Of Pillars, Pensions and Dilemmas

The so called Pensions' Dilemma seems to periodically emerge on the national agenda. This issue of the adequacy and sustainability of our pensions' system seems always round the corner. It regularly presents itself as a problem that, we are told, needs immediate focus. Invariably the issue is brought to our attention in a dramatic manner; "are we still in time?", "a poverty bomb ticking away!" etc., etc. We are expected to start worrying. But is it such a cause for worry?

The current prevailing pensions' set-up in Malta is not a funded pensions system. The National Insurance contributions regularly paid by employees and employers, (1/10 each of salary value subject to a ceiling), do not go into an exclusive fund that is solely utilised to generate income and provide funds for the payment of pensions. The N.I. contributions are instead accounted for, or rather lost, in the labyrinth of Government's general overall tax revenue. The N.I. contributions are utilised to pay for pensions, healthcare, hospitals, unemployment and so many other benefits. So our Pensions set-up is not funded at all. Described as a Pillar One system it is based on the "Pay As You Go" principle whereby tax paying workers provide for the pensions of retired citizens. Such a system is functional and has its merits. The adequacy of the pensions paid out is subject to national affordability as well as arbitrary decisions taken by Governments that have the prerogative to determine how much and what percentage of the general revenue gets allocated to pensions' payments. As such I do not see where the so called dilemma lies. If a Government of the day decides to sustain a certain level of pensions payments then it will be incumbent on such a Government to responsibly identify affordable funds. This is also done by avoiding expenditure on wasteful or superfluous practices. Such negative practices for example can be identified in a public sector that is notoriously overmanned and is loaded with a good number of costly and relatively unrequired and underutilised human resources. It is wasteful to unnecessarily keep on increasing the number of public sector employees. One thousand five hundred employees unnecessarily added on to the Government payroll mean an additional annual recurring € 30,000,000 payroll expenditure. Thirty million may go to pay a € 12,000 pension to 2,500 additional pensioners or may go to improve the values of pensions being paid out.

In other words the Pillar One PAYG pension system, as prevailing in Malta, has no overwhelming reason to be considered, currently or in the foreseeable future, an unsustainable dilemma. Making it a system that constantly delivers decent pensions depends on good economic governance and on what priorities the Government of the day gives to its revenue allocations and spending decisions. It appears there is national consensus so that Governments out of the general revenue, allocate adequate funds to guarantee pensions that ensure a decent standard of living to retired citizens.

Regarding this Pillar One system, morally, what is so unfair for the current generation of workers to contribute to the pensions of current retirees? Retirees over the years contributed to fund an infrastructure of roads, energy, housing, hospitals, education and whatever else. For over forty years, through NI payments, Income Tax, VAT and various indirect taxes haven't retirees contributed enough to be the beneficiaries of a Pay as You Go Pensions System? Condemnable I would say is a whole succession of Politicians in Governments who waste and mismanage public funds, running up huge deficits and National Debts, that go to jeopardise a sensible "Pay as You Go" Pensions System.

Now besides a First Pillar PAYG Pensions' System there are two further approaches to Pensions' administration. There is what is called a Second Pillar approach whereby Employers and Employees become legally obliged by Government to pay extra additional pension contributions that will go to create a pension scheme personal and particular to each single Employee. This personal Pension Scheme will travel with the Employee from one job to another.

Governments look upon Second Pillar Pensions as supplementary and in parallel to a First Pillar set-up. This implies that the introduction of a compulsory Second Pillar alongside a First will result in additional deductions to Employees' salaries and additional costs to Employers. In as much as a Second Pillar pension system will increase the cost of labour the MEA does not favour its introduction, definitely not in the foreseeable future. This increase will percolate down to the cost and price of businesses' and industries' end services and products, rendering them less competitive. Foreign direct investors too will be less inclined to invest in an expensive work environment. Unions invariably do not favour an obligatory Second Pillar proposal as this will result in an imposed reduction in the take home pay of Employees. For the aforementioned reasons the present Labour Government too is not in favour, and has emphatically declared no plan for the introduction in the foreseeable future of an obligatory Second Pillar Pension option.

The Opposition, the Chamber of Commerce and it seems the Union Haddiema Maghqudin (UHM), do not agree. The Opposition has declared its support for the imminent introduction of a compulsory Second Pillar option and the Chamber of Commerce does not oppose such an introduction, declaring a Second Pillar to be an inevitable and required development. The UHM is of the same opinion as Chamber.

Now besides the Second Pillar there is a third pillar approach. This Third Pillar, similar to the Second Pillar, is also to be considered additional to the First Pillar set up. This Third Pillar consists in a voluntary setting aside of savings by the individual employee, savings to be invested in a private personal pension scheme. Such savings by the date of retirement, would provide an additional pension salary as well as lump sum payments, to the retiree.

Here Government must actively intervene to encourage this voluntary Third Pillar take up. This encouragement will come through significant tax benefits to whoever opts to go this way. Employees must be encouraged and incentivised to develop an ethic of personal responsible saving for their future. Tax benefits for savers will go to make such positive voluntary behaviour worthwhile to the individual.

This Labour Government has adopted the Third Pillar option and the Minister of Finance has duly announced defined tax benefits that will accrue to whoever opts to invest in a pension endowment policy. The MEA fully supports the Labour Government's adoption of this Third Pillar option and believes such an approach will go to reduce a future possibility of poverty line pensions.

The Insurance Sector here has an interest, and a role, to fulfil and contribute to a Third Pillar success, this by providing flexible and attractive retirement insurance products.

The raising of the pension age by the Nationalist Government some years back was a very courageous and responsible decision, taken irrespective of its unpopularity. This delay by a few years to the pension entitlement contributes enormously to the sustainability of our First Pillar PAYG Pensions System. It implies that able bodied and capable persons will keep working for some additional years so contributing further to general economic wealth creation, while simultaneously not availing themselves of Pension payments.

A further additional support to the adequacy of Malta's Pension System will come from encouraging pension age retirees to continue in employment. This voluntary prolongation of the working life, (part time work, reduced week, reduced hours), will result in an ability to supplement and increase one's pension income and so avoiding poverty traps.

In conclusion MEA is very much in favour of the Government's current effort to support and encourage a widespread voluntary adoption of Third Pillar Pensions. Government is correct in spearheading this effort with tax concessions to whoever opts to go the Third Pillar way.

In ruling out an immediate compulsory second pillar scheme this Government is avoiding a reduction in employees' disposable incomes. This Government also appears very conscious not to add further costs to employers as these will result in more expensive services and products.

It will make sense to have National Insurance Contributions accounted for exclusively for Pensions' Payments and work related benefits only. General health expenditures, including Mater Dei and Medicines, should be hived off on their own and must not feature as labour costs that get directly reflected in the cost and price of a Company's service or product making it less competitive and less saleable.

Finally this whole argumentation must not ignore the fact that demographic 20 year projections do point out that an isolated First Pillar PAYG system will come under severe stress. This as the ratio between gainfully employed and retired citizens may from 4 workers to 1 retiree change to 2 workers to 1 retiree. This is not a problem to be overlooked, however it may not be so serious and come about if one takes into consideration a current trend of increased female participation in the workforce as well as an influx of foreign workers.

So in conclusion, a Third Pillar voluntary approach must be consistently sustained perhaps not with just tax exemptions but also with direct Government bonus payments made into the personal pension schemes of citizens who are prepared to invest, through a Third Pillar option in their future.

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