Notes for USS Pension Members

Andrew Oswald

May 2000

In the last few weeks the pages of the Times Higher Educational Supplement have contained a debate begun by an article of mine (a version of the argument is printed below). The article was published in the THES in the middle of April.

The piece published in response, by David Chynoweth of USS, on April 28, seems to me to talk a fair amount of sense. But there are some parts I find less persuasive.

I record some reactions below.

<u>Some points for other members of the Universities Superannuation Scheme:</u>

1. As far as can be ascertained from the fractionally out-of-date figures on the USS website, about 80% of assets are now in equities (ie. in the stock market). This appears to me much too high for safety at this juncture. I believe that stocks and shares are likely to give poor returns over the next year or two. Anyone who wishes to read my views on the likely behaviour of the stock market, and the economy, may find them in the three web papers entitled “The Fall of 13 Years Ago”, “Low Real Oil Prices Not a New Economy” (which was published last year in the Financial Times, and was also recently described in The Economist), and “Is Recession 2000 in the Pipeline?” (which was recently published in Investors Chronicle).

2. I do not share Mr Chynoweth’s apparent view that the actuarial surplus in our pension fund automatically belongs to the employers. In a sense, USS cannot do so either, because in a small way it has been making concessions by giving us things

like slightly more generous life insurance cover. My opinion is that the business of USS is primarily to provide pensions (not extra insurance that is readily available elsewhere), so do not welcome that. And the abolition of the young spouses' reduction, which is probably understood by only a few dozen of the hundred thousand members of USS, is not something I view as sensible or fair. In any event, these steps distribute only a tiny amount of the surplus.

3. It is now clear that the main reason the surplus is smaller than otherwise is because huge amounts of money have been transferred over the last few years to the employers. This has been done principally through the adoption of the 14% rule. I have no doubt that this was legal. The ethics of it, however, appear to me to be very much cloudier.

4. USS plans to continue this, over the next decade, in an attempt to get the actuarial surplus down to only £700 million. In April 2000, my guess is that the surplus stands at around £1.8 billion pounds. As the USS website, www.usshq.co.uk, does not appear to give today's valuation, this can be only a rough estimate. If correct, it is approximately a surplus of £60,000 per pensioner.

Andrew Oswald   www.oswald.co.uk

…………………..

Article overleaf

A version of the article below was published in the Times Higher Educational Supplement on 14 April 2000

Did you know how rich you were?

Andrew Oswald, Professor of Economics, University of Warwick.

Would you like to retire on two-thirds salary or just half your salary?

That is a tough one. Let me have an hour to think about this.

If you are anti-materialist, anti-market forces, in favour of candles and inefficient recycling and sandals, and think that money does not buy contentment, you are probably happy with the latter. The ratio of one half is the proportion stated in our contracts, after all. We are British, for heaven's sake. We were brought up to go with the flow.

In that case, you should stop reading now. Turn to the Wittgenstein review on the next page. All I have to offer is lucre.

The rest of this piece is for the half-dozen university teachers in the UK who are still with me. Well, the good news is that you and I are a great deal richer than is widely realised by 99.9% of the professors and lecturers in this country. Although most have no idea, our pension scheme is stuffed with more money than it knows how to deal with. It has an un-spendable surplus of, very probably, between one and two billion pounds and is going to have to think what on earth to do with the shekels.

Nothing, probably, if it gets its way.

There is an explanation. It is simple but sounds drier than a mathematical economics textbook. The first and more interesting part is that the stock market has massively outperformed the expectations of the actuaries who started USS, the Universities Superannuation Scheme. The other is that we all have something called a defined-benefit pension scheme, and not, like American academics, a defined-contribution pension scheme.

All this means in English is that, when you retire, the cash you then get to live on until you join the big university in the sky will depend on your final pay packet. In other words, the pension is a ratio of your final salary. In the States, your retirement income as an academic depends on the amount that you have paid in. In that sensible country, you even get to choose your own shares. But the British are not allowed to do anything as interesting and libertarian as that with their money.

USS is one of the largest funds in the country. Its assets may be somewhere at the thick end of between 20 billion and 30 billion pounds, and it has more than 100,000 members and pensioners.

In the old days, people thought the stock market would grow about 6% or so a year. So that is the kind of number that the actuaries punched into their adding machines. Then they worked out, given your payments and mine, how rich you could be on retirement. Hence the retire-on-half-your-pay if, assuming you could cope with QAA with a sense of humour, you did plenty of years in universities.

Well, actually stock markets have printed money for as long I can remember. The average return has been about 11% a year (compare that to betting on the UK lottery, where the average rate of return if you work it out is minus 50% a week, or in other words so low that it would be against the law as an investment, which is why dull old people like me never buy lottery tickets).

The rest, as they say, is arithmetic. If you thought shares would go up 6%, and they actually went up 11%, every year you would be able to salt away the 5% extra. And USS has. Of course it has reinvested that – again and again and again. There is no bad behaviour here. Nothing wrong has been done, unless, perhaps, you count keeping silent about things that members would have found rivetingly interesting.

There is only one problem with this excellent strategy. Soon you have so much money bulging out of every pocket that it gets embarrassing. You start dropping twenties when you walk to the coffee room and fifties when you get in your car. Then you definitely prefer not to mention it to anyone.

Given the surplus in USS, there is a good chance we could, with the mildest bit of pressure on them, go over to a 2/3 not ½ retirement pay ratio. If you do not believe me, ask them and look at the numbers. Big numbers. Very very big.

Although charming people if you ring them up (I have and they are), those ladies and gentlemen are still keeping things to themselves. Quiet. Very very quiet.

And you thought your economist colleagues down the corridor would never turn out to be useful for anything.