the age distribution of the public service workforce.
- This needs to be reflected in the forecast for pensions payments (levels of new retirements) and receipts (pension contributions).

Pension payments & lump sums

Payments = pension/lump sum payments x no. of pensioners/retirees



Pension payments & lump sums

Number of new retirees			
	Retirement at Normal Pension Age	Ill-health retirement	Early retirement
13-14	410	87	293
14-15	422	94	299
15-16	430	96	315
16-17	456	100	321
17-18	469	112	330
18-19	501	109	333
19-20	483	122	322
21-22	501	117	335
22-23	510	105	341

Change on previous forecast			
	Retirement at Normal Pension Age	Ill-health retirement	Early retirement
13-14	0	0	0
14-15	0	0	0
15-16	0	0	0
16-17	0	0	0
17-18	20	-5	10
18-19	25	-7	15
19-20	27	-10	22
21-22	28	-12	29
22-23	30	-14	35

Number of deaths			
	Retirement at Normal Pension Age	Ill-health retirement	Early retirement
13-14	349	85	270
14-15	351	94	294
15-16	355	98	287
16-17	362	103	300
17-18	372	115	308
18-19	398	112	311
19-20	383	126	301
21-22	398	121	313
22-23	405	108	319

Average lump sum indicators	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Commutation rates, %	29.67%	34.21%	29.10%	30.09%	31.10%	28.79%	28.79%	28.79%	28.79%	28.79%
Unit costs, £m	76,204	80,947	91,014	36,030	52,531	60,012	51,337	45,645	45,945	46,245

*numbers are provided for illustration purposes

- Outturns and projections for member numbers and average costs (incl. dependants)
- Changes on previous forecast by retirement type, where possible
- Patterns in past trends can help understand future profiles

Receipts

Employers contribution (ER)= pensionable paybill x ER contribution rate
Employees contribution (EE)= pensionable paybill x EE contribution rate

Determinants	Data
Workforce numbers and salary	Expected changes in workforce from department
Contribution rates	As agreed with HMT
Uprate by earnings growth	Confirmed pay growth rates and OBR assumptions

$\% \text{ change in pensionable paybill} = \% \text{ change in (workforce + pay + drift + residual)}$

- It is important to make sure that workforce assumptions reflect realistic expectations of the number of people expected to be employed, not recruitment plans, which may contain a degree of optimism.
- Any other causes of shifts in contributions, other than above determinants, should also be explained – e.g. structural/grade changes in workforce.

- Please explain key drivers of change and any unusual movements.
- It is particularly helpful for us to see the breakdown of changes by driver, e.g. as in this reconciliation table
- Please also identify any non-monetised forecast risks and uncertainties

Ref	Expenditure £'m	15-16	16-17	17-18	18-19	19-20	20-21	21-22	TOTAL
Pensions									
E1	Change in cessations assumption	0	(10)	(31)	(54)	(81)	(110)	(144)	(430)
E2	Change in CPI assumption	0	0	(31)	(47)	(29)	(29)	(29)	(165)
E3	Change in redundancy assumption	0	(2)	(6)	(9)	(13)	(16)	(20)	(66)
E4	Change in average value of pension	0	(3)	2	4	(7)	(18)	(23)	(45)
E5	Change in number of awards	0	(3)	(6)	(21)	(13)	2	7	(34)
E6	Change in 2015-16 closing paybill amount	0	(2)	(2)	(2)	(2)	(2)	(2)	(12)
E7	Change in widows(ers) assumption	0	1	2	2	3	4	6	18
E8	2015-16 out-turn	26	0	0	0	0	0	0	26
	Total increase/(decrease) in pensions expenditure	26	(19)	(72)	(127)	(142)	(169)	(205)	(708)
Lump Sums									
E9	Change in redundancy assumption	0	(13)	(13)	(13)	(14)	(14)	(14)	(81)
E10	Change in average value of lump sum	0	(15)	89	21	(89)	(12)	(38)	(44)
E11	Change in number of awards	0	(18)	(21)	(102)	136	29	25	49
E12	Adjustment for 'double counting'	0	1	5	7	8	9	11	41
E13	2015-16 out-turn	15	0	0	0	0	0	0	15
	Total increase/(decrease) in lump sum expenditure	15	(45)	60	(87)	41	12	(16)	(20)
Transfers Out									
E14	2015-16 out-turn individual transfers out	(54)	0	0	0	0	0	0	(54)
E15	2015-16 out-turn group transfers out	0	200	0	0	0	0	0	200
	Total increase/(decrease) in transfer out expenditure	(54)	200	0	0	0	0	0	146
	TOTAL INCREASE/(DECREASE) IN EXPENDITURE	(13)	136	(12)	(214)	(101)	(157)	(221)	(582)
Income £'m									
Contributions									
I1	Adjustment of 'target' yields	0	0	22	22	22	24	24	114
I2	2015-16 out-turn	(52)	(25)	(25)	(25)	(23)	(24)	(25)	(199)
I3	2016-17 forecast	0	96	70	72	71	74	77	460
I4	Change in DH growth assumptions	0	0	(16)	(37)	(58)	(84)	(65)	(260)
	Total (increase)/decrease in contributions	(52)	71	51	32	12	(10)	11	115
I5	2015-16 out-turn individual transfers-in	(4)	0	0	0	0	0	0	(4)
I6	2015-16 out-turn group transfers-in	(2)	0	0	0	0	0	0	(2)
I7	2015-16 out-turn income from premature retirement benefit	7	0	0	0	0	0	0	7
I8	Income from premature retirement benefits - 16-17 onwards	0	14	14	14	14	14	14	84
	Total (increase)/decrease in transfers-in and PRB	1	14	14	14	14	14	14	85
	TOTAL (INCREASE)/DECREASE IN INCOME	(51)	85	65	46	26	4	25	200
	Total increase (decrease) in cash requirement	(64)	221	53	(168)	(75)	(153)	(196)	(382)

Questions?