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Reform of police pensions in England and Wales

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ABSTRACT

We analyse pension reforms for police officers in England and Wales using force-level data. We quantify the impact on overall police pension plan liabilities, examining incidence across police officers, national and local taxpayers. We also examine reforms of retirement rules, especially concerning early retirement on grounds of ill-health. Differences in ill-health retirement across forces are statistically related to area-specific stresses of policing and force-specific human resource policies. Reforms in 2006 impacted primarily on the level of ill-health retirement among forces with above-average rates of early retirement. We find that residual differences in post-2006 ill-health retirement rates across forces are related to differential capacities to raise revenue from local property taxes.

1. Introduction

This paper considers recent reforms to the pension arrangements of police in England and Wales. It calculates the effect of these reforms, both immediately and in 'steady state', on police pension plan liabilities, constructing a simulation model of the pension plan and changing model parameters to reflect the various reforms. It examines the incidence of the reduction in pension liabilities between taxpayers and police officers. It then utilises econometric methods to examine one specific component of the reforms: the change in the procedures for and finance of early retirement on grounds of ill-health, and analyses the incidence of this reform between national and local taxpayers as well as police officers themselves. Given that there has been very little academic research into public pension plans in the United Kingdom and no research, to our knowledge, into police pensions or police labour markets in particular, these are new contributions to the literature.

Unlike the United States, most public sector pension plans in the United Kingdom (UK) are unfunded and operate explicitly on a pay-as-you-go (PAYG) basis.[1] The UK's police pension plan is no exception. The combined projected pension liabilities (Projected Benefit Obligation or PBO) of these UK public sector plans were calculated in 2010–11 to be £959.5 billion[2] (of which only £66.2 billion was funded) with the projected unfunded liabilities of the police pension plan alone estimated at £93.8 billion, or around 10% of the total. Efforts to curtail public pension liabilities in recent years have involved raising normal pension ages, reducing accrual rates, changing indexation provisions and reducing rates of early retirement on grounds of ill-health. All these reform methods have been applied to police pensions. It is however important to note at this point that only the reform of early retirement provisions described here has an immediate impact on police pension liabilities, since other components of the reforms either apply only to new entrants to the police pension plan or are subject to transitional provisions. Hence, there are questions both on intergenerational incidence and incidence across interest groups.

Another important feature of public pension plans in the United Kingdom (UK) – again in contrast to the United States – is that public sector plans in the UK are broadly nationwide plans, with common normal pension ages, accrual rates etc. across local jurisdictions. Nevertheless, although pay and pensions are set nationally, many public sector workers are employed and managed by local authorities; hence many pension plans – those for police, local government

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[1] That is, there has been no deliberate policy of attempting to pre-fund these plans. The most significant exception, in terms of size of plan, is the Local Government Pension Scheme which is notionally fully-funded but is in practice somewhat under-funded.

[2] In US dollars, this is a total liability of around 1.6 trillion. See Treasury (2011b).

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employees, teachers and firefighters – are administered and managed at the local level.[3] Until recently, these local authorities had considerable discretion in workforce practices, including how they managed early retirement on grounds of ill-health. So in the case of the police, whilst there is a fixed nationwide normal age at which police can first retire, local discretion has allowed rates of early retirement on grounds of ill-health to vary widely across jurisdictions (there was no other 'avenue' to early retirement in the police pension plan in the period under consideration). This local discretion raises a tension as to 'who pays' for early retirement, which can be summarised as follows.

Local police services, in common with local government and fire services, are financed by a mixture of central government grant allocations and local taxes levied on domestic properties within local jurisdictions. In the case of the police: until 2006, pension payments to police officers, whether they had retired under normal arrangements or through ill-health retirement, were wholly financed by employee contributions (set at a common national rate) and by central government grant allocations. Because local authorities had discretion within broad government guidelines as to how they managed ill-health retirement in this period, they had an incentive within the financing mechanism to utilise ill-health retirement as a vehicle for removing lower quality officers (for example, those with lower fitness or general aptitude and commitment) from their workforce, wholly at the expense of the national government.

This diffusion of costs across jurisdictions led to high rates of ill-health retirement of police officers in general, coupled with widespread variations in rates across police forces. For police officers, the incentive to utilise ill-health retirement as a workforce management tool was exacerbated by the unique peculiarity of the police officer's terms of employment, under which a police officer cannot be made redundant before the first age at which he or she could normally retire (i.e. age 50).[4] The discrepancy between the incidence of perceived local benefits and national costs arising from discretionary retirement was noted by the central government and in 2006, among the reforms to the police pension plan, a cost-sharing policy was introduced by which part of the cost of ill-health retirement would be borne by the local employer and indirectly, therefore, by the local taxpayer. The implications of this specific policy change are discussed later in the paper.

The paper is therefore structured as follows. The next section provides a brief background on institutions, and on pension and retirement policies in the police service, including ill-health retirement. It then examines the effect of the various reforms on overall liabilities of the police pension plan. To do this, a simulation model of the police pension plan as it existed prior to 2006 is constructed for a representative cohort of police officers, benchmarked on parameters obtained from a variety of official sources, on which we simulate the various reforms. The model is described briefly in the text; a fuller description is provided in an online appendix to this article.

Section 3 shows that the overall package of reforms introduced in 2006 will, in steady-state, reduce discounted pension liabilities of the police pension plan by around 23%, with the bulk of the incidence of this reduction born by police officers; the national government (and future national taxpayers) is thereby beneficiary. We provide tentative evidence of the effect of the even more substantial reform to police pensions which is planned to be introduced in 2015, generating not only larger gains to national taxpayers but also within a shorter time span.

Section 4 focuses on the ill-health retirement component of the 2006 reform. We show that it accounts for a very small fraction of this reduction in long-term liabilities. We estimate that the reform increased the average working tenure (reduced the length of retirement) by around half a year largely bringing high ill-health retirement rates in a minority of forces into line with the average.[5] However, given the very gradual transition to the other new features of the police pension plan, only these changes to ill-health retirement provisions have any immediate impact on pension liabilities.

Finally, we take account of the cost-sharing component of the ill-health retirement reform. The effect of the reform on early retirement rates will be ameliorated to the extent that local police authorities can increase local taxes to offset the reduction in central government support for ill-health retirements. Using econometric methods, we show that the tax-raising capacity of local police authorities varies widely, and that controlling for variations in the elasticity of tax revenues to property tax rates, local taxes are higher in jurisdictions where ill-health retirement rates are higher under the post-2006 cost-sharing regime. The incidence of this component of the reform is therefore more complicated than other components: there is a small shift of costs from the national government (taxpayers) to police officers through the reduction in early retirement in some police forces, but a more significant potential long-run shift from national taxpayers to local taxpayers through the introduction of a cost-sharing mechanism for ill-health retirement.

2. Background

2.1. Institutions

All policing in England and Wales is carried out at the local level by 43 territorial police forces. Forces are normally organised at the county level, albeit with some county forces merged into larger 'territorial areas' (e.g. 'Thames Valley') or 'joint forces' covering larger municipal areas such as Greater Manchester and, for most of London, the Metropolitan Police. A typical police force in England and Wales covers a population of around 1 million people, although the joint forces typically cover larger populations and, in the case of the Metropolitan Police, over 10 million people.[6]

Despite the decentralised territorial nature of policing in England and Wales, all police officers, irrespective of rank, are appointed to the national 'Office of Constable' – a procedure dating back to the year 1066 (but more mundanely enshrined in the Police Acts of 1964 and 1996) – by which an officer is sworn into the office by their local police force and thereby gains powers of search and arrest that are not available to the general public including, under certain conditions, the power to arrest outside their own territorial area. Police officers therefore do not have an 'employment contract' with an individual police force, and thereby lack certain standard employment 'rights' such as the right to form a trade union and take industrial action. Equally, except under certain very specific conditions, a police officer cannot be made redundant, and will continue in the 'office of constable' (irrespective of actual rank) until he or she cannot undertake the full variety of tasks – both physical and mental – required by their office. For that reason, the age of 'normal' retirement for a police officer

[3] The term 'nationwide' in the United Kingdom takes account of the distinct arrangements for the four nations of the UK: England, Wales, Scotland and Northern Ireland. 'Local' jurisdictions in the UK are counties or large metropolitan areas such as Greater London and Merseyside. In what follows, we compare the 'national' level (of England and Wales, which have identical arrangements) with the 'local' level of counties or large metropolitan areas i.e. the second and third tiers of the UK's jurisdictional disaggregation. Our discussion of 'national' v 'county or metropolitan area' in the UK parallels to a great extent the US's distinction between 'state level' and 'county or city level' jurisdictions.

[4] It should be noted, however, that high rates of ill-health retirement were also observed in the late 1990s among other groups such as firefighters and ambulance crews even though such workforces had conventional employment contracts: see Treasury (2000), Table 2.

[5] A considerably greater increase in working tenure (reduction in retirement tenure) is involved, of course, for those who would have taken ill-health retirement.

[6] 'Nationwide' police activities, such as homeland security, serious crime, fraud etc. are devolved to specialised units in some of these forces, notably the Metropolitan Police. As is apparent a 'county' in England and Wales is typically a larger territorial jurisdiction in terms of population than a county in the United States.

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