



# **Reaction & Proposals to the document: Strengthening the Pension Systems – A Strategy for an Adequate & Sustainable Maltese Pension System**

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Position Paper  
September 2015

## **Executive Summary**

The document presented by the Pensions Working Group is a continuation of the pensions reform which was initiated in 2007. It is part of a long term planning process which is indispensable to ensure sustainability and adequacy of the first pillar pension. In its reactions to the proposals, the MEA states that many of the reforms since 2007 and ones included in this report are compatible with the recommendations that it has put forward since 2005, and also reflect demographic changes which have brought about a transformation in the labour supply over the years particularly with respect to female participation, the number of foreign employees, and persons who continue to work beyond retirement age. The Association adds that this is also a result of the fact that the economy has managed to generate productive jobs to accommodate the increase in labour supply, even during the international recession.

The MEA agrees with accreditation of contributions for persons pursuing life-long learning and to raise children, and adds that this should be extended to persons taking care of elderly bed-ridden parents.

On the matter of payment of N.I. contributions by part-timers whose job is their secondary employment, the MEA proposes an evaluation of the possible increase in labour costs in industries with a high incidence of part time workers, and how this measure will affect employees who have a part time job in addition to full time employment, and who would thus already be paying the full N.I. in their full time employment.

The Association expresses strong disagreement with the removal of the mandatory retirement age, arguing that it would be far better to retain the current system, whereby the employer and the retiring employee may enter into negotiations for a possible extension of employment with conditions – e.g. reduced hours - that are acceptable to both.

The measures related to the deferment of pensions will probably not be effective in retaining people in the labour force beyond retirement. The Association suggests that

continued training, work-time reduction and job re-design to enable people to remain productive beyond retirement would be more effective means to achieve this objective.

The MEA recommends that the PWG should also look into the fact that with the introduction of the Guaranteed National Minimum Pension, the differential between the minimum and the maximum pension entitlement will be reduced. This could become a source of tension between those who would have contributed the minimum and those who paid the highest contributions throughout their career. Unless the ceiling is raised, eventually everyone will more or less receive the same first pillar pension irrespective of level of contributions paid.

The Association reacts positively to the fact that rather than introducing a second pillar, the PWG is recommending incentives for more persons to invest in third pillar products. The position paper also accentuates that the adequacy of the first pillar depends not just on the levels at which it is set, but also extensively on individual choices, and mentions that many pensioners abroad are living in poverty because they do not own their property and are paying rent which eats into a good part of their pension. The proposal to set a Home Equity bank is welcomed by the Association, as it will allow retired persons flexibility in turning their fixed assets into cash if necessary.

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## Introduction

The issue of pension reform is a critical one for Maltese society, and centres around the extent to which, in an ageing society with an increasing mortality age, the system allows for a growing segment of the population to live decently beyond retirement age. The matter touches with the aspects of the quality of life and comparisons with other countries must also take into account factors that are not directly related to the level of pensions as such, amongst them the availability of free health care, and home ownership.

Pension reform is of paramount importance to employers. It affects their cost of labour, and also the supply and composition of the labour force. The Malta Employers' Association has always been at the centre of the debate for pension reforms, and in 2005 had issued a number of recommendations which were:

- To raise the retirement age gradually to 65
- To incentivise a higher female participation rate in the labour force
- To have a system whereby pension funds are accounted for separately from health and other benefits
- To shift from a system relying exclusively on PAYG to a partly funded system
- To raise maximum pensionable income
- Introduce fiscal incentives for private pension schemes
- Incentivising a higher activity rate among the retired work force
- N.I. contributions to be increased to a minimum of 40 years to qualify for a full pension with accreditation given for childbearing; life-long learning; looking after elderly parents

A number of these recommendations were included in the reforms which were announced in 2008. The document which has been presented by the Pensions Strategy Group in June 2015 is a positive continuation of the pensions debate and

reform, with a number of recommendations that should serve as a basis for constructive discussion among the social partners.

The review is also important because it takes into consideration numerous ongoing changes in the labour market over the past decades which also have an impact on the sustainability of the pension system. Amongst these is the remarkable increase in female participation, the increase in labour supply through the influx of foreign employees, and an increasing number of persons who opt to work beyond retirement age. These trends are expected to be sustained in the near future. As predicted by the Association years ago, female participation will approach – and possibly surpass – the EU average in the coming five years. In fact the average participation of the segment younger than 39 years is already higher than the EU average. The main reasons for this are:

- economic necessity,
- changes in culture and attitudes towards working women,
- women prefer to have financial independence even if they are married,
- a higher level of education amongst women,
- more flexible working systems in both public and private sectors.

Employers are also receiving more requests by persons approaching retirement age to continue working, and applications by retired persons to work for them. This is due to the following reasons:

- persons reaching retirement age are healthier and adopting culture of active ageing
- some employees find that the first pillar pension implies a drastic fall in their standard of living, especially those who might not have reserves for retirement

- more flexible working systems in the private sector which, in many cases, allow pensioners and employers to reach a productive compromise between work and leisure
- fiscal incentives have encouraged persons reaching retirement age to remain in employment.

The labour supply is also being transformed by the ever growing number of foreign employees in Malta, currently exceeding 20k or 12% of the labour force. This trend is not sector specific, but is evident in practically all economic sectors. Many of these foreign workers are paying N.I. contributions and spending a considerable portion of their earnings in the domestic economy, generating demand and increasing government revenues.

Another issue which was being highlighted years ago and which has been addressed with moderate success is that of early exit from the labour force either through early retirement schemes or else through individuals being boarded out.

In general, the MEA's position was that the relatively low labour participation rate that prevailed a decade ago was, in reality, an opportunity and part of the solution in making the first pillar more sustainable, which was not available to other countries with a high labour participation. The Association had always maintained that the actuarial studies of ten years ago were too pessimistic.

The fact that the labour supply has increased, coupled with a resilient economy that has managed to generate productive jobs even during the years of international recession, has eased the pressure on the sustainability of the first pillar. However, this does not mean that we are out of the woods and the fundamental challenge of how to make pensions sustainable and adequate remains.



This document presents MEA's reactions to the recommendations proposed by the Pension Strategy Group as listed in the report.

### **Recommendation 01: Crediting Contributions for Child Rearing, Family Growth, and Gender Equality**

The MEA agrees with this principle and has been campaigning for it in its position papers related to pension reform. This is an active labour market policy measure which will incentivise more persons to work. The Association also recommends a similar crediting to employees who may temporarily suspend their working career to look after elderly parents. As the population gets older, this is becoming as much of an issue as child rearing.

### **Recommendation 02: Crediting Contributions for Human Capital Development and Life Long Learning**

The Association also agrees in principle with crediting temporary career suspension due to life long learning commitments. This was proposed in its previous recommendations. The recommendation to give accreditation to apprenticeship schemes is positive in acknowledging the economic contribution of vocational education.

### **Recommendation 03: Accounting for Contributions Paid under the age of 18 by persons born before 1962**

This recommendation is supported by the Association as it addresses an anomaly with respect to the employment of young persons. All contributions should be accredited, irrespective of age.

## **Recommendation 04: Removing the Ceiling on the Payment of Contributions Post-65 Years of Age**

The document points out that: *'The current ceiling of 65 years on the payment of contributions by employers and employees is an obstacle to encouraging and incentivising more active participation of elderly persons'*. There is no reason why this should be the case as employees are free to work beyond the age of sixty five. This will be more of a minor revenue generating measure than an incentive to work. It is recommended that, the fact that a person opts to continue working beyond the age of sixty five and is exempted from paying N.I. contributions should act as a sort of recognition to the long service and productive hours given to society.

## **Recommendation 05: Reconciling Atypical Employment with the Contributory Principle**

Thus far, employees only pay N.I. on what is termed as their principal employment. The distinction between the principal and the secondary employment in past years was more pronounced as benefits such as vacation leave and bonuses only accrued to the principal job in cases where employees had more than one part time job. This was amended through the legal notice which provides part timer with pro rata benefits as full timers. The logic behind this recommendation is understandable but one will have to evaluate the possible increase in labour costs in industries with a high incidence of part time workers, and how it will affect employees who have a part time job in addition to full time employment, and who would thus already be paying the full N.I. in their full time employment.

### **Recommendation 06: Facilitating the Transition of Workers from the Shadow to the Formal Economy**

The Association fully supports actions to shift employees to the formal economy. There should be educational campaigns to sensitise employees to the risks of the informal economy, including not being entitled to a pension and other coverage by social security. However, it must be acknowledged that, unlike the case in many third world countries, a good section of those employed in the informal economy do so to hide their income and in some cases may be earning more than formal rates. In such cases, they will be provided for their own insurance, with all the exposure to personal risks that this entails. In many cases, the informal economy in Malta is more a case of evasion than exploitation.

### **Recommendation 07: Introducing an Economic Migration Policy for Malta**

The fluctuations in labour supply caused by migration cannot occur haphazardly. It should complement a general national manpower strategy that addresses current and projected skills shortages. Managed migration can be positive for Malta, and possibly an indispensable factor in the sustainability of our welfare system.

MEA fully endorses any measures that grant foreign workers full employment rights, provided that they will also contribute to the welfare state. The Association has always taken a strong stand against exploitation and discrimination. Migrant workers may partially counterbalance the negative effects of an ageing workforce.

## **Recommendation 08: Incentivising Active Participation of Elderly Persons through the Removal of the Mandatory Retirement Age**

**MEA categorically disagrees with the removal of the mandatory retirement age.**

The current situation, whereby an employer can stop a person from being kept in employment upon reaching retirement age has to be retained. Distinguishing between the retirement age and the pensionable age will create many issues that can also work against the interests of elderly employees.

Many companies conduct manpower planning exercises which project employment plans and career paths for existing employees. Part of this manpower planning process factors in natural wastage through retirement. The removal of the mandatory retirement age will make it difficult for companies to conduct such exercises.

This measure will also create issues in cases of redundancies, as the Last in First Out rule will drain companies of young people.

Another consideration is the motivation to work beyond the pensionable age. As mentioned in the introduction to this document, elderly persons have different reasons for wanting to continue working. There is a difference between a person who feels healthy, able and willing to contribute to organisational goals and one who is clinging to his/her job simply because s/he discovers that their pension does not provide for their retirement aspirations.

It is far better to retain the current system, whereby the employer and the retiring employee may enter into negotiations for a possible extension of employment with conditions – e.g. reduced hours - that are acceptable to both. Employers do value the contribution of elderly employees because of their expertise, experience and potential to train and induct younger persons. Yet the retention of a person beyond retirement

age is based on productivity considerations and organisational goals. It cannot be considered to be a type of social service as social services are meant to be provided by government, not employers.

The worst case scenario is one where employees feel compelled to remain in employment because of the inadequacy of the first pillar pension. This does not appear to be the case. Figures provided by the PWG reveal that more than half of those who reached the age of sixty one and who had paid forty years contributions still opted to retire in spite of having the option to remain in employment till the age of sixty three.

A final consideration about this recommendation is the impact it will have in the public sector. If the mandatory retirement age is removed, there will definitely be some who would try to hang on to their job even in the afterlife!

### **Recommendation 09: Strengthening the Inter-generational Social Contract through a PAYG Notional Defined Contribution Pension System**

In spite of the current position of the PWG to do away with the notional defined contribution (NDC) system, the idea should not be scrapped completely but moved to the back burner. The introduction of an NDC pension scheme could be a means of providing options, particularly for young persons, to enhance their first pillar entitlement. This has been pioneered in Sweden, where a notional capital account is maintained for each contributor, with balances earning a rate of return that is declared by the pension plan each year; and notional payments into this account are made over the entire life history of the individual. The concept is, of course, very challenging, since the return that contributions earn is a notional one, set by the government, not necessarily the product of investment returns in the markets.

## **Recommendations 10, 11 and 12: Ensuring a Fair Balance between Contributions and Benefits Across Generations**

The MEA agrees with these recommendations in so far as they are meant to work towards announcing any changes in the pension system well in advance. The fifteen year notice mentioned would be sufficient for persons affected to make necessary arrangements.

The idea of a flexible retirement which is not dependent on the full 41 years of service is a good incentive for persons who may have insufficient contributions to be entitled to the full pension.

Increasing the contributory period to 41 years is realistic given the changing demographic environment.

## **Recommendation 13 and 14: Incentivising Late Exits from the Labour Market; Incentivising the Deferral of a Retirement Decision**

It is doubtful whether the incentives mentioned in the paper will influence a person to postpone retirement. Forfeiting the pension for a marginal increase in such pension for the remainder of a person's life may not be an attractive idea.

A more effective method to encourage late exits from the labour market is to inculcate a culture of active ageing, which the Geneva Association refers to as **the fourth pillar**, defined as: *'the future need for a flexible extension of work-life, mainly on a part-time basis, in order to supplement income from the three existing pillars'*. One way of achieving this is to encourage continued training, work-time reduction and job re-

design to enable people to remain productive beyond retirement. This may entail training to both employers and employees.

This is a different approach from removing the mandatory retirement age, or introducing the fiscal incentives mentioned under this recommendation, but the end result in the medium term would probably be better. It is recommended to design an age management strategy on the lines proposed by the Geneva Association to complement the pensions strategy.

### **Recommendation 15: Defining the Guaranteed National Minimum Pension**

The Guaranteed National Minimum Pension is a good safeguard to partially offset the eroding purchasing power of pensions. The phasing of this system could be introduced at a more accelerated rate. The topping up of the National Minimum Pension for couples living on one pension discriminates against those couples who are entitled to two pensions because they have contributed to them throughout their working lives. The aspect of social justice is understandable from a distribution of income perspective, yet couples who have two pensions should not be substantially disadvantaged. This concept could create social tensions if extended further.

**The PWG should also look into the fact that with these measures, the differential between the minimum and the maximum pension entitlement will be reduced. This could become a source of tension between those who would have contributed the minimum and those who paid the highest contributions throughout their career. Unless the ceiling is raised, eventually everyone will more or less receive the same first pillar pension irrespective of level of contributions paid.**

## **Recommendations 16 and 17: Establishing Relativity of the Old Age Pension with the National Minimum Wage and Synchronising the Old Age Pension Retirement Age with Article 62 (A) of the Social Security Act**

The Association agrees with establishing a relativity between the First Pillar and the National Minimum Wage as otherwise the purchasing power of the first pillar pension will be eroded. Recommendation 17 corrects an inconsistency between the Retirement Age and the Social Security Act, as the 2007 reform left the retirement age of the Old Age pension at sixty years of age. It will now be increased to sixty one in line with the SSA.

## **Recommendations 18 and 19: Introducing Incentives for a Voluntary Third Pension and Nudging Persons to Save for Retirement**

The Malta Employers' Association has consistently warned against the introduction of mandatory second pillar pensions in favour of incentivising the Third Pillar. In its 2011 document on pension reform, the MEA stated that:

*'MEA ... advocates implementing fiscal incentives to stimulate a higher take up of third pillar packages, and also continuous media campaigns to encourage savings. People need to understand and act on the knowledge that the first pillar on its own simply cannot guarantee a 'decent' standard of living during retirement. This would be a better route than introducing a mandatory second pillar.*

*There is still a strong argument in favour of the second pillar pension in that it shifts the pension system from its current dependence on the pay as you go. However, this objective will still be achieved through the introduction of a voluntary third pillar. The*



*third pillar will also allow for more flexibility in the manner in which individuals and households manage their assets, as its voluntary nature will determine whether they save at all, or whether they would prefer to invest in financial or real assets (i.e. property).'*

Government needs to influence people's aspirations about the first pillar by making it clear that the first pillar will act as a safeguard to a basic standard of living. It will not guarantee the purchasing power that a person had throughout his/her working life. People need to be encouraged to make choices early in their lives to enhance the basic first pillar through incentives and encouraging a culture of asset management and long term planning.

The adequacy of the first pillar also depends on individual choices. Compare a family living on the first pillar who live in a rented place without any energy saving equipment to another living in their own home and hardly have any utility bills to pay. Even if they have the same income, currently their disposable income net of rent and utilities may result in a disparity of €3,500 between them. To a family depending on the average first pillar income, this amounts to 5 months pension! *Therefore the adequacy of pensions does not only depend exclusively on what is provided by the state through the contributions, but also on individual choices.* It is these choices that are driving many pensioners to the brink of poverty in many industrialised countries. The MEA has been claiming that a culture of dependency is detrimental to our society, and that people cannot expect the state to provide for all their needs through handouts. The general public must be made to understand this point through educational campaigns.

## **Recommendation 20: Accessing Wealth Accumulated in Property for Retirement Income**

In the document released in 2005 on pension reform, the MEA had stated that: *'many persons are buying a second property on grounds that the appreciation on property is*

*higher than the net returns on other type of investments, including private pensions schemes. Such persons would argue that they can enjoy the property in the meantime, and it will also serve as a precautionary asset during retirement which they can convert to liquid assets if they need money to stay in a retirement home. If they do not need to resort to this, the property will be bequeathed to their heirs. In Malta the percentage of home ownership is relatively high (60%), and many consider the mortgage payment as a type of saving, since the value of property, thus far, has appreciated'.*

The setting up of a Home Equity bank will address the situation whereby retired persons maybe 'asset rich and cash poor' and is a positive move to allow pensioners to make their assets more liquid to meet their needs if required.

### **Recommendation 21: Inculcating a Culture of Literacy with regard to Financial Savings and Investments and Retirement Income**

This recommendation ties in with recommendations 18, 19 and 20. As mentioned earlier, educational campaigns are important to enable individuals to identify choices available and to manage their future. This could include some mandatory lectures to young persons attending post- secondary courses and possibly at places of work.

### **Recommendation 22, 23 and 24: Maximum Pensionable Income; Annual Re-Assessment; Calculation of Pensionable Income for Persons in the Transitional Group**

The indexation mechanism recommended in the report, which will calculate pension increases based on a formula which factors in national wage growth and inflation is a more objective system than the one which is based exclusively on collective

agreement increases. There may be a problem in computing the wage growth variable of the index and this may need to be administered, if implemented, by a committee composed of the different stakeholders.

The calculation of pensions based on the best three years of the last 15 years for employed persons and the best 10 years of the last 15 years for self-employed persons born from 1952 to 1961 makes sense.

## **Conclusion**

The ongoing discussion on pension reform involves the input and perspectives of many stakeholders: government, employers, self-employed, pensioners' associations, youth associations who may have different, and at times, conflicting interests. Yet one determining factor which is common to all as members of society is the economy's potential to be competitive and to generate wealth. This is a pre-condition to the sustainability of any pension system. The recent experience in Greece, which had to resort to cutting pensions to wrestle with its financial problems is a lesson which all social partners must learn from. Hence fiscal consolidation, and economic prudence that has the necessary foresight to balance out immediate demands with long-term sustainability is essential for inter-generational equality.

Entitlement to a pension is not an automatic right, but is a result of sound economic management and ultimately, on how hard and productive we work. The pension system is of interest to the business community. Besides the social aspect, pensioners are a growing segment with an impact on aggregate demand. Their purchasing power, or lack of it, has an impact on business. The ageing population will also tax the economy's resources through increased expenditure on health services that are also financed through the social security contributions.

Therefore a pensions strategy has also to look beyond the proximate issues that are directly related to pension systems and seek synergies and solutions in the wider social and economic environment.