Social Impact Assessment – White Paper “Pensions – Adequate and Sustainable”

Pensions Working Group

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Contents

Contents Contd

Appendices

List of Figures

List of Tables

Glossary

Average Replacement Rate for Existing 2/3 Retirement Pension	Average replacement rate accruing to those retiring in year and those who are retired in year t.
Average Replacement Rate for New 2/3 Retirement Pension	Average replacement rate accruing to those retiring in year t.
Average Replacement Rate from Hypothetical Annuity	Average replacement rate accruing to a new retiree if he/she were to invest in an annuity bought with the accumulated capital he/she has at the moment of retirement.
Average Replacement Rate if all Balance is Annuitised	Average replacement rate derived from Pillar 2 Pension if pension income accrued to the contributor is transferred to an annuity.
Class I Contributions (Employees)	10% by the State, 10% by the Employer, 10% by the Employee subject to an established minimum and maximum contribution.
Class II Contributions (Self-Employed/Self Occupied)	15% of the earned/annual income subject to an established minimum and maximum contribution. The contribution payable by the State is equivalent to 50% of this contribution.
COLA	Cost of Living Increase
Current Scenario	The resulting scenario if the current pensions system is maintained.
Disposable Income	The amount of income available to households after payment of personal income taxes and national insurance contributions.
EIA	Environmental Impact Assessment
ETC	Employment & Training Corporation
EU	European Union
EU-15	EU Member States prior to last enlargement
EU-25	All current EU Member States
GDP	Gross Domestic Product
Government	Unless otherwise specifically stated in the document the term Government refers to the Government of Malta
HBS	Household Budgetary Survey
ISSA	International Social Security Association
MCESD	Malta Council for Economic and Social Development
MEU	Management Efficiency Unit
MFSA	Malta Financial Services Authority

MFSS	Ministry for the Family and Social Solidarity
MPI	Maximum Pensionable Income
NAP	National Action Plan for Employment
NI	National Insurance
NSO	National Statistics Office
PAYE	Pay As You Earn
PAYG	Pay As You Go
Pillar 1	Public earnings related schemes [State Grant (Government), Employer, Employee]. Referred to in the White Paper as First Pillar.
Pillar 2	Pension schemes that are invested in funds managed by either Government or the Private Sector (Employer, Employee). Referred to in the White Paper as Second Pillar Pension Scheme (SPPS).
Pillar 3	Individual Retirement Provisions. Referred to in the White Paper as Third Pillar Pensions Scheme (TPPS).
PROST	Pension Reform Options Simulation Toolkit
PSCF	Pension Scheme Compensation Fund
Purchasing Power	The extent to which a given monetary unit can buy goods and services. Purchasing power is directly linked to the Retail Price Index and can be used to compare the material wealth of an average individual in different periods.
PWG	Pensions Working Group
Reformed Scenario	The resulting scenario following the implementation of the reform proposed in the White Paper.
Replacement Rate	The ratio of average pension to average wage for each age and gender cohort in year t.
RPI	Retail Price Index – a price index which measures the average level of the prices of a general basket of goods and services bought by final consumers.
Self-Employed	Unless otherwise specifically stated in the document the term self-employed incorporates the self-employed and self-occupied as defined in the Social Security Act.

Executive Summary

This report is an independent Social Impact Assessment of the proposals to reform the current pensions system put forward in the White Paper “Pensions: Adequate and Sustainable”. This report has been commissioned to the Management Efficiency Unit by the Pensions Working Group.

The report contains eight (8) Sections which are summarised in the following paragraphs.

Section 01 - Introduction

Section 01 contains an introduction to the report and defines the main categories of social impacts on which this assessment is based, namely:

- *Lifestyle* relating to the way people behave and relate to family, friends and cohorts on a day-to-day basis;
- *Cultural* relating to shared customs, obligations, values and other elements which make a social group distinct;
- *Community* relating to infrastructure, services, and social cohesion;
- *Quality of life* relating to sense of place, perception of belonging, security and liveability, and aspirations for the future; and
- *Health* relating to mental, physical and social well being.

The Section also provides the terms of reference established for the project, the methodology that was used to carry out the assessment, and other items which provide the background to the report.

Section 02 – Identification of Stakeholder Coverage

Section 02 provides the categories of stakeholders, or in other words those individuals, groups or entities that would be impacted by the proposed reforms to the pensions system. These were classified into two categories:

- contributors and beneficiaries; and
- implementation stakeholders.

The contributors and beneficiaries were further sub-divided into different categories, namely:

- workers by age (young workers, middle age workers and those nearing retirement age);
- current pensioners;
- workers by status of employment;
- workers by type of employment;
- employers;
- gender considerations;
- persons with disability;
- widows, widowers and survivors; and
- foreigners working in Malta and Maltese working abroad.

Some of the categories were subsequently broken down into further sub-groups, such as by age groups in the case of employees. These categories were based on similar characteristics that prevail in the various sub-groups in relation to the effects of the proposed reforms.

The implementation stakeholders identified include:

- the Government;
- the Malta Financial Services Authority (MFSA); and
- the banks and financial intermediaries.

A number of other categories have been identified which, however, do not fall within the remit of the proposed pensions system. These include:

- pre 1979 Public Service employees (in relation to their service pension);
- the Armed Forces and Police personnel (in relation to their service pension);
- Members of Parliament; and
- Maltese nationals working in Third Countries.

This Social Impact Assessment addresses only those stakeholder groups which have been identified as Contributors, Beneficiaries and Implementation Stakeholders and which are covered by the proposed pension system.

Section 03 – Macro Social Impact if No Changes are Carried Out

Section 03 provides an analysis of the macro social impacts resulting should the current pension system be maintained. The main potential social impacts resulting from the inadequacy and unsustainability of the current pension system are listed below. These potential impacts and others are expanded upon in the main text of Section 03 of the report.

- Lifestyle impacts:
  - The decrease in disposable income as a result of the inadequacy of the pension is likely to lead to a decrease in consumption thereby effecting people's lifestyle on retirement.
  - Pensioners are likely to need to financially depend on their relatives, which would lead to a lack of independence.
  - The decrease in disposable income is likely to decrease the pensioner's expenditure on their social life since income would be spent on essential items, leading to social exclusion for pensioners.
- Cultural impacts:
  - The current pension system has a cultural impact on the development in gender roles since it does not offer incentives for part-time or other atypical employment, and does not recognise family responsibilities for pension entitlement.
  - The inadequacy of the state pension may lead to a conflict between the 'old' and the 'young' as well as age discrimination whereby the younger generations would look at the older generation as an additional financial burden.
- Community impact:
  - An increase in the aging population increases the demand for services for the elderly such as homes for the elderly, health services, home services including cleaning, nursing and maintenance and meals on wheels. If pensioners would not afford to get these services privately, there would be increased pressure on the Government infrastructure, the community, non-governmental organisations and neighbours to provide these services.

- Quality of life impacts:

  - The decrease in average pension as a percentage of average wage would result in a negative quality of life impact for pensioners because in comparison to other citizens, that is, those in employment, their income would be considerably lower.

  - In order to reduce the pension deficit, Government may need to increase taxation, which would lead to a decrease in disposable income which may in turn lead to a decrease in consumption or saving. The former would lead to a decrease in quality of life during employment, while the latter would lead to a decrease in quality of life on retirement.

  - The unchanged ceiling would lead to an increase in quality of life during employment, because as wages increased, contributions would fall, and disposable income would increase. However this would be at the expense of having a lower pension on retirement and therefore a lower quality of life.

  - Today's workers would look at retirement negatively, with a fear of ending up in poverty and therefore perceive a deterioration of their quality of life for the future.

- Health Impacts:

  - Increased stress and anxiety on pensioners to make ends meet.

  - Potential melancholy and depression on those over 61 who are fit and willing to work but who are disincentivised to work beyond retirement age under the current pension system.

Section 04 – The Macro Social Impact of the Proposed Reforms to the Pensions System

Section 04 provides an analysis of the macro social impacts resulting from the proposed pension system. Once again, these social impacts are grouped into the categories identified in Section 01. The main potential social impacts identified in the report are listed below and are divided into potential positive and negative impacts. The main text of the report expands upon these impacts and also provides the basis on which they were identified.

Lifestyle Impacts

- Potential positive lifestyle impacts:

  - Pensioners would have a more adequate pension and can be more financially independent than if current system is maintained. They would also be able to maintain a standard of living which is closer to that enjoyed during pre-retirement than if the current system is maintained.

  - With contributors not having an option to liquidate Pillar 2, this would ensure a more adequate pension.

  - The transition period for the mandatory introduction of Pillar 2 and other changes allows some time to prepare for the change.

  - The proposals in the White Paper offer incentives for increased participation in the labour force.

- Potential negative lifestyle impacts:

  - Contributors would have lower disposable income as a result of Pillar 2 contributions.

  - If employers transfer the increase in labour costs as a result of Pillar 2 contributions to consumers as price hikes, this could result in inflation.

  - A mandatory Pillar 2 system may be perceived by contributors as an imposition on their saving decisions.

- The proposal in the White Paper that part of the Pillar 2 matured fund is taken as annuities, may result in a decrease in household income and an increase in the risk of poverty since once the spouse dies, the widow/er would not benefit from any proceeds.

- The increase in retirement age may require retraining and redeployment for those with strenuous or stressful jobs and therefore induce a change in lifestyle.

Cultural Impacts

- Potential positive cultural impacts:

  - The proposed reform would bring about a change in perception of invalidity pension as the principle of 'rehabilitation or alternative work before pension' is encouraged.

  - The discrimination that exists under the current system is eliminated as the same calculation baseline for both the employees and self-employed is used.

  - The new pension system reinforces the "new" gender roles and acknowledges the importance of female participation in the labour force.

  - The proposed reforms also provide increased value to life-long learning.

- Potential negative cultural impacts:

  - As the Maltese population has for the past two centuries relied mostly on the State for welfare support, some people may find it hard to accept the culture of self-help as introduced in Pillar 2.

  - As job security has been given a high priority in the value system of employees, it may be difficult for people to adjust to the fact that the 'job for life' culture may no longer be applicable as a result of the proposals in the White Paper.

Community Impacts

- Potential positive community impacts:

  - The increase in the retirement age and the potential increase in female participation rate is likely to result in increased demand for childcare and elderly services.

  - A more adequate pension could reduce the dependence of pensioners on the community for free services.

Quality of Life Impacts

- Potential positive quality of life impacts:

  - The introduction of Pillar 2 and Pillar 3 would supplement pension income and provide a better standard of living/quality of life upon retirement.

  - The proposals in the White Paper for a strict regulation of Pillar 2 including MFSA regulation and the introduction of the Compensation Fund would ensure peace of mind for contributors.

  - Incentives to work beyond retirement age provide the opportunity for more disposable income and hence a better quality of life for those wishing to work beyond retirement age.

  - The credit system being proposed for periods of child bearing and rearing allow parents to dedicate themselves on a full-time basis to their child, therefore enhancing the child's quality of life.

  - The credit system being proposed for career breaks taken for life-long learning enhances employees' quality of life as they feel that they have better competencies and a positive contribution to make throughout their career.

- Potential negative quality of life impacts:
  - Insecurity in the financial markets would give rise to concern among contributors on the return to be earned from their Pillar 2 contributions, thus negatively impacting their quality of life.
  - The increase in the retirement age may adversely impact the quality of life for those with aspirations to enjoy their hobbies during the retirement portion.

Health Impacts

- Potential positive health impacts:
  - For those who regard work as a source of personal satisfaction and as a means of social belonging, the increase in retirement age would result in positive health impacts.
  - Ring-fencing health contributions ensures that contributions are truly being used to fund the health service.
- Potential negative health impact:
  - As a result of the increase in retirement age, work-related stress, demands and pressures could impact negatively on the individual's physical and mental health.

Section 04 also provides a comparison of the macro social impacts of the current and proposed pension systems.

Section 05 – Social Impacts on Specific Groups

Section 05 of the report analyses the social impact on the specific groups that were identified in Section 02 of the report. The impacts discussed in this Section are specific to a particular group and do not show the complete impact for an individual. For example, a female who would be 42 in 2007 and who has a clerical job, would need to view the impacts for her age group (40-42), workers by type of employment (clerical and administrative workers) and gender considerations to get a complete picture of how the proposed reforms would impact her group. Moreover, reference to particular status, for example marital status, circumstances and commitments a person might have, is made in the various sub-sections of Section 05.

In the age-specific analysis, carried out in Section 05, the project team observed that those persons aged 43 and 44 in 2007 will be those most negatively affected by the proposed reforms to the pension system. This group will be the first group that will have their pension income calculated on the basis of 40 years contribution period and would not have Pillar 2 to supplement their pension income. This type of analysis was carried out for other specific age groups, namely:

- 60 – 55 age group;
- 54 – 49 age group;
- 48 – 45 age group;
- 44 – 43 age group;
- 42 – 40 age group;
- 39 – 36 age group;
- 35 – 26 age group;
- 26 – 16 age group; and
- future workers.

The project team carried out a similar analysis to assess the social impact of the proposed reforms on persons covered by the proposals depending on their type of employment, status of employment, whether they are public or private sector employees, full-time or part-time employees and also the impact on employer organisations of different sizes including the public sector. This Section also provides an analysis of the social impact, arising from the proposed reforms on persons with disability, widows, widowers and survivors, foreigners working in Malta and Maltese nationals working abroad, and gender specific impacts.

The specific impact on the various groups identified is depicted mostly by tables and graphical analysis.

Section 06 – Short, Medium and Long Term Assessment of Social Impacts

In Section 06, the issues and impacts brought forward in Sections 03, 04 and 05 are then assessed in three individual time frames as follows:

- the short term which refers to the period 2005 to 2010;
- the medium term which refers to the period 2011 to 2025; and
- the long term which refers to the period 2026 to 2050.

The project team noted that in the short term the proposed pension system would have a negative impact on retirees in terms of lower pension income. In the medium term, replacement rates would still be falling thus the positive impact of the proposed reforms would still not be felt by retirees in terms of higher pension income. Replacement rates start improving over the long term, when although replacement rates are still decreasing, they are higher than if the current system had to be maintained. Further improvements are expected over the period 2050 to 2072 when replacement rates would start increasing. During the period 2026-2072 retirees would benefit from higher pension income as a result of the reforms being proposed in the White Paper.

Section 07 – Determination of the Appropriate Responsibility of the State in Ensuring Adequate Pension Provision

Over the past years, people have mostly relied on the State for welfare support. In the proposed pensions reform the State is considering a shift from this reliance to the principle of self-help. Consequently, an assessment on the determination of the appropriate responsibility of the State in ensuring adequate pension provision and the balance to be attained with the principles of self-help and of individual choice was carried out in Section 07 of the report.

Section 08 – Mitigation Strategies for Arising Social Issues

Finally, Section 08 of the report identifies the major social issues and risks resulting from the implementation of the proposed reform to the pensions system put forward in the White Paper. A number of mitigation measures are proposed with the aim of offsetting the issues and risks arising from the implementation of the proposed pensions system. Risks include less spending power as a result of the introduction of Pillar 2 contributions and a potential increase in price hikes to compensate for higher costs of production resulting from the increase in contributions. Other risks that may result consist of the risk of a deficit in the Pension Account and of the risks arising from the choice of indexation mechanisms. The burden of Pillar 2 contributions on the unemployed (should the credit system not be applicable to such employees), an increase in the number of people claiming invalidity benefits as a result of an increase in retirement age, and the negative impacts resulting from the change in the calculation of pensionable income to the average of 40 years are amongst other identified risks.

Details on the above-summarised risks, together with other risks that were not mentioned in this summary may be found in the main body of the report. Such issues and risks together with their corresponding mitigation measures were grouped into a number of thematic areas, namely:

- consumption and savings;
- cost of production;
- pension account;
- indexing;
- credit system;
- retirement age;

- pension payouts;
- employment;
- social responsibility; and
- family friendly measures.

The mitigation measures outlined in Section 08 are not mutually exclusive. To ensure success and minimise the risks of the proposed reforms, the mitigation measures must be implemented as a holistic, integrated approach.

Details on each of the Sections summarised in the preceding paragraphs relating to the current and proposed pension systems may be found in the main body of the report.

Appendices

The report also contains four (4) appendices which provide supplementary information to the text, namely:

- Appendix 1 - Review of Social Impact Assessment Methodologies;
- Appendix 2 – International Social Security Association (ISSA) Feedback – this includes a report prepared by ISSA on Version 4 of the White Paper and communication between the Chairperson of the Pensions Working Group and ISSA in relation to the published version of the White Paper;
- Appendix 3 - Working of Projections of Pension Income; and
- Appendix 4 - Government Expenditure in EU Member States.

01 Introduction

This Social Impact Assessment of the proposals put forward in the White Paper "Pensions: Adequate and Sustainable", published in November 2004, is intended to provide an independent assessment of the proposals being put forward by the Pensions Working Group from a social standpoint. This report has been commissioned to the Management Efficiency Unit by the Pensions Working Group.

01.1 Social Impact Assessment

A Social Impact Assessment "includes the processes of analysing, monitoring and managing the intended and unintended social consequences, both positive and negative, of planned interventions (policies, programs, plans, projects) and any social change processes invoked by those interventions. Its primary purpose is to bring about a more sustainable and equitable biophysical and human environment"[1].

1.1.1 Social Impact

A social impact can be defined as a consequence to people of any proposed action that changes the way they live, work, relate to one another, organise themselves and function as individuals and members of society. This definition includes social-psychological changes, as are people's values, attitudes and perceptions of themselves and their community and environment.

01.2 Terms of Reference

The terms of reference established for this project were:

- o the identification of the stakeholder coverage of the proposed reforms to the pensions system;
- o the macro social impact if no changes are carried out to the pensions system;
- o the macro social impact of the proposed reforms to the pensions system and how these compare to (ii) above;
- o the social impact of the proposed reform on specific groups: employers, employees, women, current pensioners, persons at various stages of their work, persons who are yet to enter the workforce, etc;
- o that the social impact in (ii), (iii) and (iv) above assess the short term (2005 – 2010), the medium term (2011 – 2025), and the long term 2026 – 2050);
- o an assessment on the determination of the appropriate responsibility of the State in ensuring adequate pension provision and the balance to be attained with the principles of self-help and of individual choice; and
- o an articulation of the mitigation strategies for arising social and economic issues.

01.3 Methodology

Following a review of documentation related to social impact assessments (SIAs), which can be found in **Appendix 1**, the project team decided to adopt a mix of qualitative and quantitative research methods as indicated by the World Bank in undertaking this assignment.

Quantitative research methods may be termed as a type of research which uses numbers for data and statistics to analyse results. On the other hand, qualitative research methods produce data that is not easily translated into numbers. In social research, the latter method is widely recognised as a useful scientific technique to analyse data[2].

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[1] International Association for Impact Assessment (2003) *Social Impact Assessment - International Principles*. Special Publications Series No.2 May 2003.

[2] Rubin A. & Babbie E. (1997) *Research Methods for Social Work*, Third Edition. Brooks/Cole Publishing Company, London

In order to carry out the quantitative analysis the project team made use of the data and simulations available to it. This quantitative analysis provided useful objective, measurable information that was used as a basis for the identification of likely social impacts of the current and proposed pension system.

Qualitative research methodologies were chosen by the project team since the quantitative analysis could only be restricted to limited data and projections and produced only financial information. Factual and quantitative data on the social impact of similar reforms in other jurisdictions was difficult to obtain.

Therefore in order to carry out the social impact assessment the project team chose to use the quantitative research method to determine the changes which are likely to result form the proposed reforms and the qualitative research method to identify the effects that are likely to result from the changes. Therefore the project team focused more on documentation review, on observations gathered during seminars, and other qualitative research methods.

From the review of SIA methodologies (**Appendix 1**), it also resulted that most SIAs focus on public and stakeholder involvement. Moreover, some of the models that were reviewed adopt a proactive or active approach in the formulation of the SIA. While taking into consideration these factors, given the time constraints and the nature of the issues, the project team decided to exclude focus groups and other direct involvement.

Therefore, the main research methods used by the project team consisted of the following:

- documentation review:
  - review of the White Paper on the proposed pension reform entitled "Pensions: Adequate and Sustainable" and other literature provided by the Pensions Working Group;
  - review of other documentation including the World Bank Report[3], the International Social Security Association (ISSA) Report[4] and other reports prepared by the constituted bodies; and
  - review of documentation in relation to social impact assessments and impacts of pension reforms in foreign jurisdictions.
- observations and feedback from the general public and other stakeholders:
  - review of press cuttings and feedback from the general public on the website: www.pensions.gov.mt that dealt with the various responses to the pensions debate; and
  - feedback gathered from seminars that the project team attended on the proposals in the White Paper.
- quantitative analysis:
  - use of the Pension Reform Options Simulation Toolkit (PROST) to simulate the proposals of the White Paper using the data files provided by the World Bank; and
  - use of the Household Budgetary Survey (2000) for calculation purposes.

In Section 02, the stakeholders were mainly identified through a review of related documents, in particular the White Paper, whereby the project team identified which stakeholders are covered by the proposals in the White Paper. These stakeholders were broken down into specific groups.

The following two sections, Section 03 and Section 04, present an analysis of the macro social impact if no changes are carried out and of the macro social impact of the proposed reforms to the pensions system. Following a review of documentation (refer to **Appendix 1**) that indicates the

[3] World Bank (2004) *The Maltese Pension System: An Analysis of the Current System and Options for Reform.*

[4] ISSA (2004) *Observations' on "The Modernisation of Pensions Framework: Securing Sustainable Adequacy" – Malta Draft 4.0, 24 August 2004*

variables/categories a social impact assessment should address, the project team decided to group the social impacts into the five categories of impacts defined in the EIA Training Course Manual (2002) "Social Impact Assessment", namely:

- o *Lifestyle* relating to the way people behave and relate to family, friends and cohorts on a day-to-day basis;
- o *Cultural* relating to shared customs, obligations, values and other elements which make a social group distinct;
- o *Community* relating to infrastructure, services, and social cohesion;
- o *Quality of life* relating to sense of place, perception of belonging, security and liveability, and aspirations for the future; and
- o *Health* relating to mental, physical and social well being.

As highlighted earlier, the quantitative analysis consisted of an analysis of the output produced by PROST, as well as, projections of pension expenditure coverage by using data from the Household Budgetary Survey and PROST.

PROST is a computer-based tool designed by the World Bank to model pension contributions, pension benefits, system revenues and expenditure. The model, which is in use in over 46 countries worldwide, enables users to assess the current and future adequacy and fiscal sustainability of their individual pension system. PROST can be used to model different reforms and assess their impact over a long time frame. The model provides policy-makers with a quantitative analysis of pension regimes and allows policy-makers to make informed decisions on the basis of simulations, adapted to the particular circumstances of a country, provided by the model.

Following the attendance to a training programme organised by the World Bank, members of the project team obtained the user's licence of the PROST 11, which was used in the formulation of **Tables 1**, **3**, **4**, **8**, **11**, **12**, **13**, **14**, **15**, **16** and **18** together with **Figures 1**, **2**, **3**, **4** and **5** found in the report.

PROST files modelling options for reform in the Maltese pensions system, namely the base case for Malta (Filename: Malta basec) and the reformed scenario (Filename: Malta 2cp6750) were used to carry out the projections given in the report. The data input to the files was carried by the World Bank on behalf of the Pensions Working Group. The demographic data applied in these files was obtained from the World Bank through the Malta Council for Economic and Social Development (MCESD).

In order to study the social impact on current and future pensioners in terms of their disposable income an exercise using data from the Household Budgetary Survey and PROST was carried out. The Household Budgetary Survey (2000)[5] provides 11 household categories, two of which include pensioners. These two categories were those considered for this exercise, namely:

- o a household consisting of one adult 65+ which will be referred to as **Household 1**. This household represents a typical retiree who holds the status of a single person or a widow/widower; and
- o a household consisting of 2 adults, no dependent children with at least one adult 65+ which will be referred to as **Household 2**. This household is typical of a married couple aged over 65 years of age.

The average annual expenditure of these two representative households was derived from the Household Budgetary Survey. These figures were used in several Tables throughout the report, namely: **Tables 2**, **6**, **19**, **20**, **21** and **22**. The average pension that will be received by retirees retiring during the period 2005-2072 was computed through the product of the replacement rate and the average wage. The average wage for the projection period 2005-2072 was adjusted by the annual real wage growth, which was assumed to amount to 3% in line with the assumptions made in the White Paper. The rate of real wage growth takes into account the COLA. The latter takes into

[5] National Statistics Office (2000) *Household Budgetary Survey*

consideration the inflation rate of the particular year. Since inflation is already partially included in the average wage, the average pension figures for the projection period were not adjusted to inflation. These computations were then used to show how much of the average annual expenditure of the two households would be covered for by the pension income received.

The average annual expenditure, referred to above, refers to the two households' average annual expenditure on the basket of goods, defined in the Household Budgetary Survey, which covers expenditure on:

- food, beverages and tobacco;
- clothing and footwear;
- housing and energy;
- household equipment and house maintenance;
- health;
- transport and communication;
- recreation and culture;
- education, catering and accommodation services; and
- other services.

The average that the two households spent in the year 2000 to buy the above commodities was taken and the values of this average annual expenditure, for the two households, for the period 2005 to 2072 was calculated assuming a 2.5% inflation as per the assumption taken in the White Paper.

The complete data set for this exercise and explanatory notes can be found in **Appendix 3**.

The terminology used in the tables as well as throughout the report is defined in the **Glossary** found in the beginning of the report.

01.4 Acknowledgements

The project team acknowledges the assistance provided by the following persons, who contributed in the process that has ultimately led to the formulation of the Social Impact Assessment, namely:

Mr David Spiteri Gingell, Pensions Working Group

Mr Gordon Cordina

Ms Sue Vella

National Statistics Office

Economic Policy Division

Ms Tatyana Y Bogomolova, World Bank

Department of Social Security

01.5 Disclaimers

The Social Impact Assessment (SIA) does not reflect the findings of the following:

- the Actuarial Studies relating to the parameters of Pillar 2, commissioned by Government through the MFSA, to an international firm of actuaries; and
- the Economic Impact Assessment commissioned to the Economic Policy Division.

These two documents are not considered in the Social Impact Assessment since a final version of these reports was not available to the project team at the time of publication of this document.

The PROST projections featured in this report are based on the data files, provided to the project team by the World Bank. The data in these files was not subject to validation in the context of the preparation of this report.

During the PROST training course it was noted that the proposed extension in the retirement age as modelled in PROST did not reflect the White Paper proposals. The White Paper proposes that the increase in retirement age is as follows:

- 61 for those retiring till 2013;
- 62 for those retiring in the years 2014 - 2017;
- 63 for those retiring in the years 2018 - 2021; and
- 65 for those retiring as from 2022.

In the years in between PROST extrapolates the extension in retirement age by gradually increasing the retirement age on an annual basis. For example in PROST if one enters the retirement age as 62 in 2014 and 63 in 2018, PROST automatically extrapolates this as if those retiring in 2015, 2016 and 2017 are to retire at the age of 62.25, 62.5 and 62.75 respectively. The project team therefore thought it was necessary to modify this data to reflect the proposals in the White Paper.

The period considered in the analysis of this report covers the years 2005 to 2072 since it reflects the timeframe for the PROST projections provided in the data files.

The analysis and calculations carried out in this report reflect the assumptions taken in the White Paper, in particular the following assumptions were used:

- an inflation rate of 2.5%;
- a real annual GDP growth of 4% until 2020 and of 2.5% thereafter; and
- a real annual wage growth of 3%.

Furthermore, it should be noted that the ISSA (2004) report found in **Appendix 2** is based on a previous draft of the White Paper which was prepared in August 2004 (Version 4). Therefore, the references as well as some of the observations made are not applicable to the White Paper (November 2004). **Appendix 2** also contains communication between the Chairperson of the Pensions Working Group and ISSA in relation to the published version of the White Paper.

Unless otherwise specified, any age reference in the report refers to the age of individuals as at 1st January 2007 in line with those provided in the White Paper.

02. Identification of Stakeholder Coverage

The proposed reforms of the pensions system would undoubtedly affect a number of stakeholder groups. These include those persons, groups or entities that would be affected positively or negatively by the proposed reforms to the pensions system.

02.1 Stakeholders Covered by the Proposed Pension System

In identifying the stakeholder coverage in terms of those individuals or entities that could potentially be impacted by the proposed reforms to the pensions system, it has been thought useful to classify these stakeholders in two distinct categories, namely:

- contributors and beneficiaries; and
- implementation stakeholders.

2.1.1 Contributors and Beneficiaries

Contributors and beneficiaries are those persons, groups or entities that would be affected by the proposed pensions system in terms of either the contributions they make or the benefits they receive. In a sense these stakeholders are the main "givers" and "takers" that would ultimately secure the sustainability of the system. The contributors and beneficiaries were further divided into different categories, namely:

- workers by age (young workers, middle age workers and those nearing retirement age);
- current pensioners;
- workers by status of employment;
- workers by type of employment;
- employers;
- gender considerations;
- persons with disability;
- widows, widowers and survivors; and
- foreigners working in Malta and Maltese working abroad.

Some of the categories were subsequently broken down into further sub-groups, such as age in the case of employees, based on similar characteristics that prevail in the various sub-groups. Having similar characteristics can mean that there are certain commonalities in the way the members of the sub-group are affected. The categories and sub-groups that have been identified are expanded further hereunder.

Workers by age (young workers, middle age workers and those nearing retirement age)

Each age group was chosen on the basis of common features applicable to the members of these groups that would result from the proposed gradual implementation of the different measures. Some of the groups would be affected more than others as indicated hereunder. A detailed analysis of the rationale used in the selection of these groups and the respective social impact accruing to these groups is given in Section 05 of the report. The categories of ages refer to the respective age as at 1st January 2007.

- Future workers (nearing 16/18);

  This category of workers is faced with important decisions such as whether to pursue their studies or enter the world of work, a decision which might be influenced by the pensions system that is being proposed in the White Paper.

- 16/18 – 25 age group;

  The members of this age group have either just started working or else are furthering their studies.

- 26 – 35 age group;

  Persons forming part of this age group or a younger age group would retire at 65 and although they would have less years of Pillar 2 contributions than a younger age group they are expected to have a more adequate return on their investment.

- 36 – 39 age group;

  The members of this age group would retire at 65 and would have their accumulation period for the Two-Thirds Pillar 1 Scheme increased from 30 years to 40 years. This age group can only have a maximum of about 29 years of contributions on Pillar 2 before they reach retirement age.

- 40 – 42 age group;

  This age group would retire at 65. The accumulation period for this age cohort is increased from 30 to 35 years. The base-line for calculation of the Two-Thirds Pillar 1 Pension for this group would be the average of income earned over a 40 year period.

- 43 – 44 age group;

  The accumulation period for this age group is increased from 30 years to 35 years with the retirement age being 65 years. All those that are younger than 44 years would have their Two-Thirds Pillar 1 Pension calculated on the average of the total years of contributions.

- 45 – 48 age group;

  The workers forming part of this age group would have their Pillar 1 Pension calculated on the average of the best 10 years and would retire at 65 years of age. This age group would have the contribution period unchanged except for the 45 year olds whose contribution period would increase from 30 to 35 years.

- 49 – 54 age group;

  This category of workers would retire at 62 or 63 years and would have their Pillar 1 Pension calculated on the average of the best 5 years except for the 49 year olds who would have their Pillar 1 Pension calculated on the average of the best 10 years. The contribution period for this age group would remain unchanged at 30 years.

- 55 – 60 age group;

  Workers within this age cohort would not be affected by the change in retirement age, in the accumulation period and the base-line for calculation of the Pillar 1 Pension.

Current Pensioners

The proposals put forward in the White Paper will not affect the current pensioners and those individuals who will retire prior to the implementation of the reform. Pensions received by the two aforementioned categories will still be subject to the Cost of Living Adjustment (COLA) and will not be indexed to inflation as is being proposed in the White Paper.

Workers by Status of Employment

Consideration was also given to the different status of employment of the local population, as the reforms to the pensions system proposed in the White Paper would impact such workers in different ways. The project team addressed all the possible status of employment that people in the formal labour market can have through the categories identified hereunder:

- the unemployed;
- private and public sector (post 1979) salaried employees;
- full time, part-time and temporary employees; and

- self-employed persons.

Workers by Type of Employment

Not all sectors or types of employment would be impacted in the same way, and therefore they have been classified as:

- manual or technical workers;
- clerical or administrative workers; and
- professional or managerial workers.

Employers

The employers are “givers” to the system as they would contribute for both the Pillar 1 and the Pillar 2 Pensions Scheme. Employers have been subdivided into the following categories:

- public service/sector (public majority, independent statutory bodies, ministries and departments);
- micro and small private enterprises[6] – these refer to those enterprises employing between 10 to 50 persons and which have an annual turnover between EUR 2 million and EUR 10 million; and
- medium-sized and large private enterprises – these refer to those enterprises employing more than 50 persons and which have an annual turnover of EUR 50 million or more.

Gender Considerations

The proposed pensions system tries to address the discrimination and challenges associated with the present system.

Persons with a Disability

The proposed reform to the pensions system tries to address the increase in atypical types of employment and the disincentive for part-time employment. Therefore, persons with a disability who cannot work on a full-time basis are covered by the proposed pensions system.

Widows, Widowers and Survivors

The Widows’ Pension and the Widowers’ Pension are payable to widows or widowers who are not gainfully occupied irrespective of age or who are carrying out gainful activities but have the care and custody of children under 16 years of age. The Survivors’ Pension is an earnings-related pension payable to a widow whose husband was entitled to a Two-Thirds’ pension or whose husband would have been entitled to a pension had he reached retiring age at the time of his death.

As the proposed pensions system covers all contributory benefits, but mentions no specific measures for the widows, widowers and survivors pensions, it appears that in terms of Pillar 1 these would be affected in the same way as the other stakeholders covered. With regards to Pillar 2, the proposed pensions system would need to be amplified in relation to the regulation of what the widows, widowers and survivors of a person who would be entitled to a Pillar 2 Pension would be eligible for, if the person passes away either before or after retirement age.

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[6] Commission Recommendation 2003/361/EC concerning the definition of micro, small and medium-sized enterprises.

Foreigners Working in Malta and Maltese Nationals Working Abroad

The reality of Malta's accession to the European Union is likely to result in employment patterns that reflect a certain degree of mobility by other EU nationals who may elect to work for a period of time in Malta. In the EU provisions on social security there are two basic principles[7]:

- a worker is subject to the legislation of only one Member State[8]; and
- an employee whether employed or self-employed is insured in the country where he or she exercises his/her occupational activity.

Therefore, a person who elects to seek employment in another Member State would become subject to the legislation of the "new" country of employment.

EU legislation provides for a mechanism by which contributions in different Member States are aggregated, and final social security pensions are paid by different Member States in proportion to the contribution made in that country. Under the principle of "aggregation", if contributions are fewer than the mandatory number to qualify for a full Two-Thirds pension then account is taken on contributions in other Member States, and contributions are aggregated.

It is assumed that provisions would have to be made for the portability of Pillar 2 Pensions. The proposed pensions system does not specify the mechanism that would be applicable to cater for the mobility aspect that is likely to result in the labour market.

2.1.2 Implementation Stakeholders

Stakeholders identified under this category are mainly those institutions that, in some way or another, have a responsibility for the implementation of the proposed reform to the pensions system. In this respect the institutions that have been identified include the:

- Government;
- Malta Financial Services Authority (MFSA); and
- Banks and Financial Intermediaries.

Government

Government has more than one role in the implementation of the proposed reform to the pensions system, which can be divided into its:

- social obligation;
- financial responsibility; and
- political image and mandate.

MFSA

The Pillar 2 Pensions Scheme and Pillar 3 Pensions Scheme once implemented are to be regulated in order to ensure that Funds are performing in the desired way and in order to protect the beneficiaries. The proposed reform to the pensions system indicates the MFSA as the entity that should be entrusted with this regulatory mandate.

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7 More detailed information can be found on the website of the International Relations Unit (MFSS): http://www.msp.gov.mt/services/subpages/content.asp?id=1627&heading=International%20Relations%20Unit.

8 Workers are generally subject to the legislation of the state in which they are working, regardless of their place of residence or the location of the employer. However, persons employed in more than one state are subject to the legislation of their state of residence. If the worker does not reside in any of the states of employment, then the legislation of the state where the employer is situated applies. Furthermore, persons simultaneously employed and self-employed in two or more Member States will generally be subject to the legislation of the state of employment.

Banks and Financial Intermediaries

The banks and financial intermediaries would offer products intended to provide pension incomes that do not fall under the responsibility of the State.

02.2 Stakeholders not covered by the proposed pension system

It should be noted that a number of other categories have been identified which, however, do not fall within the remit of the proposed pensions system. These include:

- pre 1979 Public Service employees (in relation to their service pension);
- the Armed Forces and Police personnel (in relation to their service pension);
- Members of Parliament; and
- Maltese nationals working in Third Countries.

Pre 1979 employees within the Public Service

Public Officers who were employed with the Public Service prior to 1979 are entitled to a pension or a retiring allowance under the Pensions Ordinance (Cap. 93), which does not exceed two-thirds of the highest pensionable emoluments drawn by him/her at any time during his/her service in Malta. The Pensions Ordinance had in-built in it a provision wherein the retiree could exercise the option of "selling off" a portion of his/her pension in return for a gratuity payable as a lump sum upon retirement. Moreover, prior to 1979 there were the National Minimum Pension, the Retirement Pension and the Increased Retirement Pension, which are normally referred to as the flat rate pensions. Persons, including the public officers, paid flat rate contributions and were awarded a flat rate pension according to the average of contributions paid during the insured person's life. Within the Public Service there are still a significant number of persons who are still governed by this Framework and for whom no provision on the Pensions Ordinance has yet been made within the proposed pensions system.

The Armed Forces and Police Personnel

Persons employed as army officers or police officers, including those employed after 1979, are entitled to a pension or a retiring allowance under the Pensions Ordinance (Cap. 93) and to retire from the service after 25 years full service. As per article 16 of the Social Security Act (Cap. 318), ex-members of the Malta Police Force or of the Armed Forces of Malta have their contributions credited if when they retire on completion of service they have not yet reached pension age. The White Paper provides no guidelines on how officers with the Army or the Police force are to have their flat rate pensions regulated.

Members of Parliament

The Members of Parliament Pensions Act (Cap. 280) makes provision for the payment of a pension to Members of Parliament including details on how the pensionable emolument of a President of Malta, Prime Minister, Speaker, Deputy Speaker, Minister, Parliamentary Secretary, Leader of Opposition and should be calculated. Members of Parliament who are elected to the House of Representatives for at least 2 legislatures and for more than 65 months in aggregate are entitled to a Parliamentary pension over and above the honorarium and the pension derived from their original employment. Again, the proposed pensions system does not in any way regulate this form of pension.

Maltese Nationals Working in Third Countries

A number of Maltese nationals have opted, and would continue to opt, to work overseas. Malta has a number of bilateral agreements with third countries[9] with a view to safeguard the mechanism for such persons to, amongst other issues, receive a state pension. However, there are still a number of countries outside the EU with whom Malta has not developed any bilateral agreements. The proposed

[9] Bilateral reciprocal agreements have been signed with UK (1956), Australia (1991), Canada (1992) and Netherlands (2002). An agreement also exists with Libya (1990) that permits Maltese workers in Libya to pay their National Insurance Contributions in Malta.

pensions system does not make any specific provisions for individuals opting to work under these conditions.

02.3 Conclusion

This Social Impact Assessment addresses only those stakeholders who have been identified as Contributors, Beneficiaries and Implementation Stakeholders. It is important to highlight that the proposed pensions system would need to be amplified in order to regulate those categories that have been identified as stakeholders but who have a different pension regulatory framework for which the proposed reform to the pensions system provides no specific guidance. Although the number of individuals in these categories may be small compared to those who are directly regulated by the proposed pensions system, the number may be significant and any new system cannot afford not to cater for atypical pensionary provisions applicable to certain groups of society.

03. Macro Social Impact if No Changes are Carried Out

If the current pension system is retained, the main issues relating to such a scenario are related to the adequacy of the pension and the financial sustainability of the system.

PROST simulations, shown in **Table 1,** show that should the current pension system be maintained, with a 3% positive real wage growth, the average replacement rate, which is the ratio of the average pension to the average wage, would fall from 56.9% in 2002 to 8.3% in 2072. No definition or benchmark exists of an optimal replacement rate. This is so since the replacement rate depends on many factors, ranging from a country's level of economic development, the taxation system to access to housing, healthcare etc. Typically, it varies from 40% to 60% of an individual's net income, for an average, full-career middle-income individual. With this in mind, the replacement rates given in **Table 1** highlight the problem of inadequacy of the pension particularly as from the year 2030.

Table 1: Replacement Rates for Existing 2/3 Pensioners[10]

Year	2002	2005	2010	2020	2030	2040	2050	2060	2070	2072
Average Replacement Rate for Existing 2/3 retirement pension	56.9%	57.8%	55.6%	46.2%	32.5%	21.5%	15.2%	11.2%	8.7%	8.3%
Male	61.4%	61.4%	57.4%	46.5%	32.3%	20.6%	14.5%	10.8%	8.4%	8.0%
Female	44.9%	49.2%	51.5%	45.6%	33.0%	22.9%	16.3%	11.9%	9.0%	8.6%

Source: PROST 11 Malta Files

In addition to the above, **Table 2** shows the average pension income, for the period 2005 to 2072, if the current system is maintained. In order to study the social impact on current and future pensioners in terms of their disposable income the exercise explained in Section 01.3 using data from the Household Budgetary Survey and PROST was utilised.

Table 2 clearly depicts the inadequacy trend that characterises the current pension system. Currently, the average pension covers a significant proportion of the average annual expenditure of the above-mentioned households. This proportion would deteriorate over time as illustrated in the Table. As can be seen, if no reform is carried out to the pension system, the average pension income would only cover 14% of the average annual expenditure of Household 1, and 10% of the average annual expenditure incurred by Household 2 in 2072.

Table 2: Projections of Average Pension Income under Current System

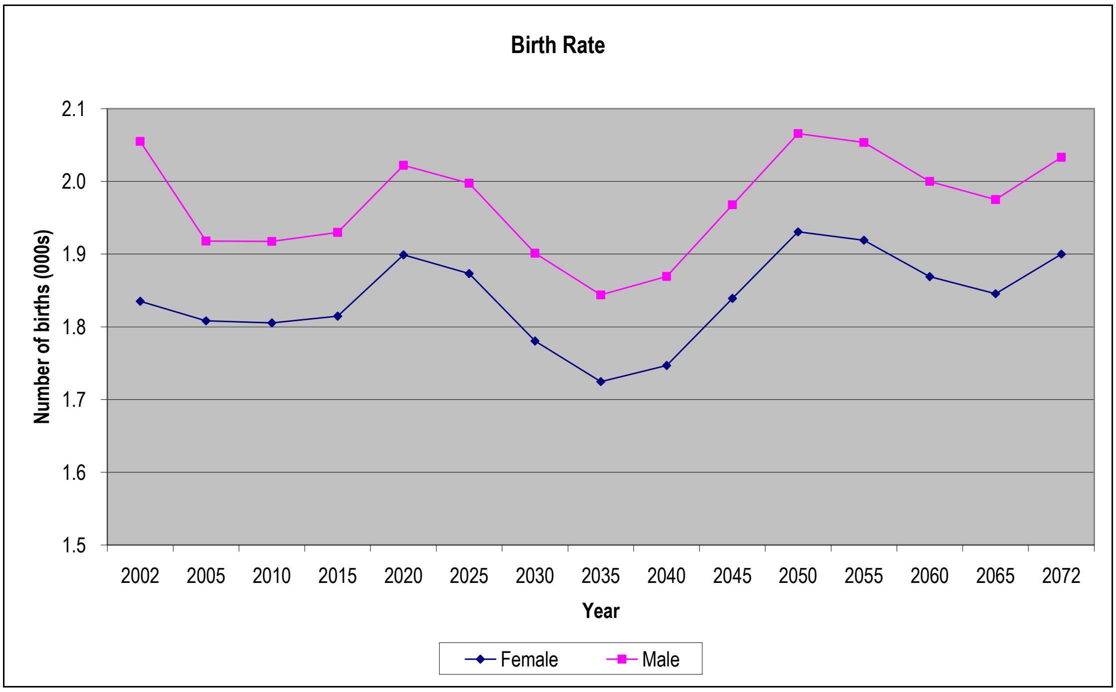
Year	2005	2010	2020	2030	2040	2060	2072
Average Pension (Lm)	2,545	2,837	3,172	3,000	2,668	2,514	2,638
Household 1: % of average annual expenditure covered by average pension	71	70	61	45	31	18	14
Household 2: % of average annual expenditure covered by average pension	49	48	42	31	22	12	10

Demographic changes, such as the decrease in the birth rates and an increase in life expectancy, shown in **Figures 1 and 2**, will impact the financial sustainability of the pension system. This is because under a Pay-As-You-Go (PAYG) system today's workers (contributors) pay for the pension of today's retirees (pensioners). Therefore with less contributors, as a result of the changes in the birth

[10] The Average Replacement Rates used in the report refer to the Average Replacement Rate for Existing 2/3 retirement pension and the Average Replacement Rate for New 2/3 retirement pension. The definitions of these rates can be found in the Glossary.

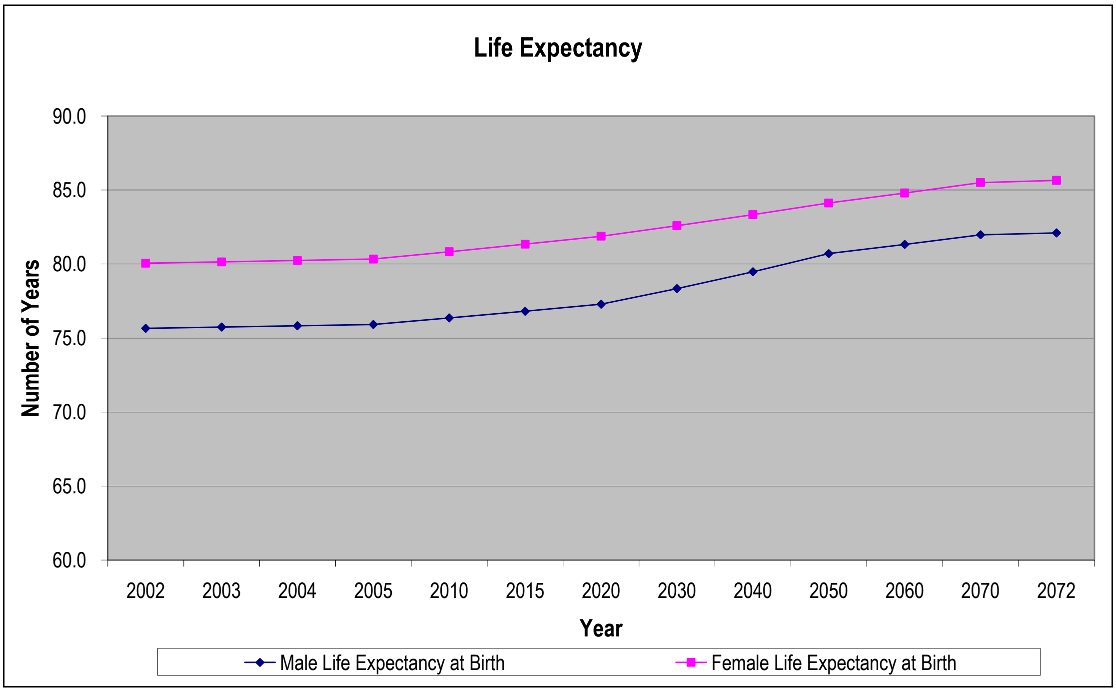
rate, and more pensioners, as a result of increases in life expectancy, the current pension system will become unsustainable.

Figure 1: Birth Rate



Source: PROST 11 Malta Files

Figure 2: Life Expectancy



Source: PROST 11 Malta Files

Table 3 illustrates the financial sustainability of the current pension system as projected by PROST.

Table 3: Financial Sustainability of Current Pension System (excluding Government Contributions)

Year	2002	2005	2010	2020	2030	2040	2050	2060	2070	2072
PAYG Total Revenue [1]	120	116	150	230	286	331	381	442	549	575
Employer and Employee Contributions	120	116	150	230	286	331	381	442	549	575
PAYG Total Expenditure	130	147	223	454	755	1,094	1,613	2,408	3,122	3,256
Pension Payments	121	137	210	433	729	1,067	1,587	2,382	3,100	3,236
Other Payments	6	6	9	14	18	17	14	13	5	3
Administrative Costs	4	3	4	7	9	10	11	13	16	17
PAYG Current Balance	(10)	(31)	(73)	(223)	(469)	(763)	(1,231)	(1,967)	(2,574)	(2,681)
1. All figures in this table are in Lm millions.										

Source: PROST 11 Malta Files

It must be noted that to calculate the pensions deficit, PROST does not take into consideration Government's contribution. **Table 4** depicts the financial sustainability of the current pension system with Government's contribution which consists of half that paid by the employers, employees and self-employed.

Table 4: Financial Sustainability of Current Pension System (including Government Contributions)

Year	2002	2005	2010	2020	2030	2040	2050	2060	2070	2072
PAYG Total Revenue [1]	180	174	225	346	429	497	572	662	823	863
Employer and Employee Contributions	120	116	150	230	286	331	381	442	549	575
Government Contribution	60	58	75	115	143	166	191	221	274	288
PAYG Total Expenditure	130	147	223	454	755	1,094	1,613	2,408	3,122	3,256
Pension Payments	121	137	210	433	729	1,067	1,587	2,382	3,100	3,236
Other Payments	6	6	9	14	18	17	14	13	5	3
Administrative Costs	4	3	4	7	9	10	11	13	16	17
PAYG Current Balance	49	27	2	(108)	(326)	(597)	(1,040)	(1,746)	(2,299)	(2,394)
1. All figures in this table are in Lm millions.										

Source: PROST 11 Malta Files

Table 4 shows that even when including Government's contribution although in the short-term, the PAYG Balance is positive, in the medium and long term, the balance becomes negative and increases at increasing rate.

Both **Table 3** and **4** show an increase in the welfare gap which would mean an increased expenditure for Government. This may necessitate an increase in taxation, a decrease in other Government expenditure, and/or increase in borrowing to cover the gap. These mitigation strategies which would only address the sustainability aspect of the pension system, would have resulting negative social repercussions on society.

The following paragraphs, based on the above projections, discuss the main social impacts that would result in the future if the current pension system is maintained.

03.1 Lifestyle Impacts

With the concept of self-help with regards to pensions which has not taken root, as well as the perception many have that the future is far too distant and would, in any event take care of itself, it is unlikely that people are today planning for their retirement in advance in order to supplement their pension. Statistics show that people are saving less and consuming more – assuming that people are consuming 98.7% of their disposable income (1.3% saving ratio)[11] – this means that if current trends persist people would not have saved enough during their working life to boost their pension income during retirement. This would lead to them having to change their consumption patterns at retirement. For example, a person who earned an average of Lm8,000 during his last years in employment and hardly saved or invested throughout his working life, would today end up with a pension of Lm4,500 per annum. This would mean that the disposable income of this individual has halved on retirement, and therefore his/her consumption and lifestyle would need to change to reflect the reduction in income. As replacement rates continue to decrease (see **Table 1**), pensioners would have less disposable income for consumption.

Another lifestyle impact relates to the independence of the pensioner. As can be seen from **Table 2**, if under the current system pensioners will not have an adequate pension to meet their essential needs, they would have to rely on family members or the community for support. This would result in the pensioner depending on others after he/she has been accustomed to a lifestyle of independence and always meeting his/her own needs, demands and expectations. This may also result in the re-emergence of the "extended family" in that pensioners would need to depend on their children or relatives to meet their expenditure. This lack of independence may also make the pensioners feel that they are being looked down at by society and that other age cohorts are pitying them.

The inadequacy of the pension may also impact the social life of the pensioner. For example, the pensioner would not have enough disposable income to maintain a quality social life as their disposable income would not permit this.

Today, even though a fixed portion of employee salaries goes to NI contributions every month, one hardly worries about becoming a pensioner as it is assumed that when one reaches that age, the state pension would suffice for a decent standard of living. The uncertainty of the future and the fear of inadequacy of the pension would cause some of today's workers to think in advance of their old age. Decisions on how much to save and how much to spend and on what to spend one's income, would influence one's lifestyle.

03.2 Cultural Impacts

Whereas there is a trend towards changing gender roles, whereby the male and female both contribute towards the income of the family, the current pension system is based on a traditional family pattern where the man is the main breadwinner and the wife is the full-time home carer who is dependent on her husband for income support. Therefore the current pension system has a cultural impact on the developments in the gender roles since it does not offer incentives for part-time or other atypical employment.

Also, since the current pension system does not recognise family responsibilities for pension entitlement purposes, it increases pressures on both parents to also work while the children are young in order to qualify for a pension – two pensions would always be more adequate than one.

As result of life expectancy changes, some persons retiring at 61 are still fully active, capable and willing to remain productive. Pensioners need a sense of belonging and achievement and traditionally remain very involved with their children's families and businesses. This may lead to a positive social impact in that it contributes to the values of sharing and helping out family members whereby the elderly may help alleviate both time and financial pressures from young family members where both partners are working. This help could include tasks such as childcare, shopping, house work and other jobs.

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[11] White Paper - *Pensions: Adequate and Sustainable (2004)*, Table 06: Savings Ratio.

The inadequacy of the state pension may lead to a conflict between the ‘old’ (pensioners) and the ‘young’ (job seekers). Since the old would still be able to work at the age of 61 but may be disincentivised to remain in the labour market, they might resort to employment in the informal economy. In a scenario where the young are more worried about their future and need to work, this becomes a threat to them and would lead to social tensions between the young and old.

The dependence of pensioners on other members of society, may also lead to an increase in age discrimination whereby the younger generations would look at the older generation as an additional financial burden, and as the cause of a decrease their disposable income.

03.3 Community Impacts

With an increase in the aging population, the demand for services for the elderly such as homes for the elderly, health services, home services including cleaning, nursing and maintenance, day care centres, and meals on wheels is already on the increase. With the current pension system not being adequate for pensioners in the future, more pensioners may end up not affording these services. This would result in increased pressures on the Government infrastructure, the community, non-governmental organisations and the neighbours to provide these services at a cost to the community. In addition, as a result of the welfare gap and in order to sustain the pension system, Government may need to reconsider the provision of its services in order to reduce its expenditure, including some of the services mentioned earlier on in this paragraph. Therefore the community and non-governmental organisations would need to shoulder this responsibility and provide these services to the elderly.

Additionally, should the current system be maintained, Government may need to for example decrease the non-contributory benefits as a result of the increase in the welfare gap. This would lead to a negative social impact on families and those needy in society. Further pressures may therefore be placed on the community in addition to those resulting from the increase in the needs of the elderly.

03.4 Quality of Life Impacts

The decrease in the average pension as a percentage of the average wage would result in a negative quality of life impact for pensioners because in comparison with other citizens, that is, those in employment, their income would be considerably lower. As **Table 1** illustrates, the replacement rate, which portrays the average pension as a ratio of the average wage in a particular year is projected to continue to fall until it reaches around 8% in 2072. In its report[12], the World Bank stated that a replacement rate of 12 % is not adequate to sustain a decent standard of living, let alone one which is around 8%.

In addition, should the current pension system be maintained, Government may need to increase taxation in order to reduce the pension deficit. This increase in taxation would lead to a decrease in disposable income which would lead to a decrease in consumption and saving. A decrease in consumption would affect the standard of living which could in turn impact on the quality of life of individuals. In order to maintain the same standard of living, individuals would be required to decrease their saving, at the expense of having a low standard of living during retirement.

The contribution ceiling has been set at Lm6,750 since 1987. Should the current pension system be maintained, as wages increase, nearly everyone would reach the maximum pensionable income. This would mean that hardly anyone would be paying an NI contribution of 10% of income as employees would be earning salaries which are higher than the ceiling. The percentage of income being paid as NI contributions would decrease as salaries would increase further above the ceiling. This would mean that employees would have higher disposable income as a percentage of total income earned, however, unless they saved part of their income, they would end up with inadequate earnings during their retirement, and therefore a higher quality of life during employment at the expense of a lower quality of life during retirement.

Whereas nowadays people during their working life look forward to retiring to enjoy quality of life and finally getting the break, recognition and reward for one’s hard work, future pensioners would look at

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[12] World Bank (2004) *The Maltese Pensions System: An Analysis of the Current System and Options for Reform*

retirement negatively and with the fear of ending up in poverty. Consequently, people might perceive a deterioration of their quality of life during retirement.

The uncertainty of the future and the fear of inadequacy of the pension would cause some of today's workers, even those at a relatively young age, to think about their future and change their lifestyle to save for the future. However, if there is not sufficient and professional guidance as well as regulation on investments, a bad decision today may result in an adverse effect tomorrow with the quality of life for the future pensioners being at risk.

03.5 Health Impacts

With the current system not being adequate, in the forthcoming years, for pensioners to live a decent standard of living, pensioners may experience increased stress and anxiety to try to make ends meet.

This is further aggravated by the following scenarios:

- demand on services for the elderly could lead to increased prices to be borne by the elderly themselves;
- with efforts being made by Government to increase employment participation, in particular women participation, this would mean that old people are unlikely to be able to rely on the extended family to care for them because their children would be in employment; and
- with decreasing birth rates, old people would have less children to rely on to take care of them. In addition, with the increase in single people without children, it will be unlikely that these people have anyone to rely on in their old age.

If the services provided by Government for the elderly, such as cleaning services and meals on wheels, do not meet the increased demand due to an aging population, and the elderly could not afford to obtain these services from the private sector, health impacts due to for example a lack of hygiene and malnutrition may result.

As discussed in the lifestyle impacts, the social life of pensioners could take the back-burner due to the inadequacy of the pension. This increase in isolation may lead to negative effects on the mental health of pensioners and to a negative outlook on the life of the pensioner.

As a result of longevity, in the future, people would still be fit to work at the retirement age under the current pension system. However, since the current pension system disincentivises people to work beyond the retirement age, they may still decide to retire at 61 even though they could work longer. The fact that they retire and are unproductive may result in mental health impacts such as melancholy and depression.

03.6 Conclusion

From the potential social impacts discussed above, one may conclude that the problems of inadequacy and financial sustainability of the current pension system would mainly lead to issues associated with:

- social exclusion of pensioners due to poverty on retirement;
- maintaining a decent standard of living on retirement;
- social tensions between the young and the old and age discrimination;
- increasing Government revenue or decreasing Government expenditure in order to reduce the welfare gap; and
- discrepancies between trends in today's society, such as gaps in labour market participation, and the current pension system.

04. The Macro Social Impact of the Proposed Reforms to the Pensions System

04.1 The Proposed Reforms to the Pensions System

The reform of the pensions system, proposed by the Pensions Working Group in the White Paper, consists of a system that is made up of three pillars (a multi-pillared system). The reform is based on eight value systems[13]:

- o preventing social exclusion;
- o enabling people to maintain standards of living;
- o promoting solidarity amongst generations;
- o raising employment levels;
- o extending working lives;
- o adjusting the existing pensions system in a balanced way;
- o rendering the pensions system sustainable in a context of sound public finances; and
- o recognising periodic gaps in labour market participation.

Following is a brief explanation of each Pillar outlining the salient points related to the three Pillars.

4.1.1 Pillar 1 Pension Scheme

The Pillar 1 Pension Scheme consists of a Two-Thirds pension that is aimed to act as a minimum pension guarantee to safeguard pensioners against poverty and thus prevent them from social exclusion. To ensure that such pension guarantee is appropriate for the future and that it maintains its purchasing value, the White Paper proposes that a mechanism be put in place against inflation erosion. Some other changes are being proposed to the Two-Thirds pension as is summarised in **Table 5**.

Table 5: The Proposed Two-Thirds Pillar 1 Pension

	Current System	Proposed Reforms
Class I Contributions	The employed person, the employer and the State each pay 10% of the basic salary of the employee.	No change.
Class II Contributions	The State and the self-employed persons each pay 15% of the basic salary.	No change.
Contribution Period	30-year contributions period.	Increased to 40 years.
Base-line for Calculation	Employees: average of the best consecutive three years from the last ten years basic wages. Self-employed: average of the last ten years' net income.	Employees and self-employed: average of the 40 year basic wage contributions accumulation history.
Pension Indexation	Pensions are currently indexed to COLA.	Pensions will be indexed to the Retail Price Index.

[13] These value systems are the eight value systems used in Chapter 04 of the White Paper and are based on the eleven broad elements for the modernising of pensions endorsed by the European Union at the Gothenburg Council. (White Paper, Appendix III, page 117.)

	Current System	Proposed Reforms
Retirement Age	Women = 60 years. Men = 61 years.	Women = 61 years in 2007. Women and Men = 65 years (this will be introduced in a scaled manner).
Working beyond Retirement Age	Employment between 61 – 65 years is subject to an earning ceiling pegged to the minimum wage and no need to pay contributions. Minimum wage ceiling is removed at age 65 and no contributions are due after this age.	Individual could work beyond new retirement age with no capping on income earned. Individual will continue paying his/her Pillar 1 contributions.
Maximum Pensionable Income	The pensionable income is capped at Lm6,750.	Current maximum pensionable income but adjusted yearly to reflect inflation.

In addition to the details outlined in **Table 5**, there are other general provisions outlined in the White Paper as part of the proposed reform to the pensions system.

- In case of those persons that for legitimate reasons do not manage to pay the amount of contributions required for a minimum pension guarantee, the State may allow for 'top-ups' to ensure that a person has the minimum required number of contributions.
- Under the proposed system while a ring-fenced account would be established for the contributory benefits and pensions, the non-contributory benefits would be financed through the Consolidated Fund. Also, a part of the social security contributions would finance health services.
- The new system would also take into account parental responsibilities, remove the elements that encourage periods of inactivity and accounts for 'credits' for unpaid periods related to continuous personal development.

4.1.2 Pillar 2 Pension Scheme

The objective of Pillar 2 is to act as an addition to the safety net provided by Pillar 1. This would enable the elderly to maintain the standard of living they enjoyed prior to retirement while at the same time promoting the concept of self-help. Pillar 2 is proposed to be first introduced on a voluntary basis as from 1st January 2006. In 2009 Government should take an assessment to determine whether it is necessary to introduce Pillar 2 on a mandatory basis as from 2010 or the year indicated by intensive appropriate actuarial studies. This Pillar consists of an additional contribution to the Pillar 1 contribution, by both the employee and the employer, which would invested in a pension fund or in an insurance scheme.

The White Paper proposes that this Pillar would consist of two parts: a part that is common to everyone and is financed by both the employee and the employer and another part that is flexible and voluntary. It is being proposed that the funds under this Pillar should be portable, but a person should not have the option to liquidate such fund.

It is also being proposed that the annual contributions for this Pillar are not taxed. A maximum tax is then paid upon maturity of the Scheme. Upon maturity, a minor part of the matured pension fund would be converted in a lump sum and given to the pensioner while the remaining income would be given to the pensioner on a yearly basis as an annuity, a contract that guarantees a payment of an annuity from the point of purchase until death.

It is proposed that the MFSA would regulate this Pillar and that there would be strict entry and performance criteria for the private sector insurance firms that are allowed to participate together with other measures to protect the beneficiaries. Furthermore, the White Paper is proposing that Pillar 2 assets are managed on the basis of the person prudent principle, whereby "MFSA, as the regulatory authority, would be tasked to design investment management standards to firstly ensure the safety and security of these assets and secondly, to create an environment in which asset management can obtain the best returns at an acceptable level of risk"[14] and diversification criteria to prohibit the speculation of such funds are established. The White Paper also captures the main provisions of EU Directive 2003/41/EC 'Activities and Supervision of Institutions for Occupational Retirement Provision' which specifies the minimum safeguards and diversification criteria that need to be introduced.

The parameters of Pillar 2 are to be defined further following actuarial studies still to be published.

4.1.3 Pillar 3 Pension Scheme

This is a voluntary pillar for those persons who want to supplement their pension income even further. The annual contributions would be non-taxable up to a capped limit. Upon maturity of the Scheme, the income earned would be taxed according to the individual's PAYE rate. Pillar 3 would be regulated by the MFSA.

04.2 Macro Social Impact

4.2.1 Lifestyle Impacts

If the current pensions system is maintained, PROST simulations indicate that people would not have an adequate pension. The introduction of Pillar 2, coupled by the reform in Pillar 1, would result in an increase in the average pension income in the long term. PROST simulations, given in **Table 6** below, show that the pension income received, if the reform in the pension system is carried out, would be higher, as from the year 2030, than the income received if the current system is maintained. The projections given in **Table 6** show that as from the year 2030, the average pension income received would cover a larger proportion of the average annual expenditure of both households than if the current pension system were to be maintained. According to the projections, after 2060, the average pension income would start to cover a higher proportion of the average annual expenditure of both households.

Table 6: Projections of Average Pension Income under Proposed System

Year	2005	2010	2020	2030	2040	2060	2072
Average Pension (Lm)							
Current Scenario	2544.99	2836.86	3171.58	2999.70	2668.08	2513.67	2638.35
Reformed Scenario	2542.40	2651.71	2860.78	3179.02	3476.61	6183.44	10115.41
Household 1: % of average annual expenditure covered by average pension							
Current Scenario	71	70	61	45	31	18	14
Reformed Scenario	71	65	55	48	41	44	54
Household 2: % of average annual expenditure covered by average pension							
Current Scenario	49	48	42	31	22	12	10
Reformed Scenario	49	45	38	33	28	31	37

The proposed reform aims to ensure that pensioners have a more adequate pension such as by having the Pillar 1 Pension indexed to the Retail Price Index. The objective of the change from the pension adjusted by the Cost of Living Adjustment (COLA) to the retail price index is to ensure that the pension remains adequate in relation to increases in prices. This ensures that relativity is maintained throughout time, and that the pension will maintain purchasing power. Pensioners could therefore be more independent as they would not have to depend heavily on other persons/family members or non-governmental organisations for help. As a result, the pensioner would be able to enjoy a more adequate standard of living and quality of life.[15]

[14] White Paper – *Pensions: Adequate and Sustainable* (2004)

[15] It is important to note that the COLA taken in Table 12 of the White Paper is a flat rate of Lm1.75 per annum for the period 2005 to 2023.

Table 7 shows a comparison between pension increases indexed to COLA and pension increases if they had to be indexed to inflation for the years 1995 to 2005. The comparison is made on both the minimum and the maximum pensionable income. These increases were calculated by taking the actual minimum and maximum pension income for 1995 and showing what the increase would have been with COLA and with inflation respectively.

As can be seen in the Table, had the pension increases been indexed to inflation, those receiving a minimum pension would have been worse off than with increases indexed to COLA. On the other hand, those receiving a maximum pension would have been better off.

Table 7: Pension Increases

	By COLA				By Inflation[16]			
	National Minimum Pension		Maximum 2/3 Pension	COLA	National Minimum Pension		Maximum 2/3 Pension	Inflation[17]
	Married	Single			Married	Single		
Year	Weekly	Weekly	Weekly	Weekly	Weekly	Weekly	Weekly	%
	Lm	Lm	Lm	Lm	Lm	Lm	Lm	
1995	33.33	29.85	77.51	1.50	33.33	29.85	77.51	3.98
1996	34.66	31.18	78.84	1.33	34.66	31.04	80.59	2.49
1997	35.83	32.35	80.01	1.17	35.52	31.81	82.60	3.11
1998	36.83	33.35	81.01	1.00	36.62	32.80	85.17	2.39
1999	38.00	34.52	82.18	1.17	37.50	33.58	87.21	2.13
2000	38.67	35.19	82.85	0.67	38.30	34.30	89.06	2.37
2001	39.67	36.19	83.85	1.00	39.21	35.11	91.17	2.93
2002	40.67	37.19	84.85	1.00	40.06	36.14	93.85	2.19
2003	41.83	38.35	86.01	1.17	40.94	36.93	95.90	1.3
2004	42.33	38.85	86.51	0.50	41.47	37.41	97.15	2.79
2005	43.50	40.02	87.68	1.17	42.63	38.46	99.86	

As discussed earlier on, people are currently saving less and consuming more. This may lead to a risk of poverty and thus a change in lifestyle if one does not save for his/her own retirement, as the income derived from the pension may not suffice for an adequate standard of living. The Two-Thirds pensions of Pillar 1 in the proposed pensions system would act, as a safety net against poverty and Pillar 2 would be an addition to the income derived from the Pillar 1 Pension to enhance the standard of living. Such measures would make it possible for a person to maintain a standard of living that would have less of an impact on one's lifestyle than should the current system be maintained.

[16] It is being assumed that the figure for inflation for the previous year would be taken, therefore pension income for year t would have been calculated on the inflation rate in year t-1.

[17] Source: National Statistics Office

Recommending that the person should not have the option to liquidate the Pillar 2 Pensions fund further reinforces this, as it would act as a safeguard by not allowing the individuals to think only of the short term and as a result have inadequate pensions in the future.

On the other hand, if Pillar 2 is introduced on a mandatory basis, the mandatory contribution is envisaged to lower the disposable income of contributors with a possible effect on the behaviour of people in terms of the decisions on how they spend their money. As a result, this may also lead to more pressure on employers to increase the wages of their employees. However, it must be pointed out that since Pillar 2 contributions are not to be taxed, contributors would benefit from a reduction in their taxable income while saving up for their future.

The changes proposed for Pillar 1 do not lead to additional costs for the employer. An example is the measure proposing that the contribution ceiling is maintained at current levels and indexed to inflation. On the other hand, the mandatory contribution on Pillar 2 would lead to an increase in the cost of production. It is important to note that Pillar 2 contributions are part of employment costs and as such are included in the Profit and Loss account of a firm. This means that these contributions would reduce the profit figure of the company. As a result, the net profit on which company tax would be levied would be lower and the company would pay less in tax contributions. It must be noted that this would result in a decrease in government revenue from taxation which would have to be recovered from alternative sources that in turn might produce other social impacts. In relation to the cost on the employer, there would however still be an impact on the company because, if for example the company tax rate is of 35%, the remaining 65% of the 2% increase would still be an additional cost to the employer. Although Pillar 2 contributions would be tax deductable to employers, the cost of the system on businesses could be transferred to the consumer through price hikes in consumables with a consequent risk of fuelling inflation. Even in the case of one-time adjustments it is anticipated that those earning low incomes would be most at risk from the financial impact of increased prices to cover increased costs. These may also have to change their lifestyle, as they would have to alter their spending behaviour.

In order to reduce the extent of the impact of Pillar 2 contributions, the Pensions Working Group is recommending that a transition period is allowed. It is being proposed that Pillar 2 is first introduced on a voluntary basis in 2006 and then in 2009, Government is to undertake an assessment to determine whether Pillar 2 should be introduced on a mandatory basis in 2010. This allows persons and employers some time to prepare themselves for this change. Furthermore, the Pensions Working Group proposes that owners of life endowment and profits-related policies are given the possibility to convert these policies into Pillar 2. In 2003, there were approximately 80,000 holders of such policies[18]. This could be done by collaboration between Government, the MFSA, and private sector financial institutions. By adopting this scheme, the social impact of the additional contribution as a result of the introduction of Pillar 2 would be partially alleviated.

If in 2010, Pillar 2 is introduced on a mandatory basis, people may perceive this as an imposition on their savings decision. On the other hand, if Pillar 2 would include a voluntary part, contributors would be offered the opportunity to have more comprehensive plans that would offer a degree of cover for unforeseen circumstances such as premature death, injury and ill health.

Besides not having the option to liquidate the Pillar 2 Pension fund, the White Paper proposes that when an individual retires, the matured pension fund is converted into a lump sum and with the bulk placed as annuities. The latter would take the form of a contract that guarantees income from the point of purchase until death. While on one hand the White Paper is ensuring that pensioners have an adequate pension throughout their retirement, on the other hand pensioners may feel they have do not have a choice on how to benefit from their own matured fund. Moreover, if the spouse takes part of the sum as an annuity, once the spouse is dead the survivor or widow/er would not benefit from any proceeds, leading to a risk of poverty and a change in lifestyle as a result of inadequate household income. However, it is important to note that if projections for the increased female participation in the labour force materialise it would result in more female spouses having their own pension.

[18] White Paper - *Pensions: Adequate and Sustainable (2004)*, p. 65.

The proposed pensions system incentivises different sectors of society to participate in the labour force as it addresses certain features characterising the current system and that are acting as a disincentive to employment. Employment would be increased by:

- o increasing the statutory retirement age to 65 years as male and female employees would be working for an additional 4 years when compared to the present system;
- o removing the capping on the income earned for those working beyond 65 years and thus incentivising people to work beyond retirement age;
- o reviewing the invalidity pensions scheme to deter abuse and promote rehabilitation or alternative work before pension;
- o recognising atypical employment would incentivise female employees who would have stopped working to raise their children to return to the labour market;
- o introducing family friendly measures that may incentivise male and female employees who cannot maintain a 40 hour job because of family responsibilities to remain active in the labour market; and by
- o removing the elements that encourage periods of inactivity or activity within the informal economy such people who are disincentivised to work on a part-time basis.

A joint report of by the EU Commission and the Council[19] states that only a few Member States presented calculations of the impact of higher employment rates, excluding that of older workers, on pensions expenditure. It continues to state that:

> ***"In estimations conducted by France, the impact of a 1-percentage point rise in employment rates would lower the share of pension expenditure in GDP by between 0.2 and 0.4 percentage points by 2040."***

If, following the implementation of the above proposals employment is increased, the current social pattern wherein grandparents often help their children in childminding duties may be altered. The increase in retirement age together with the incentives to increase the female participation in the labour market could change the pattern in childminding from one being provided by the extended family to a one entrusted to third parties. This could mean that the incentive to work is counteracted by higher expenses associated with private childcare facilities. Such expenses may alter the family lifestyle such as the decisions on how to spend one's income. On the other hand, the increase in demand for private childcare services may lead to more business take-up and employment in this sector.

Workers involved in those types of employment of a strenuous or stressful nature may have to be redeployed or required to find alternative employment in the later stages of their working life if they are not in a position to retain their current form of employment. Strenuous jobs may be concisely defined as those forms of employment that are taxing on the physiology of the person. Typical examples are masons and steel fixers in the construction industry, loaders in the manufacturing sector, etc. On the other hand, stressful jobs are those that in one way or another tax the mental abilities of a person. This may be due to the intensity of concentration required, the irregular hours that have to be worked as well as the pressures of work that prevail. Typical examples include the healthcare professions, which are constantly faced with sickness and illness and have to respond to crisis situations frequently. Moreover, these positions are also subject to irregular hours as healthcare services are provided on a 24 hours basis. In the event where a person is not in a position to maintain the current job, the person may have to be redeployed or retrained in order to be able to change his/her employment. The change in employment would lead to a change in one's lifestyle together with an uncertainty about one's own life as a result of this social change.

Increasing the retirement age to 65 years and the contribution period to 40 years may impact lifestyle, as people would have reduced leisure opportunities because they do not have another option except that of working to pay the necessary contributions. This may also lead to a restriction in one's lifestyle, as one cannot avail himself/herself of a break other than that for which credits would not be given. On the other hand, under the current system, the 30 years contribution period allows for a higher

[19] European Commission (2003) *Adequate and Sustainable Pensions – Joint Report by the Commission and the Council.*

probability for this to take place. However, the reduction in leisure opportunities might not be very significant since as shown in **Table 8** higher life expectancy at retirement, is expected to be enjoyed over time. This means that even though people would be required to work for a longer period, their retirement portion would still be maintained at today's levels for them to be able to enjoy leisure time.

Table 8: Life Expectancy at Retirement (in years)

Year	2002	2005	2010	2014	2015	2018	2020	2021	2022	2030	2040	2050	2060	2070	2072
Male															
Life expectancy at Retirement	17.9	18.1	18.4	17.8	17.9	17.3	17.4	16.6	15.8	16.3	17.1	17.9	18.3	18.8	18.9
Retirement Age	61	61	61	62	62	63	63	64	65	65	65	65	65	65	65
Female															
Life expectancy at Retirement	22.2	22.4	21.9	21.4	21.5	20.8	21.0	20.2	19.3	19.7	20.3	20.8	21.3	21.8	21.9
Retirement Age	60	60	61	62	62	63	63	64	65	65	65	65	65	65	65

Source: PROST 11 Malta Files

4.2.2 Cultural Impacts

The concept of social security can be traced back to the times of the Order of the Knights of St John, wherein the Knights helped the poor people and other sectors of society in cash and in kind. Later on in the 19th century the first Government pensions schemes were introduced. In 1921, the concept of self-Government and thus the social security measures as we know them today were introduced[20]. For the past two centuries the Maltese population has relied mostly on the State for welfare support. This mentality has acted against the concept of self-help, which has not taken root in Malta. With the proposed introduction of Pillar 2, the pensions reform attempts to make a cultural change and incentivise self-help whereby people are encouraged to think for the future and start saving for their retirement. This may also lead to objections to the proposed reform.

The number of persons claiming invalidity pensions has increased drastically since 1998. This may be an indication that the invalidity pension may be seen as a method that could be used for early retirement. Some persons may be abusing from the system to exit the labour market before reaching the statutory retirement age. The proposed pensions system suggests that the current invalidity pensions schemes should be reviewed to control the free riders and deter abuse. Moreover, the principle of 'rehabilitation or alternative work before pension' is encouraged. This may lead to a change in the way people perceive invalidity pensions.

Under the current system, the Pillar 1 Pension is calculated on the best consecutive three years from the last ten years prior to retirement in the case of employees and on the average of the last ten years' income in the case of the self-employed. Under the current system, the possibility of the self-employed declaring lower incomes during their initial years in the working world and then "pumping up" their income in the latter years to improve their pension is indeed a potential reality. Similarly, this might apply to employees who try to push forward for promotions in the latter years of employment. Under the proposed reform, it is suggested that the Pillar 1 Pension is calculated on an average of the 40 year contribution history. Should this recommendation be implemented, the pension of both the self-employed and employees would be based on the average of the 40 years. This might potentially reduce any under- declaration practices. Moreover, calculating the pension in the same way for both the employees and the self-employed eliminates the discrimination that exists under the current system.

A different impact could result from the introduction of Pillar 2 as the self-employed may still be tempted to declare lower incomes to pay less contributions and invest the resulting difference in a Pillar 3 Pensions scheme or in other priorities. This gives more choice to the self-employed as in Pillar 3, unlike Pillar 2, they could choose how to invest their own money.

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[20] Department of Social Security. (2004). *Social Security in Malta – A Synopsis* viewed on http://www.mfss.gov.mt/documents/dss/synopsis_dss.pdf.

The current pensions system is based on the traditional family pattern and customs. Over the years, as female participation in the labour market started to increase, the traditional family gender roles of the male breadwinner and the female full-time home carer went through transformations. Since the current pensions system is based on the traditional female role of a full-time home carer, it disincentivises female participation in the labour force. Moreover, it does not acknowledge the change in culture in the latest years. The proposed pension reform acknowledges such change and the importance of the female participation in the labour force by recognising atypical employment. It also considers the crediting of the individual's contributions as well as the payment of voluntary contributions for child bearing and child raising periods. This may further reinforce the "new" gender roles and the resultant cultural impacts. As a result of the expected increase in female participation rate, it is anticipated that there would be a greater demand for childcare facilities and a greater demand for the implementation of family friendly measures within the workplace. The introduction of family friendly measures may also impact the culture at the place of work. In a number of work places where family friendly measures were introduced, a cultural change was experienced whereby employees acknowledged more the importance of and at the same time the pressure that results from family responsibilities.

Moreover, the phased crediting of the individual's contributions as well as the payment of voluntary contributions in relation to child bearing and raising periods is a positive move towards the encouragement of more participation from the father in the child raising periods. A gradual cultural change may result as fathers start assuming more responsibilities in the raising of their children as they are encouraged to take career breaks to look after their family. This would also facilitate the work environment for women. It is envisaged that a culture change is slowly gathering momentum, as women are relinquishing the traditional role of full time home carers and becoming more career oriented and eager to return to the world of work.

Up to a few years ago, people were of the mentality that once they start working they have a job for life. Job security was given a high priority in the value system of employees. The increase in the retirement age may lead to the need for retraining at a relatively old age especially in the case of those with strenuous or stressful jobs who are likely to need to change their type of work. The change in employment at such a late stage, may instil a sense of insecurity. This factor may also necessitate a change in lifestyle as people have to learn how to be flexible and ready to take up a new job, even if at their later years of employment.

The increase in retirement age may also lead to another cultural impact. Young persons entering the labour market for the first time and other persons that are unemployed may perceive the increase in retirement age as leading to an increase in unemployment rates as older workers in the labour market block potential places of employment. Such persons, may not realise that while the increase in retirement age extends the workforce, if a decrease in birth rates persists, it would lead to a decrease in the number of persons available to work.

Another impact could be that of increased value to life long learning. It is today recognised that professional development is essential even at the later years of ones career. The propositions in the White Paper support this concept by proposing policy instruments that allow for 'credits' to be assigned to those who undertake periods of unpaid time for training, reskilling and continuous development.

4.2.3 Community Impacts

As it has been explained earlier on, the increase of female participation in the labour market together with the change in the female role in the family have brought with them (and would keep bringing with them) a change in the family pattern. The care of family members, which up till now was usually entrusted in the hands of the extended family, is likely to be entrusted to the private sector or to the state elderly homes. This change in the provision of care, particularly childcare, is further reinforced by the proposed increase in retirement age, as while under the current system the grandparents offer help to their children in childminding, under the proposed system it would be more difficult as they have to work for an additional four years up till age 65. This may lead to an increase in workload for the existing institutions or to an increase in the need for new services related to the care of the elderly and also in childcare services. Malta's National Action Plan for Employment (NAP) for 2004 states that EU Member States should provide childcare by 2010 to at least 90% of children between three years old and the mandatory school age and at least 33% of children under three years of age. The

NAP also states that in Malta childcare coverage of ages 3 to 6 is of 98% though only during school hours and childcare coverage of children below three is as yet unquantified. Malta has set its targets for 15% childcare coverage for children under three years of age till 2010, which is translated into an increase of 1,800 places, i.e. 300 per annum.The increase in retirement age would also decrease the possibility of employees to care for their elderly parents.

The Minimum Pension Guarantee against social exclusion would minimise the risk of poverty following retirement. This would minimise the dependence of pensioners on the community and on the State for help to be able to have an adequate and acceptable standard of living.

The mandatory participation in Pillar 1 is aimed at increasing solidarity amongst generations achieved through the Pay As You Go (PAYG) system. This may lead to an increase in community cohesion and integration as the younger generations are contributing to help the older generations who would have already given their share to society while they were still in employment by paying taxes and contributing in the upbringing of their children.

The introduction of Pillar 2 would undoubtedly mean that the market for financial products such as investment funds would have to expand to accommodate the increase in market demand for new products. Consequently, the financial sector would require the employment of more professional people.

4.2.4 Quality of Life Impacts

The introduction of Pillars 2 and 3 in the proposed pensions system could create mixed feelings. On one hand, with the implementation of the proposed system and thus the introduction of Pillar 2 and Pillar 3, pensioners would have an adequate pension. Consequently, people would feel secure and perceive a positive future for themselves and their children together with a good standard of living and quality of life. On the other hand, while this security comes at a cost, the fluctuations of the financial markets, on which funds generated from Pillar 2 and Pillar 3 would be based, would give rise to concern on the worth of one's fund upon retirement. Cases have arisen where stock market crashes have taken the toll on individuals' pensions forcing them to continue to work after retirement age as the pension received was not sufficient to sustain their lifestyle. Such cases lead to dissatisfaction due to failure to achieve heightened expectations. Individuals would consequently not know with a degree of certainty the level of their pension, contrary to the times when Government was solely responsible for the provision of pensions. Entrusting the regulation of the Pillar 2 and Pillar 3 Pensions Schemes to the MFSA and applying strict criteria for the providers of such pensions schemes would protect the future beneficiaries and would mitigate against feelings of insecurity. MFSA would also "be tasked to design investment management standards based primarily on the prudent-person pensions principle in order to, firstly, ensure the safety and security of these assets and secondly, to create an environment in which asset management can obtain the best returns at an acceptable level of risk". Furthermore, the prudent person principle should be complemented with a number of quantitative limitations related to diversification."[21] Moreover, through statements of deposits issued to them by fund managers, contributors would know with a degree of certainty that their contributions have been truly made.

In regards of the Pillar 1 Pension, establishing a ring fenced account for contribution payments, would ensure that the contributions made would be safeguarded and payment of pension benefits is secured. This would represent significant improvement over the current system, whereby all contributions are aggregated with the rest of Government's revenue within the Consolidated Fund. A deficit in the Pension Account may cause uncertainty within the general public, especially if parametric changes are introduced to make good for any shortfall. Any deficits would severely undermine all arguments that Government might have made in favour of the sustainability of the new system.

The introduction of Pillar 2 will mean an additional contribution and thus less disposable income. People, especially those aspiring to acquire their first property may have to forfeit such aspirations and commitments. Lower income could also lead to a lower quality of life, as individuals would have less means by which they could increase their quality of life. A lower quality of life may also result from a deteriorating quality of housing, as people would not have the required funds to maintain an adequate

[21] White Paper – *Pensions: Adequate and Sustainable* (2004)

standard of housing. However, it must be pointed out that although in the short term the additional required contributions would lead to lower disposable income, in the long term, if yields on investment are good, a good standard of living would be secured for the retirement portion.

Pillar 2 Pension funds may be negatively impacted by the cost of setting up the Pensions Scheme Compensation Fund because the latter would be funded through a percentage of one's own contributions. Therefore, this Fund could be seen as eroding into one's contributions and hence pension payout. Notwithstanding, employees should have greater peace of mind in that this Fund would cover them, to a certain extent, against insolvency, fraud and misuse. In addition it is important to note that it is envisaged that this percentage would be minimal.

Upon maturity, benefits generated through the Pillar 2 Pension Scheme are normally taken in one of three ways:

- as a lump sum payment;
- as programmed withdrawals over the retirement period; or
- as annuities from an insurance company.

If the pensioner is given the possibility to take the benefits as a lump sum, there is the risk of a one-off expenditure leaving the pensioner with the Pillar 1 Pension only. Moreover, if the beneficiary is allowed to take his/her pension benefits as programmed withdrawals, and the pensioner lives longer than expected, he/she may risk ending up with an inadequate pension for the last part of his/her life. The latter two cases may lead to a lower quality of life if the pensioner does not have adequate means to maintain such quality of life, as explained in the previous paragraph. On the other hand, if the beneficiary converts his/her Pillar 2 Pension as annuities, which are generally based on mortality rate, if he/she dies before the expected year, part of the benefits, are lost mostly at the detriment of the survivors. Such loss reduces the contributors' credibility in the Pillar 2 Pension Scheme. Moreover, annuities may discriminate between male and female pensioners depending on whether unisex or gender specific mortality rates are used.

The White Paper proposes that sums to be deposited into the Pillar 2 fund would be tax-free but a capped percentage of tax is to be paid on the maturity of the fund. While under the current system insurance schemes are exempt from tax upon maturity, under the proposed system endowments that pay a lump sum upon maturity would tax the individual upon receipt. This would contribute to a reduction in the pension payout and an added financial burden on the retirees.

Under the proposed reform to the pensions system, persons working beyond retirement age do not have a capping on the income earned. This removes the limitation on the income imposed by the current system. Therefore, persons working beyond retirement age would have a higher income than that possible under the current system and would thus feel more secure and have positive expectations for the future.

Associated with retirement, is a decrease in the disposable income, particularly in those cases where people would either have not invested in a private insurance scheme for an additional income to that of the pension, or else the yields generated from investment are not high enough to maintain the same standard of living. The 4 year increase in the retirement age would delay such decrease in income. Consequently, during those 4 years, people could still enjoy more or less the same standard of living and quality of life enjoyed while in employment.

On the other hand, for those people who look forward to retirement to have a break and possibly have more time to practice their hobbies, the increase in retirement age may mean a lower quality of life. Others may look forward to retirement, to spend more time with their family and their grandchildren. Therefore the increase in retirement age could also lead to an inferior quality of life to family members.

The proposed reform to the pensions system recommends that those persons who spend time out of employment to take care of their children in their early years should have their contributions credited for that period. Parents benefiting from such credits could take a full time active role in the upbringing of their own children. This may have a positive impact on the quality of the children's life.

The credits for life-long learning, forming part of the proposed reform to the pensions system, would encourage people to maximise their potential and feel that they have a positive contribution to give throughout their career. In turn, the country would benefit from a highly skilled workforce that could lead to improved competitiveness. This would have a ripple effect on the quality of life enjoyed by society at large.

4.2.5 Health Impacts

The proposed reform to the pensions system aims at increasing the employment rate as outlined earlier on in the section on the lifestyle impacts. Work is an essential and major part of one's life and could have both positive and negative effects on physical and mental health[22]. For some people, work is a source of personal satisfaction while allowing them to socialise with other people. Unemployed persons are more likely to feel isolated and suffer from mental health disorders related to depression. So the fact that people would remain in employment would have positive health impacts.

Work is not always a plain sailing experience especially when it is not well organised and involves high risks. Work-related stress, demands and pressures could impact negatively on the individual's physical and mental health. Stress could have different effects on the individuals concerned, which may include violence at work, addictive behaviours and other psychological problems (e.g. irritation and inability to concentrate). It must also be pointed out that physical and mental health problems may have an influence on one's social life, as well as by imposing certain limitations.

European Agency for Safety and Health at Work studies[23] estimate that the cost of stress at work and the related mental health problems could amount to 3% to 4% of the gross national product in the 15 EU members (pre-2004).

Certain types of employment that are of a strenuous or stressful nature may have a higher probability of a negative impact on health. Examples of such types of employment were given in the section on the lifestyle impacts. Such groups of workers might not be in a physical or mental position to sustain their form of employment for longer periods.

The proposed increase in the retirement age is not considered to be significant to the younger age groups as young workers would have the time to adapt to the changes. However, the proposed increase may have a significant psychological impact on those who are close to retiring under the current 60/61-year limit and who have retirement already in their frame of mind. The gradual progressive increase in mandatory pensionable age is considered positive in that it stems any sudden jerks and allows for a gradual absorption and adjustment to rising pensionable ages.

On a macro level, the reform to the pensions system proposes that the health funding is separated from the financing of contributory and non-contributory benefits, as announced in the Government 2004 budget. The part of the social security contribution that would finance the health services, which would be taken from the Pillar 1 contributions, would be ring-fenced accordingly. This would reassure contributors that their contributions are truly being used for the purpose of their pension, as well as to support national health services. While the increase in retirement age would increase the revenue to Government, both in terms of contributions paid (including the part to finance health services) as well as from income tax derived, it may lead to an increase in the demand for health services as older workers (61 plus) may suffer from continued stressful/strenuous jobs for a longer period, as well as, as a result of the aging population.

04.3 Comparing the social impacts between the current and proposed pensions system

Table 9 summarises and compares the social impacts in terms of lifestyle, culture, community, quality of life and health between the current and the proposed pensions system.

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[22] WHO, European Ministerial Conference on Mental Health. (12-15 January 2005). *Mental Health and Working Life.* Viewed February 7, 2005 from http://www.euro.who.int/document/mnh/ebrief06.pdf.

[23] European Agency for Safety and Health at Work. (2002). *Working on Stress.* Viewed February 7, 2005 from http://agency.osha.eu.int/publications/magazine/5/en/MAGAZINE5_EN.PDF.

Table 9: Comparing Social Impacts

Impacts	Current System Impacts	Proposed System Impacts
Lifestyle	Inadequate pensions would lead to dependence on other people.	By having a more adequate pension, pensioners could retain their independence.
	Pensioner has to live with few resources and possibly fewer outings and social gatherings.	Pensioner could have the possibility to maintain a lifestyle which is closer to that of pre-retirement than if current system is maintained.
	Income derived from pension may not suffice for an adequate standard of living.	Pensioner would have a higher probability of maintaining the standard of living enjoyed prior to retirement as a result of Pillar 2 benefits.
	During employment no additional contributions have to be paid and thus the same level of income is maintained.	During employment, contributors would have lower disposable income because of additional contributions. This may affect spending behaviour.
	Certain features act a disincentive to employment.	Employment is incentivised, with possible impact on family patterns.
	It is more possible for those people involved in strenuous or stressful employment to maintain employment until reaching retirement age.	Workers may not be able to retain their current form of employment until retirement age. This may lead to a change in lifestyle and possible uncertainty.
	With a 30 year contribution period, people have more opportunity for leisure and it is more possible to take a career break and do something for which credits would not be given.	Increasing the retirement age and the contribution period reduces leisure opportunities and time to spend with family members.
Cultural	People rely on the state for welfare support.	Self-help is incentivised with the introduction of Pillar 2.
	Invalidity pension may be seen as a method that could be used for early retirement.	Reform reviews invalidity pensions scheme to control free riders and deter abuse.
	There is the possibility of self-employed "pumping up" income and of pressure for promotions in the latter years to improve pension.	Calculating the Pillar 1 Pension on an average of the 40-year contributions will change the culture present under the current system. In the White Paper there is no mention of the valuation method that will be used in the calculation of the average earnings.
	The change in the traditional family pattern and gender roles is not recognised.	The proposed system reinforces the "new" gender roles by acknowledging the change in gender roles and incentivising female participation in the labour market.
	People generally look at their job as a job for life.	The perception of a job for life changes as in the latter years of employment there may be the need for redeployment/training as it may be difficult to retain some of the present employments (e.g. strenuous jobs).
Community	The care of elderly family members and of children is usually entrusted to the extended family or female family members.	The care of elderly family members and of children will probably have to be entrusted to the private sector following the increase in the retirement age and the increase in female participation.
	The risk of poverty following retirement is high and the pensioner may loose his/her independence.	Minimum Pension Guarantee will minimise the risk of poverty following retirement and thus the dependence of pensioners on the community and on the State for help.
Quality of Life	Under the current system pensioners would not have an adequate pension. They may feel insecure and lose their aspirations for the future.	A more adequate pension would ensure a better standard of living and possibly a better quality of life.
	Pensioners could estimate their income from the Pillar 1 Pension in quite a precise manner.	Fluctuations of the financial markets, on which funds generated from Pillar 2 and Pillar 3 would be based, would give rise to concern on the worth of one's fund upon retirement. This may be minimised by entrusting the regulation in the hands of the MFSA and ensuring that adequate mechanisms are in place.
	All contributions are aggregated with the rest of Government's revenue within the Consolidated Fund.	Establishing a ring fenced account for contribution benefits and pensions would ensure that the contributions made would be safeguarded for payment of pension benefits.

Impacts	Current System Impacts	Proposed System Impacts
	Persons working beyond retirement age have a capping on the income earning in order to receive their pension. This limits total income earned by pensioners.	Persons working beyond retirement age would not have their income capped while still enjoying a pension. This may increase their standard of living and as a result their quality of life.
	Following retirement age, people experience a decrease in income as the PAYG pension is a percentage of employment income. The increase in life expectancy leads to a greater retirement portion to life length (the period between retirement age and death) and therefore a longer period with lower income.	4 year increase in the retirement age would delay the decrease in income associated with retirement and thus people would keep enjoying more or less the same standard of living and quality of life enjoyed while in employment during those 4 years.
	Persons who spend time out of employment to take care of their children in their early years do not have contributions credited for their period.	Parents, including fathers, are no longer penalised, in terms of loss of contributions, when taking a break from employment to take care of their children.
	Under the current system no credits are given for life-long learning.	Credits for life-long learning would encourage people to maximise their potential and feel that they have a positive contribution to give throughout their career.
Health	Disincentives to employment beyond retirement age found in the current system may increase mental health problems associated with not being productive. On other hand, work related stress is avoided.	The proposed reform incentivises employment. Work could have both positive and negative effects on the people's mental health.
	All contributions are aggregated with the rest of Government's revenue within the Consolidated Fund.	Ring-fencing the part of the social security contribution that would finance health services reassures contributors that their contributions are truly being used for health services.
		Proposed increase in retirement age may have a significant psychological impact on those who are close to retiring under the current 60/61-year limit and who have retirement already in their frame of mind.

05. Social Impact on Specific Groups

This Section of the report assesses the social impact on specific groups which were identified in Section 02 of the Report.

The groups identified are the following:

- current pensioners;
- workers by age;
  - 60 – 55 age group;
  - 54 – 49 age group;
  - 48 – 45 age group;
  - 44 – 43 age group;
  - 42 – 40 age group;
  - 39 – 36 age group;
  - 35 – 26 age group;
  - 26 – 16 age group;
  - future workers;
- workers by status of employment;
  - unemployed;
  - private and public sector (post 1979) employees;
  - full-time and part-time;
  - self-employed persons;
- workers by type of employment
  - manual or technical workers;
  - clerical or administrative workers;
  - professional or managerial workers;
- employers;
- gender considerations;
- persons with disability;
- widows, widowers and survivors; and
- foreigners working in Malta and Maltese working abroad.

The impacts to be discussed in this Section are specific to a particular group and do not show the complete impact for an individual. For example a female who would be 42 in 2007 and who has a clerical job, would need to view the impacts for her age group (40 - 42), workers by type of employment (clerical and administrative workers) and gender considerations to get a complete picture of how the proposed reforms would impact her group. Moreover, reference to particular status, for example marital status, circumstances and commitments a person might have, is made in the following various sub-sections.

05.1 Current Pensioners

Current pensioners will not be impacted by the reforms being proposed to the pension system as their pension will still be indexed to COLA and not to inflation as is being proposed for the other age cohorts.

05.2 Workers by Age

The main age distinction in the proposed pensions system is that of switchers (those 45 and under in 2010) and non-switchers (those over 45 years in 2010) to the Pillar 2 and Pillar 3 Pensions in addition to the Pillar 1 PAYG pension system. In addition, as a result of the phasing in of a number of changes to the pension system, a number of other age categories have been identified as being impacted differently by the proposed pension system.

Table 10 shows how those of ages between 39 and 55 in 2007 will be affected as a result of the introduction of Pillar 2, changes to the retirement age, the accumulation period for a full 2/3 pension and the base-line for the calculation of the pension.

Table 10: Changes as a Result of Phasing in of Proposed Changes

Age in 1st Jan 2007	Pillar 2	Retirement Age				Accumulation Period (yrs)			Base-line for Calculation			
		61	62	63	65	30	35	40	Same as current[24]	Average of best 5 yrs	Average of best 10 yrs	Average of 40yrs
55+		✓				✓			✓			
54			✓			✓				✓		
53			✓			✓				✓		
52			✓			✓				✓		
51				✓		✓				✓		
50				✓		✓				✓		
49				✓		✓					✓	
48					✓	✓					✓	
47					✓	✓					✓	
46					✓	✓					✓	
45					✓		✓				✓	
44					✓		✓					✓
43					✓		✓					✓
42	✓				✓		✓					✓
41	✓				✓		✓					✓
40	✓				✓		✓					✓
39 -	✓				✓			✓				✓

The social impact will now be discussed for the specific age groups based on the above identified categories.

5.2.1 60 – 55 Age Group

This age cohort will retire at 61 years of age and therefore between 2008 and 2013. The accumulation period and the base-line calculation for this age cohort will not be changed, therefore their pension will be based on 30 years of contributions and on the best 3 of the last 10 years if they are employed and the average of the last 10 years if they are self-employed.

There is currently an increasing trend for persons wishing to continue to be part of the labour market beyond the current retirement age of 61. Currently, these persons have a limitation on the income they can receive to qualify for their pension in that they can only earn up to the minimum wage in order to safeguard their pensionable amount. The White Paper states that those wanting to work beyond

[24] Employees: best 3 years of last 10 years; Self-employed: average of last 10 years

retirement age will no longer have to forgo their pension if they earn above the minimum wage. It however does not specify in which year this is to be introduced. Assuming that this age cohort will benefit from this change, this will result in those wishing to work beyond 61 to have a choice and be able to gain the benefits from higher income. This is likely to result in a higher standard of living than if they had to retire at 61. They would also benefit from positive health impacts related to their productivity and the contribution they would feel they would be making towards the economy.

The workers within this age cohort will be impacted by the proposed reforms as they will have their pension pegged to inflation. As depicted in **Table 7** the introduction of indexation of the pension to inflation will impact low income earners and high income earners differently.

5.2.2 54 – 49 Age Group

As a result of the proposed pension system, the retirement age for workers within this age cohort will increase. The 52 to 54 year olds of 2007 will have their retirement age raised to 62 and the 49 to 51 year olds of 2007 will have their retirement age raised to 63. This proposed increase could have a negative psychological impact on those persons who are within this age cohort and who already have retirement at heart in order to enjoy the quality of life after retirement for the longest period possible. This impact has been contained in that instead of raising the retirement age straight away to 65, the White Paper proposes that the retirement age will be increased by 1 to 2 years only for this age cohort. This gradual progressive increase in the mandatory retirement age is considered positive in that it stems any sudden jerks and allows for a gradual absorption and adjustment to rising pensionable ages. In addition, it is also being proposed in the White Paper that it would still be possible for individuals to opt for a shorter career between the age of 61 and 65 years on the basis of proportionate benefits.

Table 11 which is based on PROST modelling shows that although the retirement age is being raised, because life expectancy is expected to increase, the life expectancy at retirement age will remain rather constant and therefore it is likely that persons will still remain enjoying the same years of retirement as they do today.

Table 11: Life Expectancy at Retirement (in years)

Year	2002	2005	2010	2014	2015	2018	2020	2021	2022	2030	2040	2050	2060	2070	2072
Male															
Life expectancy at Retirement	17.9	18.1	18.4	17.8	17.9	17.3	17.4	16.6	15.8	16.3	17.1	17.9	18.3	18.8	18.9
Retirement Age	61	61	61	62	62	63	63	64	65	65	65	65	65	65	65
Female															
Life expectancy at Retirement	22.2	22.4	21.9	21.4	21.5	20.8	21.0	20.2	19.3	19.7	20.3	20.8	21.3	21.8	21.9
Retirement Age	60	60	61	62	62	63	63	64	65	65	65	65	65	65	65

Source: PROST 11 Malta Files

The accumulation period for the calculation of the pension for this age cohort will remain unchanged at 30 years and therefore there will be no social impact on this age cohort in relation to this issue.

The pensionable income on which the pension will be calculated will be changed for this age cohort. The 50 to 54 year olds will have their pension calculated on the average of the best 5 years of the last ten years. This change is likely to have a minimal impact on those within this age cohort as, although it may lower the pensionable income, it will not yield such a different pension income than with the current calculation base.

The 49 year olds in 2007 will have their pension calculated on the average of the last ten 10 years. This will have a negative impact on this age group if a person has experienced fluctuations in wages during the last ten years. This would lead to a downward effect to the pensionable income which may result in a lower disposable income upon retirement than had the current system been maintained. This change is likely to have a larger impact than that on the 50 to 54 age cohort but a smaller impact than on those for which pension income will be calculated on the average of 40 years of contributions.

5.2.3 48 – 45 Age Group

The 45 to 48 age cohort are the first group to have their retirement age increased to the age of 65. This means that whilst a 49 year old has a 2 year increase in retirement age to 63, someone who is just 1 year younger has his retirement age increased by 4 years, from 61 to 65, a two year jump from the previous group. The 48 year old may perceive this as being unfair for this age cohort. The same argument as that presented in the first two paragraphs for the retirement age of the 49 to 54 age cohort can be made here, with two differences. The first is that the retirement age has been raised higher than that of the 49 to 54 cohort. On the other hand, one must realise that there has to be some form of cut-off point, and since this age group is younger, they are less likely to be planning for retirement as the previous cohort.

The pensionable income on which one's pension will be calculated will be changed for this age cohort to the average of the best 10 years. The impact on this age cohort as a result of this measure will be the same as that outlined in paragraph 5of the 49 to 54 age cohort.

5.2.4 44 – 43 Age Group

This age group is one that will be negatively affected by the proposed pension system. They will be the first group to have their pension income calculated on the average of the whole period of contributions. Although the White Paper states that those within this age cohort are to have their pension calculated on the basis of an average of 40 years of contributions, the accumulation period required is 35 years. Although it may be the case that a person would have contributed for 40 years, especially since the retirement age for this age cohort would be 65 years, there may be cases where a person would only have the minimum number of years of contributions. This measure therefore requires clarification for this age cohort. It is hereby however being assumed that the calculation would be based on the average of the total years of contributions.

The measure whereby a person's pension will be calculated on the average of the aggregated annual income earned during the 40 year time based period has positive and negative impacts. On one hand, it is positive in that it reflects the income on which the person would have paid contributions over his / her working life. On the other hand, for a person who had spent quite a number of years with a relatively low wage and then progressed towards a higher wage later in his/her career, maybe even in the last years before retirement, this would mean that this person's average wage over the 40 year period would be lower as a result of his wage in the early years of his career. This would result in a lower pension and therefore less disposable income in retirement. This situation would be worsened if the averaging does not take into account the monetary value of the 40 years of wages in the year the pension is being calculated. The downside of this measure as proposed in the White Paper is that there is no mention of the valuation method that would be used in the calculation of the average earnings.

Table 12 shows how persons within this age cohort will be impacted upon retirement as a result of the change in the calculation method. As can be seen between 2027 and 2028, which is the year when this age cohort will retire, the replacement rate falls significantly by 6.62% for males and even more significantly for women by 7.39%. This clearly highlights that those in this age cohort will be hit to a greater extent then those who will retire prior to 2027 or post 2030. The latter is because those retiring in 2030 will at least have some Pillar 2 benefits to make up for this loss in Pillar 1 Pension while those retiring in 2028 and 2029 will have to rely solely on the Pillar 1 Pension which as shown would by that time have become inadequate.

The inadequacy is confirmed by the receipt of the first year of mandatory Pillar 2 in the following year (2030).

Table 12: Average Replacement Rates[25] and Average of 40 Years Contributions

Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Males										
Average Replacement Rate of new retirees%	40.9	39.9	38.9	32.3	31.2	30.2	29.2	28.3	27.5	26.7
Percentage Change		-0.96	-0.97	-6.62	-1.09	-1.06	-0.97	-0.89	-0.84	-0.75
Females										
Average Replacement Rate of new retirees %	39.0	38.1	37.2	29.8	28.9	27.9	27.1	26.3	24.5	23.9
Percentage Change		-0.90	-0.91	-7.39	-0.94	-0.95	-0.86	-0.78	-1.78	-0.58

Source: PROST 11 Malta Files

5.2.5 42 - 40 Age Group

In the White Paper, it is proposed that Pillar 2 will become mandatory in 2010 for persons 45 years old and younger. A 45 year old in 2010 will be a 42 year old in 2007[26].

The age cohorts who will switch to the new system may currently be under the impression that the contributions they have made on Pillar 1 (PAYG) will now be lost. This is not true as although the switchers will be receiving a Pillar 2 Pension, they will still be receiving a Pillar 1 Pension and thus the contributions that they have already made will be guaranteed through the Pillar 1 Pension.

This age cohort, in relation to the others switching to a multipillar pension system, will have the least Pillar 2 contributions until they reach retirement age. One may think that as a result this age cohort may end up with not enough funds to have a Pillar 2 Pension which will be adequate to ensure a decent standard of living. They may therefore need to supplement the Pillar 2 Pension with a Pillar 3 Pension. Although it is true that the less years of contributions made to the Pillar 2 fund, the less the lump sum and the annuities to be received, it is however important to note that the Pillar 1 Pension will only be inadequate in the long term and therefore those retiring in about 20 years time will still have a rather adequate Pillar 1 Pension

Table 13 shows the average replacement rate which represents the average pension of new 2/3 pensioners in a particular year as a percentage of average wages. One notes that a 42 year old in 2007 will retire in 2030, when, although he would only have a maximum of 18 years of Pillar 2 contributions, the average replacement rate from Pillar 1 would be double that of someone retiring in 2060. In addition, when the Pillar 1 and Pillar 2 replacement rates are added together, the total average replacement rate of the person who will retire in 2030, will be higher that of a person who retires in 2029 with only a Pillar 1 Pension.

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[25] Replacement rate refers to the ratio of average pension to average wage in a particular year.

[26] Since all the other changes which depend on the age of persons are based on the age of persons in 2007, for consistency's sake the age for switchers was extrapolated downwards to 2007.

Table 13: Average Replacement Rate for New 2/3 Pensioners in the 40 to 44 Age Cohort

Year	2005	2015	2029	2030	2031	2032	2040	2050	2060	2070
Age in 2007 of persons retiring in this year				42	41	40				
New 2/3 retirement pension: Male										
Average Percentage Replacement Rate (Pillar 1)	62.4	52.0	31.2	30.2	29.2	27.1	22.5	17.2	13.6	11.8
Average Percentage Replacement Rate (Pillar 2)[27]				5.3	6.1	6.9	13.3	22.4	31.5	38.4
Total Percentage Average Replacement Rate	62.4	52.0	31.2	35.5	35.3	34.0	35.8	39.6	45.1	50.2
New 2/3 retirement pension: Female										
Average Percentage Replacement Rate (Pillar 1)	62.7	55.2	28.9	27.9	20.6	19.6	20.5	16.2	13.3	11.7
Average Percentage Replacement Rate (Pillar 2)				3.8	4.2	4.6	8.5	16.6	27.7	39.3
Total Percentage Average Replacement Rate	62.7	55.2	28.9	31.7	24.8	24.5	29.0	32.8	41.0	51.0

Source: PROST 11 Malta Files

This age cohort is the eldest one to switch to the new system and therefore the first from the switchers to retire. As a result, members of this age group have the least time to adapt to the new scenario and would be the first to test the strength (weakness) of the Pillar 2 system. This may result in loss of aspirations for this age cohort, as they may fear that the Pillar 2 scheme will not yield the same benefits as is being envisaged.

This age cohort will also have their pension based on 35 years of accumulated contributions and the base-line for calculating their pension will be calculated on the average of 40 years of pensionable income.

5.2.6 39 - 36 Age Group

Those who are 39 years old and below in 2007 will be the first group to have the entire changes of the proposed pension system affecting them, i.e. they will retire at 65, have to contribute for 40 years to receive a full pension, have their pension calculated on the average of 40 years of pensionable income, and have to pay Pillar 2 contributions.

Although, by increasing the mandatory contributions to 40 years, it might seem that this represents a greater burden on the employees who have to work 10 additional years to benefit from a pension, the reality is that today the average working life is 38 years[28]. This recommendation is to ensure that a person contributes throughout his/her working life for a full pension as against the 30 years today, which allows for abuse through the invalidity system. Therefore, although it may seem that this measure would have a negative social impact in that the quality of life would be impacted with an additional 10 years in employment, in fact in real terms on average, is a two year increase in required contributions. The impact of the additional 10 years on quality of life cannot be as such determined since the decision between work and leisure and the satisfaction derived from the balance is highly subjective.

In relation to the measure whereby the pension for persons within this age cohort will be calculated on the average of 40 years pensionable income, the same impact may apply as that outlined for the 40 to 42 age cohort. It is however important to note that, as wages increase (as is being assumed with an annual real wage growth of 3% per annum), and considering that the ceiling for pensionable income currently set at Lm6,750 will be indexed to inflation (which is being assumed at 2.5% per annum) most people will be earning wages above the ceiling for most of their career. **Table 14** shows that, whereas currently the contribution ceiling is higher than the average nominal wage, taking the assumptions outlined above, as from 2020 the ceiling will be lower than average nominal wages. As a result, the pensionable income of people along their career is likely to be close to the ceiling and therefore the calculation method is unlikely to impact their pension benefits. They could therefore have peace of

[27] Average Replacement Rate from Hypothetical Annuity

[28] World Bank (2004) *The Maltese Pensions System: An Analysis of the Current System and Options for Reform*

mind, that fluctuations in their wages, which are likely to be above the ceiling, will not impact their pension income and erode on their disposable income and therefore quality of life during retirement.

Table 14: Contribution Ceiling and Average Nominal Wage (in Lm000s)

Year	2002	2005	2010	2015	2020	2025	2030	2040	2050	2060	2070	2072
Minimum Wage	2.5	2.6	3.1	3.8	4.5	5.2	6.0	7.7	9.9	12.7	16.5	17.3
Contribution Ceiling	6.6	6.9	7.8	8.9	10.0	11.4	12.9	16.5	21.1	27.0	34.5	36.3
Average Nominal Wage	3.7	4.2	5.6	7.6	10.2	13.6	18.9	34.4	60.3	102.2	167.6	183.7
Percent of Contributors Earning Above Ceiling	10.1	11.3	15.9	22.9	43.4	62.6	79.9	83.8	85.4	87.3	89.5	89.7
Male (%)	11.0	11.8	15.5	23.5	46.6	66.4	83.0	86.8	87.8	89.2	91.2	91.3
Female (%)	8.3	10.2	16.8	21.7	37.5	55.6	74.1	78.3	81.2	84.0	86.7	87.0

Source: PROST 11 Malta Files

5.2.7 35 - 26 Age Group

The 35 to 26 age cohort is the one that will be impacted considerably as a result of the inadequacy of the Pillar 1 Pension. An inadequate pension will lead to low disposable income and as a result pensioners will have a much lower standard of living when compared to other citizens. This would also mean that following retirement, pensioners would need to alter their lifestyle considerably as they would not afford to purchase the same goods and services as they did prior to retirement. However, this age cohort will have between 30 and 39 years of Pillar 2 contributions and will therefore be able to maintain a decent standard of living through a Pillar 2 Pension.

Table 15 shows the replacement rate for new pensioners in the years at which this age cohort will retire, that is, between 2037 and 2046. It can be noted that whereas the replacement rate for Pillar 1 decreases from 24.6% to 19.5% for males and from 22.2% to 18.0% for females, the replacement rate for Pillar 2 increases from 10.7% to 18.7% for males and from 6.8% to 12.9% for females. Since Pillar 2 increases at a higher rate than Pillar 1 decreases, the result is a net increase in the total average replacement rate to be enjoyed by every person retiring in any one year within this period.

Table 15: Average Replacement Rate on Retirement for the 26 to 35 Age Cohort

Year	2002	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046	2050	2060	2070
Age in 2007 of persons retiring in this year		35	34	33	32	31	30	29	28	27	26			
New 2/3 retirement pension: Male Switchers														
Average Replacement Rate (%) (Pillar1)	62.4	24.6	23.9	23.2	22.5	21.9	21.4	21.0	20.5	20.0	19.5	17.2	13.6	11.8
Average Replacement Rate (%) (Pillar2)[29]		10.7	11.5	12.4	13.3	14.2	15.1	16.0	16.9	17.8	18.7	22.4	31.5	38.4
Total Average Replacement Rate	62.4	35.3	35.4	35.6	35.8	36.1	36.5	37.0	37.4	37.8	38.2	39.6	45.1	50.2
New 2/3 retirement pension: Female Switchers														
Average Replacement Rate (%)	62.7	22.2	21.6	21.1	20.5	19.9	19.5	19.2	18.8	18.4	18.0	16.2	13.3	11.7
Average Replacement Rate (%) (Pillar2)		6.8	7.3	7.9	8.5	9.2	9.9	10.6	11.3	12.1	12.9	16.6	27.7	39.3
Total Average Replacement Rate	62.7	28.8	28.9	29.0	29.0	29.1	29.4	29.8	30.1	30.5	30.9	32.8	41.0	51.0

Source: PROST 11 Malta Files

[29] Average Replacement Rate from Hypothetical Annuity

5.2.8 25 - 16 Age Group

Under the proposed reform, since the retirement age would be 65 years, then in order to have 40 years of contributions as is being required in the proposed pension system, everybody would need to start working by the time they are 25 years of age. This may impact decisions of travel, that are either not related to studies, or else to a work experience where the contributions paid could be taken into consideration, or furthering one's studies after a obtaining a first degree. This loss of travel experience and personal development may have a negative impact on the quality of life or youth.

The entry of Pillar 2 would bring a financial burden as this would effectively mean a raise in contribution from current levels, initially by 2% and subsequently by 5%, on employees resulting in a reduction in disposable income that could in turn have a degree of impact on the economy. This impact may be particularly felt by youths with low income and those starting a family, wherein all major expenses are usually incurred and who would now be affected by a rise in contributions. In general, this reduction in income may lead to increased claims on employers to increase wages. The latter would in turn expect an increase in productivity in order to mitigate against any loss in competitiveness, impinging on the contributors' leisure time and quality of life.

Future Workers

As a result of the raise in the retirement age, one may think that it would be harder in the future for young people to enter the labour market since those over 61 would remain in the labour market for an additional 4 years. It is however important to note that the 'labour stock' over time would decrease as a result of a reduction in birth rates.

Table 16 shows the changes in those in employment age between the current and proposed system.

Table 16: Comparison of Those in Employment Age between Current and Proposed System (in 000s)

Year	2002	2003	2004	2005	2010	2015	2020	2030	2040	2050	2060	2070	2072
Total Population	397	397	397	399	404	408	410	410	398	388	381	369	366
0 - 14	74	72	70	68	61	56	56	57	55	56	59	58	58
Current system 15 - Retirement Age	257	258	259	259	257	253	244	233	216	195	182	185	185
Proposed system 15 – Retirement Age	257	258	259	259	260	262	265	254	244	222	205	203	204
Current system - Retirement Age +	66	66	68	71	87	98	110	120	128	137	140	126	123
Proposed system - Retirement Age +	66	66	68	71	84	90	90	98	100	110	117	107	105

Source: PROST 11 Malta Files

Table 16 shows that the number of persons aged between 0-14 would decrease as a result of the decrease in the birth rate. As a result, under the proposed system, although those in retirement age would be less in comparison with the current system as a result of the increase in retirement age, those in employment age would not be proportionately higher. This therefore implies that the future workers should not fear attempting to join the labour market as a result of the increase in retirement age, because the net effect of the increase in retirement age with the decrease in birth rates nearly balances out.

05.3 Workers by Status of Employment

5.3.1 Unemployed

Individuals within this category would be affected differently by the reform in the pensions system proposed in the White Paper. A proportion of the unemployed that register with ETC are entitled to credits in terms of NI contributions. This ensures that the unemployed individual, entitled to these credits, receives pension benefits upon retirement. During the unemployment period, this proportion of individuals enjoys welfare benefits in order to have a decent standard of living. The increase in the retirement age would directly increase the period of unemployment for an unemployed individual.

The impact of this change would depend upon the income received during the unemployment period, in terms of welfare benefits, and how this compares to the pensionable income. If the latter is higher than the welfare benefits, then the unemployed would be worse off with an increase in the retirement age since the higher income would now accrue at a later stage. Assuming that the pensionable income is higher than the welfare benefits, or social assistance, received by the unemployed, the impact of the increase in the retirement age on these individuals would be negative in financial terms. Moreover, these individuals would have to adjust their consumption and savings patterns to reflect the loss in income during these additional four years.

On the other hand, the increase in the retirement age has a positive impact on the unemployed category as they have more time for job search and the probability of finding employment is higher. The younger age cohort might also be positively affected by the increase in the retirement age and by the increase in the length of service required to obtain a full pension. Younger unemployed have relatively more time, in the proposed system, to find a job.

In its proposals for Pillar 2, the White Paper does not specify whether those unemployed who are currently exempt (benefiting from the credit system) under Pillar 1 would enjoy a similar arrangement with respect to the contributions required for the Pillar 2. If Government had to opt for offering the same arrangement in case of Pillar 2 contributions, this category would be positively affected. Exempt persons would benefit from income earned from Pillar 2 over and above the pension income received from Pillar 1. On the other hand, if Government maintains the credit system for Pillar 1 but does not make it applicable for Pillar 2, those unemployed who are currently considered as exempt under Pillar 1 contributions would have to pay, if Pillar 2 is made mandatory, contributions for Pillar 2. This would essentially defeat the original concept of exemption given that the credit system was introduced to alleviate the burden of contributions off the unemployed. Mandatory Pillar 2 contributions would result in a decrease in this category's disposable income (derived from social welfare benefits).

The White Paper could also be considering another alternative for the Pillar 2 contributions from the unemployed. Pillar 2 could be made voluntary for those unemployed who are currently exempt under Pillar 1. Under this option, Government would continue to pay contributions for these exempt individuals for Pillar 1 and abstain from paying contributions for Pillar 2. Exempt individuals (under Pillar 1) would still benefit from Pillar 1 Pension income and would be provided with the opportunity to substantiate this income by contributing to Pillar 2. Another alternative could be that the unemployed are entitled to credits that are tied to training and/or community service. If one of these options had to be chosen, those unemployed who are either exempt under Pillar 1 or else entitled to credits would be alleviated from the financial burden of having to make compulsory contributions to Pillar 2.

5.3.2 Private and Public Sector (post 1979) Employees

This category encompasses all full-time and part-time employees who are actively involved in the labour market. The impact of the proposed pensions system on this category would vary by age and gender cohort analysed in this and other Sections of this report. On a general note, private and public sector employees would be affected in the following ways:

- people aged 48 years and below would be required to work until the age of 65. This involves a change in the future plans of an individual as well as a change in consumption and saving patterns during the years 61 to 65 and also over one's lifetime;
- individuals aged 39 years and below would be required to work for an additional ten years, than is currently required, in order to qualify for a full pension upon retirement. This has an impact on the health of the individual, both in the case of a strenuous/manual job and in case of professional employment. Moreover, it would directly influence the lifestyle and overall quality of life of an individual by reducing personal free time and leisure. On the other hand, one must note that the average working life in Malta has been established to be at 38 years. This means that overall people are currently working for a duration of 38 years and thus the reform would extend this period by 2 years;
- the change in the base-line period for the calculation of pension benefits from the average of the best three years out of the last ten years, to the average of the last 40 years would provide an opportunity for workers to earn a pension that reflects their overall working life earnings. This would have a positive impact on the individual since his/her achievements and earnings earned over a lifetime, rather than a minor share, would be considered to calculate pensionable income. The downside of this measure as proposed in the White Paper is that there is no

mention of the valuation method that would be used in the calculation of the average earnings. This proposed change might also have a negative impact especially on lower income earners. If an individual earns a low wage for a significant proportion of his/her working life and a relatively higher wage in the last few years, the average earnings for the 40 years would be significantly compromised by the lower-income years thus decreasing the pensionable income of the individual;

- the contributions to Pillar 2 (if made mandatory) would directly impact the employee's disposable income for a minimum of 40 years. As a consequence, the consumption and saving patterns of the individual would change, and the freedom of choice with respect to both savings and consumption would be reduced;
- the proposed pensions system would limit the ability of an employee to acquire additional work experience in foreign countries (excluding EU countries and countries with which Malta has a social security agreement) to a couple of years due to the 40 year required length of service;
- the indexation of the ceiling on contributions and the maximum pensionable income to inflation would have a positive impact on the individual's purchasing power upon retirement since the individual would be fully compensated with the increase in the general price level on an annual basis; and
- the removal of the capping on income earned by those persons who opt to continue working beyond the statutory retirement age provides more flexibility guaranteeing a quality of life and a good standard of living.

The introduction of Pillar 2 would mean an additional financial burden on employees as this would effectively result in a rise in contributions from current levels, initially by 2% and subsequently by 5%, resulting in a reduction in disposable income. This impact may be particularly felt by younger and lower income groups, by married couples with children on one pay and by other groups that have restricted income. In the White Paper, it is being proposed that Pillar 2 is first introduced on a voluntary basis in 2006. Government is then to undertake an assessment in 2009 to determine whether Pillar 2 should be introduced on a mandatory basis in 2010. This would allow employees some time to prepare themselves for this change. Furthermore, the Pensions Working Group proposes that owners of life endowment and profits-related policies are given the possibility to convert these policies into Pillar 2. In 2003, there were approximately 80,000 holders of such policies. This could be done by collaboration between Government and MFSA, and private sector financial institutions. By adopting this scheme, the social impact of the introduction of Pillar 2 could be partially alleviated.

Although the increase in contributions would benefit the employees in the long term, in the short-to-medium term the employees' quality of life and standard of living might suffer because of the lower disposable income. The reduction in the disposable income of employees may lead to wage increase demands which would impose a further burden on the employer over and above the increase in contributions the latter would suffer through the introduction of Pillar 2. The employees might in turn be expected to increase productivity levels further to mitigate the impact of the increase in labour costs. Should this happen, demand for higher productivity would create a less family friendly workplace, since family friendly measures may be perceived as a reduction in productivity. However, it must be pointed out that since Pillar 2 contributions are not to be taxed, employees would benefit from a reduction in their taxable income while saving up for their future.

The system proposed in the White Paper indicates that contributions to Pillar 2 should not be taxed on an annual basis but that a maximum tax, established at a fixed percentage rate, should be paid upon maturity of the Scheme. However, the tax which is being proposed to be paid by contributors upon retirement, would have an impact on the individual in terms of the income received in the year of the retirement (or the year of maturity of Pillar 2) and the individual's overall level of wealth. The White Paper does not specify the rate of tax which is to be charged upon maturity of the Scheme. This missing information may yield a degree of uncertainty and result in people being resistant to the introduction of this Scheme.

An equal mandatory contribution rate on Pillar 2 may be more taxing to low income earners than to medium to high income earners. Although contributions are relative to the income earned there is still a possibility that the established percentage, in monetary terms, would have a greater effect on the low income earners. This might in turn lead to the development of a perception that Government has not been socially just with all sectors of society.

A mandatory Pillar 2 may carry a very high opportunity cost for employees in terms of savings and investment alternatives. Funds given up as contributions to Pillar 2, might have gained a better return if invested elsewhere. The mandatory scheme would thus directly impact on the individual's investment decisions and ultimately on the individual's wealth.

An important distinction must be made here between private and public sector employees in terms of the impact of the proposed system in relation to job security. The reaction of private employers to the proposed additional contribution to be paid as part of Pillar 2 might significantly outweigh that of Government as an employer. In this context, private sector employees face a relatively higher risk in terms of job security when compared to public sector employees. Private sector employers may not take too kindly to an increase in labour costs and might therefore strive to decrease other costs of production or increase prices. Either way, public sector employees would in this sense be affected to a lesser extent than private sector employees.

5.3.3 Full-time and Part-time Employees

Full-time Employees

The impact of the proposed system on this particular category is highly similar to that described in the case of private and public sector employees. Full-time employees would be affected by the factors mentioned in the Section 5.3.2. In addition, the proposed reforms might have other effects which are specific to individuals in full-time employment which include:

- depending upon the reaction of employers, full-time employees may not be granted wage increments in the forthcoming years due to the increase in the costs of labour brought about by the additional contribution suggested to be made by employers in the White Paper; and
- the productivity of full-time employees may be influenced negatively as the latter would be required to work for a longer period. With the proposed reform in the retirement age, as well as, the increase in the length of service, full-time employees nearing retirement age would have worked for nearly 40 years and would be older. This may result in lower productivity and consequently employees might accrue negative consequences in financial terms.

Part-time Employees

Under the current PAYG system, part-time employees suffer from discriminatory measures and are to some extent discouraged to participate in the labour market. The proposed pensions system proposes a downward revision in the contributions that these workers should pay. This would act as an incentive for individuals seeking to work on a part-time basis to participate in the labour market. Atypical working patterns would be encouraged under the new system. This reform is likely to benefit mostly the female component of this sector, which relies more on atypical working patterns. Women would have a better chance of being entitled to a pension whilst having, at the same time, fulfilled their family obligations. This reform in atypical employment coupled with the introduction of credits for career breaks and for child rearing, also proposed in the White Paper, would have a significant positive impact on this category specifically on women in terms of their labour market participation.

The removal of discriminatory measures applicable to this category of employment being proposed in the White Paper would also incentivise those individuals in the informal economy to start declaring their employment by taking up formal employment on a part-time basis.

The White Paper fails to specify the conditions that would apply to this category in Pillar 2. The impact of Pillar 2 cannot therefore be assessed since the White Paper did not specify whether the part-time employees would have to contribute the same percentage as full-timers.

The White Paper also abstains from making reference to temporary workers. The impact that the introduction of Pillar 2 would have on this category is dependent on the impact that this would have on firms employing people on a temporary basis. These firms might regard the employment of these workers as an unviable option if further contributions have to be paid even for a relatively short period of employment. This would directly affect the temporary workers in terms of a reduction in job opportunities.

5.3.4 Self-employed Persons

This category would be affected by the reform both in Pillar 1 and 2. The reformed PAYG system proposed in the White Paper proposes a change in the base-line for the calculation of the Two-Thirds Pillar 1 Pension from the average of the last 10 years' net income for self-employed persons to the average of 40 years. Pension benefits would therefore be dependent on the average income earned by the self-employed over the 40 years, nearly a lifetime, of his/her business. Periods of lower declared earnings, would lower the average contributions resulting in a lower pensionable income. This change would make the system fairer among members of this category since the incidence of under-declaration of income would be reduced. Furthermore, it introduces equity between the employed and the self-employed in terms of the base-line for the calculation of the Two-Thirds Pillar 1 Pension. The downside of this measure as proposed in the White Paper is that there is no mention of the valuation method that would be used in the calculation of the average earnings.

The increase in the contributory years may pose a greater burden on self-employed persons who have heavy manual jobs such as construction workers, tile layers and plasters. Additional details about the social impact on manual workers can be found in Section 5.4.1.

Pillar 2 contributions would adversely affect this category in a twofold manner since the self-employed individuals would have to contribute a significant percentage to make up for both the employee and employer contributions. The reform might have a significant impact on the self-employed due to an increase in costs since the increase in contributions for both employee and employer would have to be shouldered by the same individual. Moreover, in the case of small-scale businesses transaction costs may be higher thus further increasing the effect.

The negative social impact may be partially offset by introducing a scheme, as is being proposed by the PWG, whereby owners of life endowment and profits-related policies are given the possibility to convert these policies into Pillar 2. This could be done by collaboration between Government, the MFSA and private sector financial institutions.

05.4 Workers by type of Employment

5.4.1 Manual or Technical Workers

The main impacts, on this specific group, of the proposed reform lie in the increase in the retirement age and in the extension in the length of service, from 30 to 40 years, required to obtain a full pension. Manual work is associated with significant physical activity and strain. This strenuous activity cannot be conducted for a constant, long period of time for physiological reasons mainly. The extension in the retirement age and the additional 10 years proposed in the new system might result in too heavy a burden, in terms of physical strain, for the manual worker. In this context, this reform may seem socially unacceptable for this category.

Manual workers usually enter the labour market at a relatively young age, sometimes at sixteen years. With the current retirement age set at 61, manual workers are working, on average, for a period of over 40 years and a significant proportion claim invalidity due to the nature of their job. The increase in the retirement age would further increase the problem both in terms of strain for the workers and the burden on State finances of invalidity pensions. Such a reform could be diminished through the introduction of alternative employment opportunities for the manual workers to take up in the last years of their working life that would require significantly less physical strain and would enable this category to work for the whole 40 years and ensure a full pension. Retraining opportunities should be provided to these individuals so that alternative employment could be sought in the additional years.

Another important consideration is the return to be earned from Pillar 2. The White Paper proposes that upon retirement age the retiree would be given a lump sum from the contributions to Pillar 2 and the remaining sum, which constitutes a larger proportion, would be set up as annuities. If this category suffers from a lower life expectancy when compared to other workers in alternative types of employment, then the return from Pillar 2 (annuity-based) may be enjoyed for a smaller number of years in the case of manual workers. Essentially, this would mean that these workers would not benefit from the same return from Pillar 2 as other groups and would not be able to enjoy the same standard of living.

The increase in the retirement age may lead individuals in this category, who are not able to work for these additional years, to leave the workforce and seek social assistance, unemployment benefits or invalidity pension thus restricting their social right to leave the workforce in a dignified manner.

5.4.2 Clerical or Administrative Workers

Workers occupying clerical and administrative positions would be affected, to a large extent, in similar ways as in Section 5.3.3 of this report. Other specific impacts that may result include the following:

- the indexation of the ceiling on contributions and the maximum pensionable income to inflation would have a positive impact on the individual’s purchasing power;
- the increase in the retirement age and the increase in the length of service from 30 to 40 years would result in a reduction in leisure;
- the change in the base-line period taken for the calculation of pensionable income under Pillar 1 from the average of the best three years out of the last 10 years to the average of 40 years prior to retirement age, might impact this category negatively since the lower income earned in the earlier stages of the person’s working life would decrease significantly the person’s working life average earnings and therefore his/her pensionable income; and
- Pillar 2 provides an opportunity for employees of this category to supplement pensionable income received through Pillar 1 with an additional income. The income derived through Pillar 2 would be needed to supplement earnings from Pillar 1 since the salary of clerical workers and therefore the contributions are likely not to be enough to secure an adequate pension in the future.

5.4.3 Professional or Managerial Workers

The changes in the Pillar 1 Pension proposed in the White Paper, specifically the increase in the retirement age and the length of service required to earn a full pension, might have a negative impact on this category. Professional workers are required to invest a number of years prior to entering the labour market in tertiary and post-graduate education. If it is assumed that the 40 years of service would be calculated from the retirement age downwards, then this would mean that an individual would have to start working at a minimum age of twenty-five to be eligible for a full pension upon retirement.

The proposed system provides for the introduction of credits to be given to individuals to compensate them during their absence from employment due to periods of further studies. However, only those individuals who have already entered the labour market would be entitled to such credits. In other words, periods of studying prior to entry in the labour market would not be eligible for credits. Therefore, a person who has completed his/her studies and started working at the age of twenty-six would not be eligible for a full pension since that extra year cannot be recouped in terms of credits. Thus, learning, in the White Paper, is being promoted only after the individual starts to participate actively in the labour market. In this context, the proposed system penalises those professional workers who in order to gain their initial position and employment status require a longer academic background prior to joining the workforce.

The increase in the retirement age affects this category also in terms of the possible inability of some professional workers to continue working for a longer period of time in certain stressful positions. Individuals occupying certain stressful jobs, such as healthcare professionals, might not be in a position to sustain their form of employment for longer periods due to the long, irregular hours, pressure and intensity of concentration required to carry out such jobs. On the other hand, a proportion of these workers may not be affected by the proposed change in the retirement age since persons occupying managerial positions sometimes opt to continue to participate actively in the labour market post retirement. In this context, the change in the conditions applicable to those people who wish work post-retirement would have a positive impact on these workers. The new system proposes the removal of the discriminatory measures, characteristic of the current system, which are imposed on individuals who work after the retirement age. The latter would be able to work with no capping on the income earned and enjoy pension benefits from both Pillar 1 and Pillar 2 while continuing to pay contributions for Pillar 1.

The introduction of Pillar 3 may have a positive effect on this category. Pillar 3 may prove to be more accessible to medium and high-income earners and might contribute to these social groups declaring their real income so as to benefit from tax free Pillar 3 contributions. However, this is really a universal principle that cannot and should not be mitigated against. In fact there are already freely available schemes for those who wish to provide for their retirement planning.

05.5 Employers

Following the implementation of the proposed reform, the pensions system would be made up of three Pillars. The Class I and Class II Contributions of Pillar 1 would remain the same. As for Pillar 2, the White Paper proposes that Pillar 2 should be first introduced on a voluntary basis and then in 2009 Government should make an assessment to determine whether it is necessary to introduce Pillar 2 on a mandatory basis as from 2010. If Pillar 2 is introduced on a mandatory basis, as suggested by the Pensions Working Group, Pillar 3 would be introduced on a voluntary basis and would concern solely the employees as it is something personal to each individual and the employer is not obliged to make a contribution.

It follows that the employers would be mostly impacted with the introduction of Pillar 2. The introduction of Pillar 2 would mean an additional contribution for both the employers and the employees. The "new" required contributions would lead to an increase in the costs for the employers due to the additional contributions that have to be made, as well as the cost of the extra administrative work that would result from this system. However, this is partly mitigated, since the contributions made on Pillar 2 are deductable from the taxable income Pillar 2 contributions are part of employment costs and as such are included in the Profit and Loss account of a firm. This means that these contributions would reduce the profit figure of the company. As a result, the net profit on which company tax would be levied would be lower and the company would pay less in tax contributions. It must be noted that this would result in a decrease in government revenue from taxation which would have to be recovered from alternative sources that in turn might produce other social impacts. In relation to the cost on the employer, there would however still be an impact on the employer because, if for example the company tax rate is of 35%, the remaining 65% of the 2% increase would still be an additional cost to the employer. Consequently, this could contribute to a loss of competitiveness on the part of the Maltese businesses, which could have negative social and economic implications. Apart from the impact on competitiveness, such increased financial burdens could also lead to other measures such as higher unemployment as businesses seek to do the same with less. Should the cost of the system on businesses be transferred to the consumer through price hikes in consumables, a risk of fuelling inflation would result.

As can be seen from **Table 14**, the percentage of contributors earning above the ceiling would increase considerably during the time period under study, starting from 10.1% in 2002 and reaching 89.7% in 2072. The reason behind this is that whereas the contribution ceiling is being pegged to inflation at 2.5 %, the nominal wage growth is being assumed at 3%. As a result, the contributions paid by the employers on Pillar 1 as a percentage of wages would decrease proportionately.

As an example, in the contributions paid on Pillar 1 and on Pillar 2 are calculated for a job position starting in 2005 with a wage of Lm5,500. As the contribution ceiling is increased yearly by 2.5% inflation, a 3% nominal wage growth is assumed. As it can be seen from the Table, in 2005 only 10% of the wage is paid as total contributions. As Pillar 2 is introduced in 2010, this increases to 12% and remains constant up till 2024. In 2025, it is proposed that 5% would be paid for Pillar 2 and as a result the total contributions paid would amount to 15%. This remains constant up till 2047. The change in 2048 takes place because from 2048 onwards the wage earned is higher than the ceiling and as a result the Pillar 1 contribution is calculated and paid on the ceiling rather than on the wage. In real terms a 9.96% of the wage is paid as a Pillar 1 contribution instead of the initial 10% or a total contribution of 14.96%. By 2072 the total contributions paid would have gone down to 13.86%.

Table 17: Contributions paid under the Proposed Pensions Reform

Year	Ceiling (inflation 2.5%) Lm	Wage (3% growth) Lm	Pillar 1 contribution Lm	Real % Pillar 1 contribution (%)	Pillar 2 contribution Lm	Real % Pillar 2 contribution (%)	Total real % contributions (%)
2005	6,750	5,500	550	10.00	-	-	10.00%
2006	6,919	5,665	567	10.00	-	-	10.00%
2007	7,092	5,835	583	10.00	-	-	10.00%
2008	7,269	6,010	601	10.00%	-	-	10.00%
2009	7,451	6,190	619	10.00%	-	-	10.00%
2010	7,637	6,376	638	10.00%	128	2.00%	12.00%
2011	7,828	6,567	657	10.00%	131	2.00%	12.00%
2012	8,024	6,764	676	10.00%	135	2.00%	12.00%
2013	8,224	6,967	697	10.00%	139	2.00%	12.00%
2014	8,430	7,176	718	10.00%	144	2.00%	12.00%
2015	8,641	7,392	739	10.00%	148	2.00%	12.00%
2016	8,857	7,613	761	10.00%	152	2.00%	12.00%
2017	9,078	7,842	784	10.00%	157	2.00%	12.00%
2018	9,305	8,077	808	10.00%	162	2.00%	12.00%
2019	9,538	8,319	832	10.00%	166	2.00%	12.00%
2020	9,776	8,569	857	10.00%	171	2.00%	12.00%
2021	10,020	8,826	883	10.00%	177	2.00%	12.00%
2022	10,271	9,091	909	10.00%	182	2.00%	12.00%
2023	10,528	9,363	936	10.00%	187	2.00%	12.00%
2024	10,791	9,644	964	10.00%	193	2.00%	12.00%
2025	11,061	9,934	993	10.00%	497	5.00%	15.00%
2026	11,337	10,232	1,023	10.00%	512	5.00%	15.00%
2027	11,621	10,539	1,054	10.00%	527	5.00%	15.00%
2028	11,911	10,855	1,085	10.00%	543	5.00%	15.00%
2029	12,209	11,180	1,118	10.00%	559	5.00%	15.00%
2030	12,514	11,516	1,152	10.00%	576	5.00%	15.00%
2031	12,827	11,861	1,186	10.00%	593	5.00%	15.00%
2032	13,148	12,217	1,222	10.00%	611	5.00%	15.00%
2033	13,476	12,584	1,258	10.00%	629	5.00%	15.00%
2034	13,813	12,961	1,296	10.00%	648	5.00%	15.00%
2035	14,159	13,350	1,335	10.00%	667	5.00%	15.00%
2036	14,513	13,750	1,375	10.00%	688	5.00%	15.00%
2037	14,875	14,163	1,416	10.00%	708	5.00%	15.00%
2038	15,247	14,588	1,459	10.00%	729	5.00%	15.00%
2039	15,628	15,025	1,503	10.00%	751	5.00%	15.00%
2040	16,019	15,476	1,548	10.00%	774	5.00%	15.00%
2041	16,420	15,941	1,594	10.00%	797	5.00%	15.00%
2042	16,830	16,419	1,642	10.00%	821	5.00%	15.00%
2043	17,251	16,911	1,691	10.00%	846	5.00%	15.00%
2044	17,682	17,419	1,742	10.00%	871	5.00%	15.00%
2045	18,124	17,941	1,794	10.00%	897	5.00%	15.00%
2046	18,577	18,479	1,848	10.00%	924	5.00%	15.00%
2047	19,042	19,034	1,903	10.00%	952	5.00%	15.00%
2048	19,518	19,605	1,952	9.96%	980	5.00%	14.96%
2049	20,006	20,193	2,001	9.91%	1,010	5.00%	14.91%
2050	20,506	20,799	2,051	9.86%	1,040	5.00%	14.86%
2051	21,018	21,423	2,102	9.81%	1,071	5.00%	14.81%
2052	21,544	22,065	2,154	9.76%	1,103	5.00%	14.76%
2053	22,083	22,727	2,208	9.72%	1,136	5.00%	14.72%
2054	22,635	23,409	2,263	9.67%	1,170	5.00%	14.67%
2055	23,200	24,111	2,320	9.62%	1,206	5.00%	14.62%
2056	23,780	24,835	2,378	9.58%	1,242	5.00%	14.58%
2057	24,375	25,580	2,438	9.53%	1,279	5.00%	14.53%

Year	Ceiling (inflation 2.5%) Lm	Wage (3% growth) Lm	Pillar 1 contribution Lm	Real % Pillar 1 contribution (%)	Pillar 2 contribution Lm	Real % Pillar 2 contribution (%)	Total real % contributions (%)
2058	24,984	26,347	2,498	9.48%	1,317	5.00%	14.48%
2059	25,609	27,138	2,561	9.44%	1,357	5.00%	14.44%
2060	26,249	27,952	2,625	9.39%	1,398	5.00%	14.39%
2061	26,905	28,790	2,691	9.35%	1,440	5.00%	14.35%
2062	27,578	29,654	2,758	9.30%	1,483	5.00%	14.30%
2063	28,268	30,544	2,827	9.25%	1,527	5.00%	14.25%
2064	28,974	31,460	2,897	9.21%	1,573	5.00%	14.21%
2065	29,699	32,404	2,970	9.17%	1,620	5.00%	14.17%
2066	30,441	33,376	3,044	9.12%	1,669	5.00%	14.12%
2067	31,202	34,377	3,120	9.08%	1,719	5.00%	14.08%
2068	31,982	35,409	3,198	9.03%	1,770	5.00%	14.03%
2069	32,782	36,471	3,278	8.99%	1,824	5.00%	13.99%
2070	33,601	37,565	3,360	8.94%	1,878	5.00%	13.94%
2071	34,441	38,692	3,444	8.90%	1,935	5.00%	13.90%
2072	35,302	39,853	3,530	8.86%	1,993	5.00%	13.86%

The impacts on employers will be further assessed for the different categories of employers identified earlier on in this report:

- public sector;
- micro and small private enterprise; and
- medium-sized and large private enterprises.

The White Paper also states that the common/mandatory Pillar 2 “should not restrict employers and organisations from creating supplementary pension funds over and above the proposed Pillar 2 Pensions Scheme in order to render the organisation or work place more attractive for hiring and the retention of employees” (p. 58). This would lead to a culture change as employers would start offering pension funds as part of the employment package.

Another impact on the employers is the change in culture required, because of the effects resulting from the increase in the female participation in the labour force that may result following the implementation of the White Paper and also from the following recommendations of the proposed pension reform:

- the increase in retirement age and thus an older workforce; and
- the introduction of family friendly measures in the workplace.

The employers may have to change their present values in order to integrate older employees and female employees in their organisation. Ideally, such a positive change towards equality is to be reflected in the amendments of the present human resources policies, such as in the recruitment and selection policies, and also in the policies related to the training and personal development of employees.

A demand may be made on employers to offer more flexible arrangements in terms of working hours and patterns by those who opt to work beyond the statutory retirement age as it is probable that most of these individuals would not wish to maintain the same level of activity they had prior to their retirement age. On the other hand, they may be forced to settle for similar conditions unless Pillar 2 is actually matured upon the statutory retirement age.

The introduction of family friendly measures, as a result of the increase in retirement age and female participation, would have positive impacts on employers since they would attract highly capable employees with family responsibilities. On the other hand, such measures may have a negative impact if women of child-bearing age are seen as bringing more obligations and ‘complications’. Such introduction would also lead to an increase in costs to the employer due to an obligation to provide childcare facilities and to an increase in investment in IT, monitoring and management systems required for the introduction of family friendly measures such as flexitime, teleworking and childcare arrangements.

5.5.1 Public Sector

Government, like any other employer, has to pay the contributions of the employees working within the Ministries, the Departments, the independent statutory bodies and the public sector entities. Therefore, the introduction of Pillar 2 would mean an increase in Government expenditure. Such increase has to be forfeited from the financial resources available for other Government priorities. If Government does not have the necessary financial resources to implement its policies, especially those policies of a social nature, the people that would have benefited from such policies would lose such opportunity in improving their quality of life and/or standard of living. Moreover, since the Public Sector is a large employer, it is more prone to impacts from inflation and could lead to an increase pressure on wages.

The increase in retirement age would automatically lead to an extension of the present public sector labour force. However, since the increase in retirement age is proposed to be implemented in a scaled manner and since the birth rate is decreasing rather than leading to an increase in the labour supply this would lead to an older workforce.

Presently, Government has a surplus of employees. Since offering early retirement schemes to surplus employees would go against the concept of increasing labour force participation as is required by the pension reform, Government may need to redeploy the surplus employees. One of the measures proposed in the Budget Speech 2005 to address this problem is that "wherever possible, retirees would not be replaced except in those instances where replacement is absolutely necessary so as not to disrupt essential services". Such surplus workers may block potential positions that could have otherwise been taken up by the workers that are being incentivised by the White Paper to enter the labour market. Consequently, such workers have to seek employment within the private sector or abroad. The limitation in choice may hinder aspirations for the future and create a sense of insecurity.

5.5.2 Micro and Small Private Enterprises

The contributions that have to be made in respect of Pillar 2 would lead to an increase in the costs due to the additional contributions that have to be made. The impact of such additional contributions would not be essentially different between the micro/small enterprises and the medium-sized and large private enterprises, as the costs for the enterprises would increase in proportion with the number of employees. However, the increase in transaction costs may have a significant effect on the micro/small enterprises, which are generally family run businesses and less likely to have a Human Resources Department and/or an Accounts Department.

The increase in variable costs may lead to a loss of competitiveness. The owners of micro and small enterprises may have to downsize their organisations in order to remain competitive. Another option besides downsizing could be that micro and small private enterprises merge with other private enterprises to benefit from economies of scale.

Downsizing and merging decisions are decisions that are hard to take as they involve a lot of issues, including those of an ethical and moral nature. This may impact the employers' lifestyle and their mental health, especially if they are subject to high levels of stress.

The reduction in profits may also lead to a change in the income available for the employers themselves and in the employees' salaries. One may also decide that there are no available funds to offer supplementary pension funds for the employees in addition to what is mandatory for the Pillar 2 or to invest in a personal Pillar 3 Pensions Scheme for the employer. This would lead to a change in lifestyle due to lower income in terms of lower pension payouts. As a result, one may need to reorganise his/her priorities on how available income is to be spent, since the standard of living would not be maintained.

The introduction of family friendly measures and its related costs, some of which are fixed costs, may lead to a burden that is greater on micro and small enterprises rather than on medium-sized and large enterprises.

5.5.3 Medium-sized and Large Private Enterprises

As was explained in Section 5.5.2, the impact resulting from the costs incurred due to the additional contributions that have to be made would be the same as the micro and small enterprises percentagewise. However, such costs increase directly proportionately to the number of employees, and therefore, the cost would be higher the more employees a company employs. However, the additional costs incurred in relation to the additional transaction costs are more likely to be absorbed by the medium-sized and large private enterprises that have larger economies of scale than by smaller and small enterprises.

Should the additional contribution costs lead to a loss of competitiveness the impact would be the same as explained in Section 5.5.2. Similarly, the same impacts attributable to the reduction in profits may result.

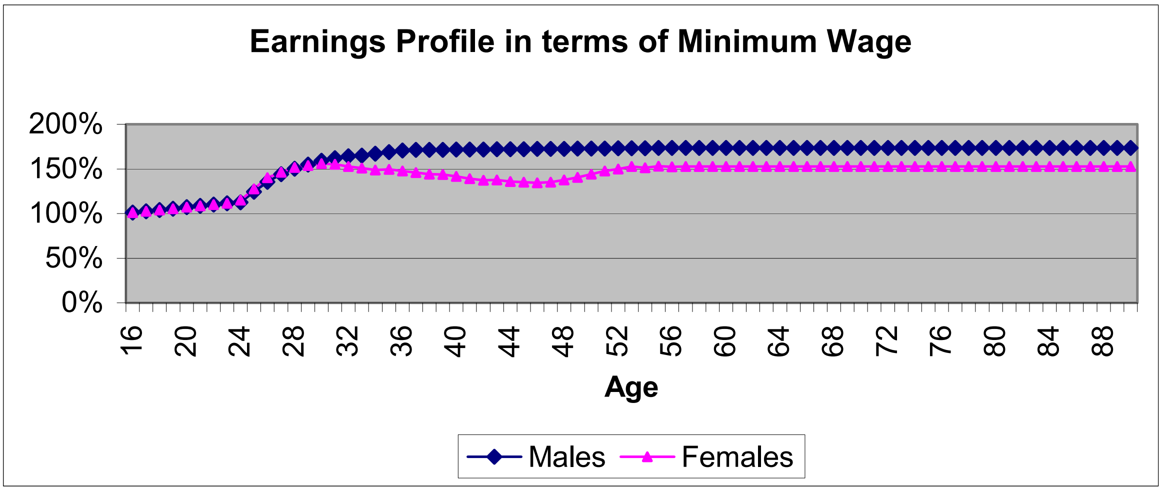
05.6 Gender Considerations

The proposed pensions reform is based on the contributions being paid by the employees, and is therefore based heavily on labour market experience. Consequently, the Pillar 1 Pension is only guaranteed to those who paid Pillar 1 contributions while in employment. According to the Gender Equality Action Plan 2003-2004 published by ETC, women receive four-fifths of male earnings in similar occupations and across age groups, which statistic is also comparable to that across the European Union. Consequently, considering that women are more likely to earn lower wages when working, they may still be in a high risk of low pensions following the implementation of the proposed reform to the pensions system.

Under the proposed pensions system, the Pillar 1 Pension would be calculated on the average of the 40 year contributions accumulation history for both employees and self-employed. Although, this is a positive move since it is a more realistic approach in terms of portraying what contributions were actually paid, it may negatively impact female employees who generally receive lower wages especially in the early years of employment and also who may take longer in career progression.

Figure 3: Male and Female Earnings Profiles shows the difference in the earnings profile of males and females. The females' earning profile, which is given in terms of the minimum wage, is lower than that of males. This difference is sustained for each age cohort given in the Figure. As can be seen the female earnings' profile stands at a lower level than the male profile for the majority of age groups. Moreover, whereas male earnings are rather constant throughout working life, female earnings fluctuate between the years 16 to 56 and seem highest close to retirement.

Figure 3: Male and Female Earnings Profiles



Source: PROST 11 Malta Files

There are three options of how a pensioner may take the benefits generated from Pillar 2: as a lump sum, as programmed withdrawals or as annuities. The PWG is proposing that the Pillar 2 benefits are taken partly as a lump sum and the remainder as annuities. In the case of annuities if the pensioner dies before the expected year based on life expectancy, part of the benefits would be lost at the detriment of the survivors, who in most cases are females due to higher life expectancy. In the case of females who actively participate in the labour market and provide for their individual Pillar 2 contributions, the return from an annuity-based Pillar 2 would be lower than in the case of males due to the higher female life expectancy at retirement. As a result, female pensioners live with lower payouts throughout their retirement. It is important to note that this impact is minimised if a unisex mortality rate is used to calculate the annuity payment rather than the gender specific rate.

As can be seen in the PROST projections shown in **Table 18** females have a lower individual support ratio when compared to males. This means that females have to work for a lower number of years to cover every year of likely retirement. The individual support ratio for females, as shown in the Table, would remain lower than that of males for the period covered by the White Paper. This arises since the length of service required for both females and males is the same but females' life expectancy at retirement is higher than that of males. PROST simulations show that at retirement women have a higher life expectancy than men and that this trend would be sustained over the period 2005-2072. This results in a higher retirement portion as a percentage of life length for women.

The only gender specific change proposed by the White Paper is the increase of the retirement age to 61 years for females as from the year 2007. This means that as from 2007 all women employees would have to retire at 61 years irrespective of their age. Although this measure would bring equity between genders, the overnight increase in retirement age may have a drastic impact particularly on those women nearing retirement age that would already have retirement in their frame of mind. Any aspirations for the future would have to be delayed by one year.

As from 2007, the retirement ages of males and females would increase in parallel until they reach 65 years in 2022. Since women enjoy a higher life expectancy at retirement age, the increase in the retirement age would still erode, but to a lesser extent than in the case of males, the pensionable period.

Table 18: Projections of Life Expectancy Changes in Malta

Year at retirement	2002	2005	2010	2014	2018	2020	2030	2040	2050	2072
Males										
Retirement age	61	61	61	62	63	64	65	65	65	65
Life expectancy at retirement	17.9	18.1	18.4	17.8	17.3	17.4	16.3	17.1	17.9	18.9
% Retirement Portion/Life Length (Age 15+)	28	28.3	28.6	27.5	26.4	26.6	24.6	25.5	26.3	27.5
Individual Support Ratio (Age 15+)	2.6	2.5	2.5	2.6	2.8	2.8	3.1	2.9	2.8	2.6
Females										
Retirement age	60	60	61	62	63	64	65	65	65	65
Life expectancy at retirement	22.2	22.4	21.9	21.4	20.8	21	19.7	20.3	20.8	21.9
% Retirement Portion/Life Length (Age 15+)	33.1	33.3	32.3	31.3	30.3	30.4	28.3	28.8	29.4	30.5
Individual Support Ratio (Age 15+)	2.0	2.0	2.1	2.2	2.3	2.3	2.5	2.5	2.9	2.3

Source: PROST 11 Malta Files

The existing pensions system is based on the traditional family and labour structures. In the past few years new forms of employment have emerged that need to be taken into consideration. People's lifestyles have changed and this has changed the form of employment associated with it. Atypical employment is even a more sought alternative among female workers. This is because once they have children it becomes more challenging for them to balance the demands of a 40-hour job with the responsibilities associated with child rearing. The proposed reform to the pensions system, as opposed to the current pensions system, which is built on the traditional model of the family, acknowledges the change in culture leading to a change in gender roles and the importance of female participation in the labour force. Female participation is increased through a number of measures including the following:

- recognising atypical employment such in the case of women who stop working to raise their children and women who cannot maintain the "normal" 40 hour job since it removes the minimum contribution to be made;
- considering a policy instrument for credits that takes into account parental responsibilities in relation to child bearing; and

- introducing family friendly measures.

Such measures acknowledge and reinforce the change in culture that has taken place and is still taking place. Women are no longer seen as full time home carers but their contribution to the labour market is valued. Introducing child-raising credits to a person's pension contributions encourages mothers and fathers to take an active role in raising their children. This may also incentivise fathers to take a more active role in the early years of their children, by opting for career breaks, something which is lacking in the present culture.

On the other hand, by increasing the retirement age to 65 years for both men and women, one is postponing the age of annuitisation. This would lead to higher monthly annuity payments when compared to the present retirement age as interests are accumulated for 5 more years in the case of women and for an additional four years in case of men.

The increase in retirement age and in the contribution period forces employees to remain in employment up to the age of 65 years. In comparison to the present system, this leads to a reduction in time available for leisure opportunities and also to less opportunities of passing time with the children. Grandparents may no longer be able to provide support in childminding. The latter change together with the increased female participation in the work force may lead to a change in child caring, as mothers may have to opt for the provision of private childcare services. A similar impact may result on elderly care, as generally it is the tradition that female family members take care of older family members such as the parents.

05.7 Persons with a Disability

The introduction of Pillar 2 as proposed in the White Paper may have a significant impact on the persons with a disability. The additional contributions may lead to a reduction in income. This may have a greater impact on the employees with a disability as some of these persons may already have additional expenses in relation to their disability. A reduction in income is associated with a lower standard of living as one has a limited access to certain goods that require higher financial resources than one could afford. Moreover, although the quality of life does not necessarily depend on one's standard of living or income, personal development may be hindered by this reduction in income as there is a restriction on the means available to increase one's quality of life. This in turn has a domino effect on the community development.

The proposed reform to the pensions system intends to deter abuse. One way of deterring abuse is by reviewing the present invalidity pension scheme as for some people it may be seen as an option for early retirement. Persons with a disability, who have genuine cases that are entitled to invalidity benefits, may feel threatened by the changes in the system, especially if such changes entail more bureaucratic procedures. On the other hand, people may feel more secure as they are reassured that the financial resources available for such scheme are being used in an honest and desirable way. This reassurance is further enhanced through the proposition of the White Paper of establishing a ring fenced account for contribution benefits and pensions with appropriate transparent governance.

The proposed increase in retirement age and in the contribution period may act as a disincentive to the employment of persons with a disability. Moreover, it may be more difficult for certain categories of persons with a disability to maintain their employment to the retirement age. Consequently, they may have to be retrained and/or redeployed leading to a change in their lifestyle. On the other hand, recognising atypical employment is a positive move towards those persons with a disability that cannot maintain a 40-hour job. This may also lead to an increase in the employment rates of persons with a disability.

05.8 Widows, Widowers and Survivors

Since the White Paper covers all contributory benefits, but mentions no specific measures for the widows, widowers and survivors benefits, it appears that in terms of Pillar 1 these would be affected in the same way as the other stakeholders covered. For example, in the section on full time employees it was pointed out that the indexation of the pension to inflation would increase the individual's purchasing power. Such purchasing power is increased to the widows, widowers and survivors once they start receiving the pension of their deceased spouse.

With regards to Pillar 2, the proposed pensions system would need to be amplified in relation to the regulation of what the widows, widowers and survivors of a person who would be entitled to a Pillar 2 Pension would be eligible for if the person passes away either before or after retirement age. Unnecessary complications, resulting from the introduction of Pillar 2, create a sense of insecurity leading to a low quality of life and to a loss of aspirations for the future. Feelings of insecurity and uncertainty may also result from concern on the worth of one's fund upon retirement because of the fluctuations of the financial markets on which funds generated from Pillar 2 and Pillar 3 would be based.

Moreover, the White Paper states that when an individual retires the retirement benefits could be taken in three ways: as a lump sum payment, as programmed withdrawals over the retirement period and as annuities from an insurance company. If the spouse takes part of the sum as an annuity, in other words as a contract, which guarantees income from the point of purchase until death, once the spouse is dead the survivor or widow/widower would not benefit from any proceeds. In the case of scheduled withdrawals, if a person dies early, the remaining balance is turned over to survivors. Also, a maximum tax, established at a fixed percentage rate, should be paid upon the maturity of the Scheme. Such tax would minimise the income available for the widows, widowers or survivors.

Pillar 2 may include a voluntary tier whereby the employees have the choice to invest more on a range of schemes which could include widows' pension, invalidity pensions and others in the event that the individual would wish to increase the resultant benefit above that set by the first tier. Incentivising employees to opt for such investments would lead to a better standard of living for widows/widowers as they would have an additional income to the one derived from the pension of Pillar 1. The ability to maintain the same or nearly same standard of living enjoyed while the spouse is still alive would prevent the surviving spouse from having to change lifestyle.

Considering that females have a higher life expectancy the impacts of this section are more likely to affect the female population rather than the male population.

05.9 Foreigners Working in Malta and Maltese Nationals Working Abroad

To encourage the free movement of workers within the Member States of the European Union (EU), the EU aims to ensure that there are no disadvantages in social security. In fact EC Regulation 1408/71 is intended to coordinate the different social security schemes that exist in the various Member States. The dispositions of the EU on social security apply to those persons coming from an EU Member State or from the European Economic Community or from Switzerland.

The EU legislation does not attempt to create a common social security scheme but provides for a mechanism by which contributions in different Member States are aggregated, and final social security pensions are paid by different Member States in proportion to the contribution made in that country. Consequently, EU nationals working in Malta and Maltese nationals working in the EU would feel assured that no contributions paid are lost and that they are still entitled to Pillar 1 Pensions. It is assumed that provisions would have to be made for the portability of Pillar 2 Pensions. The proposed pensions system does not specify the mechanism that would be applicable to cater for the mobility aspect of Pillar 2 that is likely to result in the labour market.

Moving from one place to another involves an amount of stress, as one has to adapt to new cultures and systems, including the social security systems. Lack of adequate information and necessary details on Pillar 2 may lead to feelings of uncertainty while making it more difficult for EU nationals to work in Malta and for Maltese nationals to work in the EU.

The increase in retirement age to 65 years may disincentivise people to work in Malta, as there are other countries in the EU which have a lower retirement age. This may act as a disincentive because if for example a person works in country A where the retirement age is 65 years and then works in country B where the retirement age is 60 years, such person may retire at the age of 60 years and receive a proportionate Two-Thirds pension from country B. However, this person has to wait until the age of 65 years to receive the entitled portion of the Two-Thirds pension from country A.

In the proposed pensions system, the accumulation period would be increased from the current 30 years to 40 years. This would limit the ability of an employee to work in foreign countries other than those forming part of the European Union or of the European Economic Community or Switzerland or those with which Malta has bilateral agreements as not enough contributions may be available for a full Two-Thirds pension.

06. Short, Medium and Long Term Assessment of Social Impacts

This Section of the report would assess the social impact of the proposed reform to the pension system in the short, medium and long-term. It is built upon the issues brought forward in earlier sections of the report and focuses on the impact of the reform within specific timeframes. It highlights the differences in social impacts that would accrue in the three individual time spans, as follows:

- the short term which refers to the period 2005 to 2010;
- the medium term which refers to the period 2011 to 2025; and
- the long-term which refers to the period 2026 to 2050.

Moreover, in this Section two scenarios will be contemplated, mainly the:

- **Current Scenario** – this will represent the situation if the current system is maintained; and
- **Reformed Scenario** – this will represent the situation if the reform proposed by the White Paper is implemented.

In order to assess the social impact in the specific timeframes, a set of common statistics, explained in Section 1.3 (Methodology), were used in each of the three sub-sections (short, medium and long term) to analyse and compare the social impact in the respective timeframes.

In the three individual sub-sections, that follow hereunder, the percentage of annual expenditure that will be covered by pension income in the years in the short, medium and long term periods was analysed. An average of this percentage for each individual period was also calculated to enable comparisons between the three time frames. In other words, the average proportion of annual expenditure covered by pension income was estimated for the short, medium and long-term periods.

The social impact on pensioners, and on the other age and gender cohorts over the short, medium and long term in relation to the changes being proposed in the White Paper was also assessed in an analytical manner in the next three Sections.

06.1 Short Term Assessment (2005 – 2010)

The short term is defined, for the purpose of this Section, as the period between 2005 and 2010. The social impact of the proposed reform in the short term is summarised hereunder:

- it is envisaged that society as a whole would be adversely affected in the short term as the pension income received by retirees in this period would be lower under the reformed scenario. In the short term the reform would bring about a decrease in the proportion of annual expenditure covered by pension income as shown in **Table 19**;

Table 19: Short Term Projections of Average Pension Income

Year	2005	2006	2007	2008	2009	2010	Average	Difference
Average Pension (Lm)								
Current Scenario	2544.99	2588.19	2655.87	2719.91	2779.76	2836.86		
Reformed Scenario	2542.40	2559.22	2579.01	2601.18	2626.03	2651.71		
Household 1: % of average annual expenditure covered by average pension								
Current Scenario	71	70	70	70	70	70	70	(2%)
Reformed Scenario	71	69	68	67	66	65	68	
Household 2: % of average annual expenditure covered by average pension								
Current Scenario	49	49	49	49	49	48	49	(2%)
Reformed Scenario	49	48	47	47	46	45	47	

- those retiring during the period 2007 to 2010 would be on average negatively affected by the changes proposed in the White Paper. As shown in **Table 19**, in the short term the reformed pension income would be lower than that received if the current system had to be maintained between the period 2005 to 2010. This would result in a reduction in the income received by pensioners retiring between 2007 and 2010. Under the current pension system, pension income received would on average provide for 70% of average annual expenditure of Household 1, while in the proposed system this proportion would go down to 68%. This can be seen in **Table 19**. The impact on Household 2 is similar to the impact on the former household whereby as the Table shows the percentage of average expenditure covered by the average pension income would be 2% lower under the reformed scenario. This case holds for the period 2005 to 2010;
- culture is ingrained in society, thus, changes in culture resulting from the reform would take time to evolve and would not impact society in the short run. In particular, the cultural impact arising from the change in the role of the State towards the promotion of the self-help concept, referred to earlier in the report, is not likely to be felt in the short term but would take more time to start affecting society;
- the changes being proposed in the White Paper would encourage increasing female labour force participation that might be reflected in the short term. An example being the proposed changes in the NI contributions for people in atypical employment. It should be expected that this would result in an increase in the number of part-timers in the period 2005 till 2010, primarily as a result of a greater number of females returning to productive part-time employment. The impact of such a reform could be felt in the short run since such a change has long been expected and desired especially by the female portion of society. This should lead to an immediate increase in the female labour force participation rate albeit not very significant. Therefore, the envisaged negative impact on current child care and family arrangements as a result of the potential disappearance of the extended family consequent to the pension reform should not be expected to materialise in the short term;
- the proposed changes in the retirement age and the length of service required to get a full pension is not expected to affect the male cohort of society in a significant way in the short term. Females who would be in the pre-retirement stage during the period 2005 to 2010 would be adversely hit since the retirement age for females is proposed to increase to 61 as from 1st January 2007. This change is too sudden and might consequently shock the female working population especially those who would be of 58 to 60 years of age in 2007 as their plans for the forthcoming years would be suddenly disrupted. However, this change would bring equality and positively affect society as a whole;
- the credit system to provide for periods of both female and male (in case of child rearing) inactivity, which is being proposed to start as from 2007, would probably not bring about any changes in the labour market over the short term period. Bearing in mind that people could start applying for this scheme only as from 2007 and that child bearing and rearing is usually a planned activity it is unlikely that the positive impact resulting from this reform would be felt in the short term. The White Paper did not specify how the credit mechanism should work. For example, for how long the credits would be given, how often and the wage on which credits would be based were not specified. This missing information might delay the take up of such a system. Another important consideration with regard to the credit system is the possible negative effect on labour force participation rates especially for those with lower wages. This category could opt for credits instead of participating in the labour market during child rearing years thus undermining the original intention of introducing credits; and
- promotion of life-long learning through the credit system proposed in the White Paper might positively impact society even in the short run. Employees might immediately take up such an opportunity and participate in the system, which is being proposed to be introduced in 2007. Take-up rates might be high during the period 2007 to 2010 since people might have been waiting for such an opportunity for some time. This system should positively affect the economy as it promotes retraining of the current workforce and facilitates the development of a knowledge based economy.

Another important impact that might arise in this period is the change in lifestyle which the population may have to start preparing for in light of the proposed metrics of the pension system. The consultation process which will be carried out in 2005, will raise public awareness about the pensions issue in terms of its problems of inadequacy and sustainability. In the short term period, people will start to realise that under the current scenario pension income received upon retirement would not suffice to maintain their standard of living. In this context, the consultation process in 2005 will stimulate people to think and reconsider their lifestyle, commitments and consumption and savings patterns. Although, those persons who are forty-one years of age in 2005 (46 years of age in 2010), would be exempt from paying Pillar 2 contributions, they might still change their consumption and savings patterns in the short term since they would realise that the pension they would receive in the future would not be as adequate as that received today. Therefore, these individuals might change their consumption levels even during the short term period to better provide for the future by taking out private pension investments.

In the short term, those persons in the 40 to 45 age cohort would also be negatively affected, as they would have to increase their savings rate to supplement the by then rather inadequate pension income. This is especially valid for those who would be 41 years of age and over as at 2005. Individuals who in the short term period would be in their twenties and thirties may alter their consumption levels to adjust their lifestyle and prepare for the introduction of the mandatory Pillar 2 in 2010.

The commitments that people might have entered into or envisaged to enter into during the short term would influence the extent to which people would be affected by the reform. The extent of the impact of the reform on people would also depend on their earnings profile. People in the lower income quartiles might feel helpless upon the realisation that they would have to make additional contributions. The impact of Pillar 2 contributions, even if this is made mandatory in 2010, might affect this category of people in terms of their consumption and savings patterns even in the short term as they might need to adjust these patterns with immediate effect.

06.2 Medium Term Assessment (2011 – 2025)

The medium term is defined, for the purpose of this Section, as the period between 2011 and 2025. One of the major impacts that would be felt in the medium term is the introduction of Pillar 2 contributions. The White Paper proposes that Pillar 2 be introduced on a mandatory basis in 2010 for those persons who are 45 years or under in this same year. The impact of Pillar 2 contributions would start to be felt as from the year 2010. Essentially, the impact of Pillar 2 would be felt solely in the medium to long term. As from 2010, people of each age and gender cohort, below the age of 45, participating in the labour market would have to start making additional monthly contributions of 2% of wages during the period 2010 to 2024 and of 5% as from the year 2025. Therefore, in the medium term, the main impact on people would arise in terms of lower disposable income as a result of the increase, amounting to 2%, in the monthly contributions.

The period 2010 to 2025 will see the implementation of another major change of the proposed pension system. Towards the end of the medium term period a proportion of people would start earning two pensions – pension income from the reformed Pillar 1 and the pension income from Pillar 2 which, as proposed by the White Paper, would be paid partially through a lump sum with the remaining significant proportion being annuitized. The pension income to be accrued from Pillar 2, would supplement the pension received from Pillar 1 which by then would be significantly low.

The reform in the pensions system would produce other impacts in the medium term, which include:

- the replacement rate, which refers to the average pension as a percentage of the average wage, that would accrue to pensioners if the reform is implemented would still be decreasing in the period 2011 to 2025. This would mean that the average pension during this period, except for the year 2025, would be lower than that accruing under the current scenario. This in turn means that over the medium term the social impact in terms of the negative effects on quality of life would still be felt. This is clearly depicted in **Table 20** below which shows that as a result of the reform in the medium term, pension income would be lower under the reformed scenario;

Table 20: Medium Term Projections of Average Pension Income

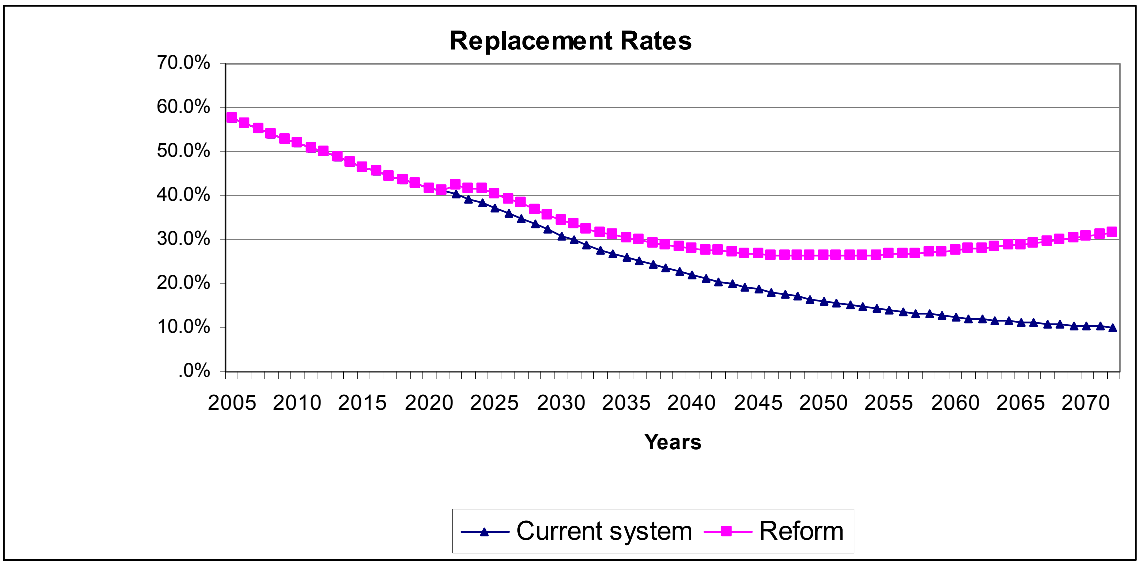
Year	2011	2013	2015	2017	2020	2025	Average	Difference
Average Pension (Lm)								
Current Scenario	2890.37	2985.35	3065.30	3125.08	3171.58	3147.92		
Reformed Scenario	2677.00	2724.29	2750.92	2790.65	2860.78	3200.91		
Household 1: % of average annual expenditure covered by average pension								
Current Scenario	69	68	67	65	61	53	63	5%
Reformed Scenario	64	62	60	58	55	54	58	
Household 2: % of average annual expenditure covered by average pension								
Current Scenario	48	47	46	45	42	37	43	3%
Reformed Scenario	44	43	41	40	38	38	40	

- **Table 20** shows that, on average in the medium term, the average pension would cover 58% of average annual expenditure under the reformed scenario rather than 63% as would be the case if the current system would be maintained. This means that in the medium term, the average pension in the reformed scenario would provide for 5% less in annual expenditure of Household 1 and 3% in the case of Household 2;
- the reform in the retirement age which is being proposed to be carried out on a gradual basis, would have a significant effect on individuals due to a reduction in leisure and an extension in the working life. As mentioned earlier in the report, this would have implications on manual and professional workers in different ways;
- proposals for increasing the length of service required to 40 years to be eligible for a full pension would be felt by society in the medium term since the reform is being introduced for persons aged 45 years and below in 2007;
- the credit system being proposed to compensate females for periods of inactivity due to child rearing and both females and males in the case of child rearing would have an impact in the medium term. Female participation in the labour force is expected to rise during this period as a result of the added flexibility that this credit system gives to female employees. Male participation rates are already high and thus no significant impact is envisaged on the participation rates as a result of the introduction of this system;
- in the medium term people would start to feel the change in culture and realise that Government would not remain the sole provider of the welfare state but that people would have to provide for their own pension. It is likely that the concept of self-help would have started to sink in; and
- the benefits of the credit system wherein people would be given 'credits' to compensate for missing contributions during periods of training and further studies would start to be reaped by the economy. It is thus expected that this period would benefit from a more educated workforce as in the medium term the positive effects of a knowledge-based economy, facilitated by the introduction of the credit system, would start to accrue.

06.3 Long Term Assessment (2026 – 2050)

In the long term, which refers to the period starting 2026 and ending 2050, an improvement in pension adequacy is envisaged. In this period, the contributions to Pillar 2 as well as the other changes characterising the reform in the pension system start reaping some benefits, although not as much as further on in the 2050 – 2072 period when replacement rates increase rather significantly. **Figure 4** below clearly depicts that in the long term (2026 – 2050) the replacement rates decrease at a decreasing rate until they stabilise in the year 2050. The Figure also shows that those retiring in the long term period (2026 to 2050) would be those most negatively hit in terms of lower replacement rates, and it is after this period that replacement rates start to increase.

Figure 4: PROST Projections of Replacement Rates



Source: PROST 11 Malta Files

In the period from 2050 to 2072, (Figure 4) replacement rates start increasing. This means that in the longer term the adequacy of the pensionable income would continue to improve over time. During this period, retirees would benefit from a higher pension income under the reformed scenario. As can be seen in **Table 21** below, the average proportion of annual expenditure that pension income would cater for in the period 2050 to 2072, is significantly higher for both households under the reformed scenario.

Table 21: Average Proportion of Expenditure Covered by Average Pension Income for 2050 to 2072

	Current Scenario	Reformed Scenario	Difference (%)
Household 1	18%	46%	28
Household 2	12%	32%	19

By 2026, people would have grown accustomed to the self-help concept and therefore, the cultural impact of the shift in the role of the State would be much lower than that felt in the medium term.

In this period, PROST projections, given in **Table 22** below, show that pension income would increase as a result of the reform thus increasing retirees' disposable income. Based on these simulations it can be concluded that over the long term, if the assumptions taken in the White Paper hold, the reforms would have been fully implemented and the benefits in terms of a higher pension income would start to impact on society. These simulations are in line with Figure 2. The Figure also confirms that this trend, the improvement over the longer term in the adequacy of pension income relative to average wage, would be maintained and further improved up to the year 2072.

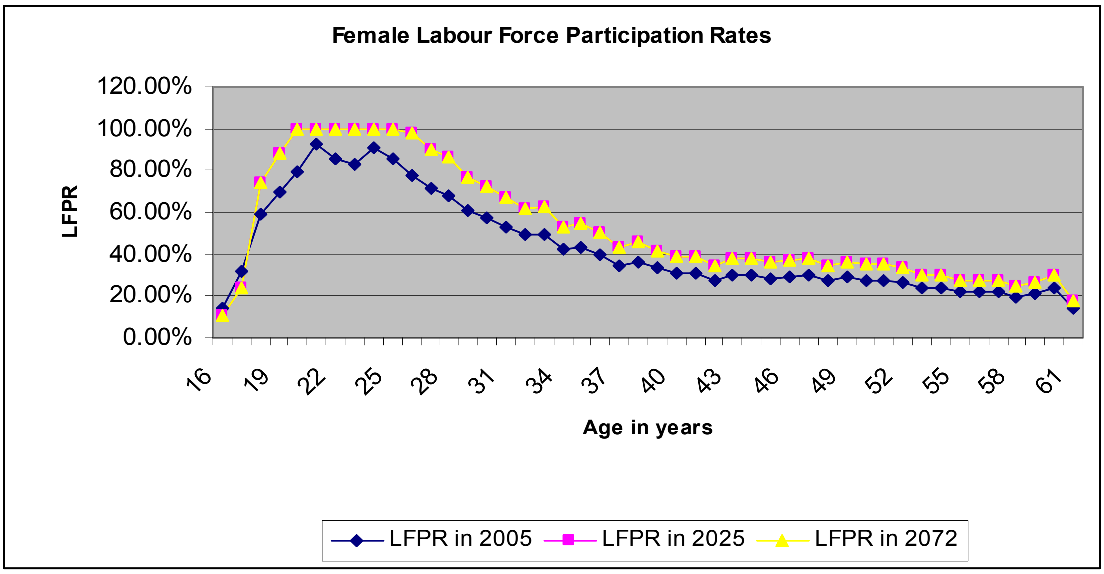
Table 22: Long Term Projections of Average Pension Income

Year	2026	2030	2035	2040	2045	2050	Average	Differenc
Average Pension (Lm)								
Current Scenario	3129.31	2999.70	2795.53	2668.08	2587.59	2533.68		
Reformed Scenario	3213.69	3179.02	3250.32	3476.61	3843.30	4374.54		
Household 1: % of average annual expenditure covered by average pension								
Current Scenario	52	45	37	31	27	23	35	8%
Reformed Scenario	53	48	43	41	40	40	43	
Household 2: % of average annual expenditure covered by average pension								
Current Scenario	36	31	26	22	19	16	24	6%
Reformed Scenario	37	33	30	28	28	28	30	

If the current system is maintained average pension would cover an average of 35% (**Table 22**) of annual expenditure while under the reformed scenario it would cover 43% of average annual expenditure of Household 1. Thus, the latter Household would profit from an improvement of 8%. As can be seen in the Table, Household 2 would also benefit from an improvement of 6% as a result of the reform.

Another positive impact which is expected to accrue especially in the long term is the increase in female labour force participation. This would happen if the reforms in atypical employment and in the credit system are implemented effectively. This would also depend on whether society would react favourably to such changes and take up these opportunities. The expected increase in the female labour force participation is given in **Figure 5** below which is based on the assumptions taken in the White Paper and simulated using PROST. As can be seen in the Figure the female labour force participation rates (LFPR) for the medium and long term (2025 and 2072) are higher than the current levels. This shows that reform would increase the female LFPR over time. However, this rate might still need to increase in order to enhance competitiveness. In order to reach the desired levels, this improvement in the LFPR might require additional measures, for example increasing the number of child day care centres and promoting flexible working arrangements through incentives given to employers offering this arrangement.

Figure 5: PROST Projections of Female Labour Force Participation Rates



Source: PROST 11 Malta Files

07. Determination of the Appropriate Responsibility of the State in Ensuring Adequate Pension Provision

07.1 Overview of the Current Scenario

Over the past years the State has played a major role in the Maltese economy through its involvement in production, its support in the welfare system and its support in terms of public sector employment. This has led people to believe that the State should and would provide them with employment, welfare support and finally with an adequate pension. The State has been considering a shift in the social contract since 1995 when it introduced the reform in the children's allowance mechanism and in 1998 the two measures which have since been withdrawn: a charge of fifty cents per medical prescription and the change in the stipend system to incorporate a loan component.

The change from an extensive welfare system, to one based on self-help is being considered due to several reasons:

- public finances are insufficient to sustain such expenditure;
- financers (mainly taxpayers) would not take too kindly to increases in taxes in order to sustain a specific sector or minority group in the economy;
- the incidence of tax and welfare fraud – tax fraud reduces government revenue. It directly contributes to a decrease in the finances available to sustain Government expenditure. Welfare fraud aggravates the financial position further as it increases the cost of running the welfare programme; and
- free riders and the underground economy.

Even though this reversibility in the role of the State may be backed by sound economic logic, it is difficult to imagine how a population that has been accustomed to this universalist approach for such a long period of time, would now accept this new concept. The Maltese Government has induced certain expectations upon the Maltese population over the years and no one person would renounce easily to such benefits. Malta's social contract, specifically where this relates to pensions, needs to be redefined coupled with a change in the role of the State wherein a new balance between State provision and individual responsibility must be established.

07.2 The Role of the State

The role of the State in a country, the extent of government activity and government expenditure are all linked together. The best and simplest measure of a government's involvement in the economy is public spending. Malta has a ratio of public expenditure to Gross Domestic Product (GDP) which stood at forty-nine (49) percent in 2003. Countries all over the world are striving to reduce this ratio as a prime objective of their economic policy. Government expenditure is constrained by a financial limit. It is due to this financial constraint that many governments all over the world are reconsidering their role with respect to welfare programmes, changing from a universalist approach to one based on the concept of self-help. These financial limitations play an important role in the determination of the extent of State provision and the balance between State support and self-help.

Some argue that public policy is needed to guide and supplement the economy. In a centralised economy, the State performs several functions in order to direct the economy and to remedy any market inefficiencies. Generally, the role of Government is summed up into three main functions:

- the allocation function – Government providing social goods for the benefit of all society members which are financed through the national budget and made available free of direct charge. These goods are made available to all members of society (non-excludable) and members are free to avail themselves of the necessary quantity without affecting the other members of society (non-rivalry);

- the distribution function – Government providing an overall state of equality i.e. emphasising prevention of poverty, through a particular tax structure, and redirecting wealth to lower-income quartiles. Society has entrusted the State with a social responsibility to safeguard society in general from the problems of poverty and social exclusion. The State is expected to fulfil its social obligation by eradicating poverty and providing a safety-net for the community; and

- the stabilisation function – Government using various instruments such as monetary and fiscal instruments to attain overall stability in the economy and therefore avoiding fluctuations in unemployment, inflation and the rate of growth.

Expanding public expenditure and government intervention in order to carry out the aforementioned functions is becoming increasingly difficult to sustain, given the demographic trends countries are experiencing – an ageing population due to a falling birth rate, an increase in life expectancy and in turn an increase in the dependency ratio. Reliance on the State for the provision of welfare support in such demographic circumstances results in a ballooning fiscal burden which is impossible to sustain over the long-term.

07.3 Review of Literature

The body of literature reviewed highlights that the relationship between the State and the individual is highly complex, as is the striking of a balance between the degree of control and participation of the two parties. There is an implied agreement between the State and the individual that determines the extent of State control. The private sector gives up part of its resources for those to be accrued as future benefits in return. The pensions system has to be considered in a similar context. The pensions debate must be seen from an economic and socio-political viewpoint, as the pensions reform requires the reconsideration of the role of the State and the achieving of a balance between State provision and the degree of self-help.

The reform in pension financing is influenced by economic, social and political factors. The attitudes and culture of a particular society would shape the perceptions and expectations of the new proposed pensions system. For the effective implementation of a new pensions system, the latter must be socially acceptable. The degree of acceptance may be pre-determined to some extent if the attitudes and mentality of society as well as the historical background are studied. The financing of a national welfare programme ultimately requires social consensus whereby the State and the community must agree on the approach to be adopted, whether collective or individual. A major difficulty arises if a shift in the role of the State is required; changing attitudes that have prevailed for decades may generate social upheaval since a society that has been accustomed to a particular Government role and fiscal stance would have modelled its behaviour over time around the support system provided by the State and shaped its saving and consumption patterns accordingly. Thus, although the reversibility in the role of the State and its expenditure may become a predictable outcome due to apparent problems in the welfare system's financial sustainability, it is not necessarily an acceptable one to society at large.

The notion of the welfare State and its key providers has changed dramatically over the years. The traditional Keynesian economist point of view depicts the fundamental role of the State as a provider and a re-distributor within the economy. On the other hand this viewpoint has received a degree of criticism in relation to the creation of self-interested trade unions, undermining of individual freedom of choice, and the creation of welfare dependency resulting from State intervention. The UK Commission on Social Justice argues that:

> ***"the welfare State must not only look after people when they cannot look after themselves, it must also enable them to achieve self-improvement and self-support….a hand-up rather than a hand-out".*** [30]

The two extreme views – on one hand the State as the sole provider of the welfare State, and on the other, sole reliance on the market mechanism – do not provide a solution to the current scenario in relation to pensions systems in Malta and in foreign jurisdictions. Countries are moving towards welfare convergence as Stated by Geyer (1998):

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[30] Commission on Social Justice, Social Justice: strategy for national renewal London: Vintage/ Institute for Public Policy Research, 1994.

"Despite varying national contexts and the policies of different political parties, the welfare States of the advanced industrial countries should become increasingly similar as the forces of globalisation squeeze them into a market-oriented welfare-State model. In essence, it does not matter whether the national institutional contexts are conservative or social democratic, or if leftist or rightist party is in power, the constraints have become so extreme that only market-conforming welfare-State structures will be allowed". [31]

Modern economies are going for welfare pluralism or as termed by Wistow et al (1994) 'a mixed economy of welfare'. The authors continue to say that: "all governments accept the principle of mixing market, State, voluntary, and informal sectors in meeting social needs".[32] While the government needs to intervene in the pensions system in order to safeguard society against inequalities and correct for market failures, the State should be a variable in a welfare society rather the provider of a welfare State. Modern welfare systems demand private resources in terms of finances and provision in pensions, health and other sectors. The past few years have witnessed a movement in the public-private mix in the provision of pensions. Structural reforms in the pensions system in many countries of the world are stressing the importance of strengthening individual responsibility for retirement pensions. This movement can be somewhat analysed by assessing the degree of Government activity in an economy.

07.4 Foreign Practice

A review of practices in European Union Member States was carried out to determine the role of the State in the individual countries. As mentioned earlier, the extent of government intervention in an economy and the shift in the role of the State can be assessed through the ratio of government expenditure to GDP. Public expenditure in the Maltese economy in 2004 stood at fifty-one (51) percent of GDP. Moreover locally, Government employs twenty-seven (27) percent of the labour force, with the public sector absorbing over one third of Malta's labour supply. This high level of involvement directly reflects the current role of the State in Malta. The graphical analysis given in **Appendix 4** illustrates similar statistics for members of the European Union. **Figure 1** of **Appendix 4** shows government expenditure as a percentage of GDP while **Figure 2** of **Appendix 3** shows social benefits paid by government as a percentage of GDP. Both figures provide data for all twenty-five EU members and Norway.

As can be seen in **Figure 1** of **Appendix 4**, Malta's Government expenditure to GDP ratio is above the average for both EU-15 and EU-25. Although the ratio of Government expenditure to GDP is widely used as a measure of the role of the State, it has its limitations. Some countries have a higher ratio of Government expenditure to GDP than Malta. However, the composition of Government expenditure by sector (public employment, welfare state and public production) and moreover the productivity of such expenditure is not reflected in the figure. With this in mind, the extent of the role of the State in a country and the shift that might be needed in this role must be seen on an individual basis.

Figure 2 of **Appendix 4** shows that the level of social benefits given by Maltese government is below the average of the EU-15 and EU-25. Social benefits given in **Figure 2** of **Appendix** 4 refer to the benefits as defined by Eurostat:

"Social benefits (other than social transfers in kind) paid by government (ESA95 code D.62) are transfers to households, in cash or in kind, intended to relieve them from the financial burden of a number of risks or needs (by convention: sickness; invalidity, disability; occupational accident or disease, old age, survivors, maternity, family, promotion of employment, unemployment, housing, education and general neediness), made through collective schemes, or outside such schemes by government units."

Today, social security benefits in Malta make up one third of government expenditure. The growth of this category of expenditure is conditional upon the growth in wages and prices and the changes in

[31] Geyer R. *Globalisation and the (non-) defence of the welfare State,* West European Politics, 21 (3), 1998, pp. 77-102.

[32] Wistow, G., Knapp, M., Hardy, B., and Allen, C., Social Care in a mixed economy, Buckingham: Open University Press, 1994.

demographics. Although Malta has a generous welfare system, as shown in the graphical analysis in **Appendix 4**, reform is necessary to ensure social cohesion and intergenerational equity. As the Governor of the Central Bank of Malta stated[33]:

> ***"The time has clearly come for a radical welfare reform which reconciles the objectives of social cohesion and intergenerational equity with financial sustainability."***

07.5 The Balance between State Provision and Self-help

In determining the degree of State provision in relation to pensions several considerations have to be made; one of the most important being people, how will they react, how long will it take for them to adjust to this new system, and whether they will be able to finance their private pension fund.

Reform requires people to adjust their saving patterns and by implication consumption patterns. At a community level, the proposed pensions system would require a change in Maltese mentality that the State is supreme and can provide for all. The self-help concept would promote the supply of effort, as individuals would be getting benefits according to the amount they initially contributed. This per se serves as an incentive to people to increase efficiency and productivity, which would in turn boost national income and GDP per capita, thus substituting the boost which government expenditure gave to the economy.

The success of the reform would depend on the capability of people to generate sufficient funds from the available resources to be self-supportive when they retire. Society should understand that although the State has to ensure that reforms do not put individuals into poverty, change is necessary to prevent the welfare system from "bankruptcy" which would be detrimental to society. Reform is necessary, but social welfare is a lifetime consideration and thus human needs must be safeguarded throughout this change. In this context, the role of government as one of the providers identified in the proposed pensions system relates to its:

- social obligation;
- financial responsibility; and
- political image and mandate.

The State must provide a safety net in order to fulfil and safeguard the aforementioned responsibilities. In the proposed pensions system, the State would still be fulfilling its distributive role through its participation in Pillar 1. Moreover, Government is currently financing the welfare gap that results since expenditure on pensions and health outweighs the income received in contributions. This welfare gap will persist and is expected to increase over the next 10 years.

This is based on three assumptions:

- the first additional year in contributions that the Pensions Account would receive through Pillar 1 as a result of the gradual increase in the retirement age would be in 2015. This is because those aged fifty-four (54) on 1st January 2007 would be the first group affected by the increase in the retirement age which would be set at 62 for this particular age-group;
- the impact on the health sector in terms of demand for health services due to the aging population as well as the overall dependence on a 'free' service, would continue to increase over time; and
- the increase in the participation of women in the labour supply may not affect the economy in the short run but in the medium to long-term, as discussed in Section 6.1.

In essence, Government would still be carrying out part of its distributive role, in fulfilment of its social responsibility, in the proposed pensions system since it would still contribute through Pillar 1 and through its intervention in the financing of the residual welfare gap.

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[33] Central Bank of Malta: *Fiscal Reform – An Imperative for Sustainable Growth and Development*, Governor's speech at the Institute of Financial Services Annual Dinner, 11th November 2004.

07.6 Conclusion

In conclusion, the above analysis clearly shows that the determination of the degree of State intervention in Malta in the provision of pensions rests on three important considerations. The first consideration is that of financial sustainability. Secondly, the State has a social obligation to provide for those in need and to preserve the social fabric, and finally the role the State takes up in the proposed pensions system, would portray and reflect its stance vis-à-vis its role in the Maltese economy, in terms of employment and the entire welfare system. In view of these considerations, the role the State should take up in Malta, within the framework of the proposed pensions system, is to gradually decrease its involvement both in financial and administrative terms in the pensions system. Notwithstanding, the State must maintain and improve upon its responsibility and social obligation to safeguard society by ensuring that the proposed pensions system is fair and promotes both social and intergenerational equity.

08. Mitigation Strategies for Arising Social Issues

This Section identifies the major social issues and risks that may result from the implementation of the proposed reform put forward in the White Paper and from the identified impacts determined in Section 04 and 05 of the report. Mitigation measures to limit the potential negative implications of the identified risks and issues are proposed.

The issues and risks have been grouped into thematic areas that reflect the main issues and risks. The following categories were used:

- consumption and savings;
- cost of production;
- pension account;
- indexing;
- credit system;
- retirement age;
- pension payouts;
- employment;
- social responsibility; and
- family friendly measures.

The shaded boxes show the risks involved. These are followed by the mitigation measures, which are not mutually exclusive. To ensure success and minimise the risks of the proposed reforms, the mitigation measures must be implemented in a holistic, integrated approach.

08.1 Consumption and Savings

The introduction of the Pillar 2 Pension is perhaps the greatest innovation to the pension reform in terms of capital outlay by both employees and employers. Consequently, this part of the pension reform has a bigger impact on consumption and savings including the following:

- it is envisaged that the Pillar 2 contributions would decrease the disposable income of contributors. This may be more taxing to low income earners than to medium to high income earners and will adversely affect the self-employed since the increase in contributions, for both employee and employer will have to be shouldered by the same individual;
- decreasing the disposable income of contributors may affect the behaviour of people in terms of the decisions on how they spend their money;
- if Pillar 2 is introduced on a mandatory basis, people may also feel restricted in their savings decisions; and
- the self-employed may be tempted to declare lower incomes to pay less contributions and invest the resulting difference in a Pillar 3 Pensions scheme as it gives them more choice in how to invest their own money.

- Government should ensure that contributors understand that although in the short term the additional required contributions would lead to lower disposable income, in the long term if yields on investment are good, a good standard of living during retirement could be maintained. Moreover, if Pillar 2 is introduced on a voluntary basis there is a higher possibility that large segments would fail to invest today for one's future retirement pension. This would lead to a national social crisis due to the increased dependence on the State for help.
- The return of women to the labour market and the consequent increase in the household's disposable income might mitigate against the increase in the contribution requirements.
- The proposed reform to the pensions system recommends that the annual contributions into Pillar 2 should not be taxed on an annual basis. In the short term, this would leave the employees with a higher net income.

- The White Paper recommends that Government and MFSA should work with the private sector financial firms to encourage them to introduce a scheme that allows owners of life endowment and profits related policies to convert such policies into the Pillar 2 Pensions Scheme. If such a scheme is introduced, the self-employed and employees opting for this scheme and who are eligible to contribute in the Pillar 2 Pensions Scheme, would inject the Pillar 2 Pension with the capital already accrued within the insurance policy. This will alleviate the employees and self-employed persons from part of the financial burden.
- Government should ensure that the implementation of the new framework is done in a transparent manner. For example, the institutions selected to manage the funds under Pillars 2 and 3 should be left to the determination of the markets and not tied down to specific funds.
- A focused educational campaign which should highlight:
  - that Pillar 2 was introduced on a mandatory basis to avoid having large segments of the population ending up with an inadequate pension and thus creating a social crisis;
  - that Pillar 2 does include a voluntary part, whereby contributors will be offered the opportunity to have more comprehensive plans that would offer a degree of cover for unforeseen circumstances such as premature death, injury and ill health; and
  - the experience of other countries where Pillar 2 was introduced on a voluntary basis.

08.2 Cost of Production

The mandatory increase in Pillar 2 contributions will lead to an increase in the cost of production. Although Pillar 2 contributions are part of employment costs and the employer would pay less in taxation as a result, such contributions would still have an impact on cost of production. For example if the company tax rate is of 35%, the remaining 65% of the 2% increase would still be an additional cost to the employer. With the increase in costs on one hand and the lower payment of taxes on the other, the following impacts may result:

- a loss in competitiveness;
- employees may not be granted wage increments in the forthcoming years;
- the productivity of employees may be influenced negatively as the latter will be required to work for a longer period;
- the cost of the system on businesses could be transferred to the consumer through price hikes in consumables a risk of fuelling inflation will result; and
- a decrease in government revenue from taxation which would have to be recovered from alternative sources that in turn might produce other social impacts.

- Since ceiling is being assumed to increase with inflation (2.5%), which is lower than the assumed real wage growth (3%), in the long term contributions on Pillar 1 would decrease.
- Government's economic policy should be focused on providing the country with the necessary infrastructure and investment environment that is conducive towards the generation of growth in GDP and hence the restoration of a "feel good factor" in the country. This should lead businesses to reap higher profits and as a result better absorb the additional costs incurred for their contribution to Pillar 2 and thereby afford to increase their employees' wages. An increase in productivity would in turn mean that Government would benefit from increased revenue from income tax and VAT which in turn would further support it in improving the said infrastructure.
- The new system should provide incentives for women, currently opting out of employment for family reasons, to return to the world of work thereby providing the household with an increased disposable income while mitigating against excessive compensatory requests for wage increases. This measure would also ensure that consumption is stimulated and increased taxes are collected. Higher consumption levels would also provide businesses with increased turnovers and hence increased profits.
- The stepping up of the mandatory contribution, from 0% to 2% and subsequently from 2% to 5% (as assumed in the White Paper for modelling purposes) could be made in a gradual manner so as to avoid sudden shocks to the economy. In this context, in the White Paper it is being proposed that Pillar is first introduced on a voluntary basis in 2006. Government is then to undertake an assessment in 2009 to determine whether Pillar 2 should be introduced on a

mandatory basis in 2010. The project team is of the opinion that this proposal is positive in that it allows persons and employers some time to prepare themselves for this change.

- Government would need to find alternative sources of revenue to compensate for the loss of revenue from income tax. Government could focus on improving tax collection rates and ensuring that the alternative sources of revenue do not in themselves create negative social impacts.

08.3 Pension Account

A deficit in the Pension Account created for the Two-Thirds Pillar 1 Pension may cause uncertainty within the general public, especially if parametric changes are introduced to make up for any shortfall. Any deficits would severely undermine all arguments that Government might have made in favour of the sustainability of the new system.

- Government should ensure that the Pension Account is administered properly and that constant monitoring and forecasting is undertaken in a way that enables future predictions of Account balances to be determined with a very high level of confidence at an early stage.

08.4 Indexing

The Two-thirds post retirement pension income and the Maximum Pension Income will be indexed to the Retail Price Index. Moreover, the Minimum Pension Guarantee will be indexed to a fair mechanism against inflation erosion. Consequently a number of issues and risks may arise.

- People who will be dependent mostly on a Pillar 1 Pension (such as those over 45 years of age and those who would not end up with a 40 year contribution Pillar 2 Pension payout) may be at the risk of poverty and consequently social exclusion if the pension entitlement proves to be insufficient to meet the essential needs.
- Should a risk of poverty index be chosen as the indexation for the minimum pension guarantee, the setting up of a “poverty index” could be the subject of hot debate. Eurostat regulations establish that the poverty index should be established at 60% of national equivalised income median. However, as this is not obligatory, Governments may choose an alternative percentage. A low percentage might have serious repercussions. Moreover linking poverty to income could also provide an unrealistic picture if the economy has a high percentage of undeclared incomes.

- The Minimum Pillar 1 Pension should be appropriately indexed to a “basket of goods” that reflect the essential needs of pensioners and take into account the consumption patterns of pensioners. Standard measures other than inflation such as median wages may also be considered to develop this index.
- Special additional benefits related to health care, utilities, rented housing, etc. may be provided so as to avoid such essential needs from eroding the minimum pension.
- If poverty line indexing is to be adopted the maximum value i.e. 60% as recommended by Eurostat should apply.
- The establishment of the index and its component parts should be an exercise, which Government undertakes in consultation with the widest spectrum of stakeholders including the social partners as well as the Opposition. The measurement of the index should be undertaken in a transparent manner that allows all stakeholders to either be involved in the process or to be able to audit the computation of the index at will.
- Government would need to establish a sinking fund to supplement the ring-fenced account in cases of fluctuations in inflation. In creating a sinking fund Government would have to set aside a certain amount of money each year to finance such a fund.

08.5 Credit System

The White Paper does not state whether credits would be applicable for Pillar 2 in addition to those being proposed for Pillar 1. For example, if Government introduces the credit system for Pillar 1 but does not make it applicable for Pillar 2, those unemployed who are currently considered as exempt under Pillar 1, would have to pay, if Pillar 2 is made mandatory, contributions for Pillar 2. This would essentially defeat the original concept of exemption given that the credit system was introduced to alleviate the burden of contributions off the unemployed.

- Government may extend the credit system for Pillar 1 to Pillar 2. This could be based for example either on the minimum wage or as a percentage of imputed wages, that is the average wage of the age cohort to which a person benefiting from credit belongs. Eligibility criteria for such credits could be introduced, for example whereby only unemployed persons who attend for training and/or provide a community service are entitled to credits.
- Pillar 2 could be made voluntary for those persons who would be exempt under Pillar 1 because of the credit system. Under this option, Government would continue to pay contributions for these exempt individuals for Pillar 1 and abstain from paying contributions for Pillar 2. Consequently, unemployed individuals would still benefit from Pillar 1 Pension income but would be provided with the opportunity to substantiate this income by contributing to Pillar 2 on a voluntary basis. Another option could be to allow those receiving credits to back-date their missed contributions on Pillar 2 once they re-enter the labour market. Therefore those receiving credits would be alleviated from the financial burden of having to make compulsory contributions to Pillar 2, while not receiving a salary.

There may be a risk of fictitious unemployment or other circumstances for which credits are to be given, which might lead to those salaried employees and self-employed who pay their legitimate dues to perceive the credit system as being unjust.

- A strong enforcement regime and resultant administrative capacity increase (ETC, MFSS, MFSA, Health Authorities, Educational Authorities) is required to ensure that the credit system is regulated effectively.
- Stiff penalties for defaulters need to be introduced.
- Intense education campaigns on the mechanics of the system and its intended benefits. Such campaigns are to include themes such as the structure of the system, how the system operates, the principle of social solidarity, the sustainability of system and financial implications.

08.6 Retirement Age

The White Paper proposes that:

- the pension age for women would be 61 years of age with immediate effect from 1st January 2007. This means that as from 2007 all women employees would have to retire at 61 years irrespective of their age;
- the 52 to 54 year olds would have their retirement age raised to 62 and the 50 and 51 year olds of 2007 would have their retirement age raised to 63; and
- those of 48 years of age and below would have their retirement age increased to 65 years.

The proposed increases could have the following impacts:

- a negative psychological impact on those persons who already have retirement at heart in order to enjoy the quality of life after retirement for the longest period possible; and
- an overnight increase in the female retirement age may have a drastic impact particularly on those women nearing retirement age as any aspirations for the near future would have to be delayed by one year.

- Although, the increase of retirement age to 65 is to be introduced in phases, a more gradual progressive increase in mandatory pensionable age could be considered since it stems any sudden jerks and allows for a more gradual absorption and adjustment to rising pensionable ages.
- In addition, it is also being proposed in the White Paper that it would still be possible for individuals to opt for a shorter career between the age of 61 and 65 years on the basis of proportionate benefits.
- Government could promote this measure in terms of increases in life expectancy and therefore individuals would still enjoy the same proportion of retirement to life length as is being enjoyed by past and current pensioners.

Certain employees may not be in a position to maintain their current job up to the age of 65, particularly those in strenuous and stressful jobs. This may lead to a feeling of uncertainty about one's own life together with the negative health impacts associated with unemployment. Employees in this situation together with employees working beyond retirement age may demand their employers to offer more flexible arrangements in terms of working hours and patterns. This may also lead to an increase in the number of people claiming invalidity benefits.

- A strong enforcement regime and resultant administrative capacity is required to ensure that the invalidity pensions scheme is regulated effectively as also stated in ISSA report (p.4).
- Measures should be introduced by Government to render certain positions less stressful or strenuous. This could be done through a regulatory framework that governs the enforcement, as well as employment conditions.
- Persons in such positions, particularly those in strenuous positions, should be offered retraining opportunities to allow them to continue to be part of the labour market albeit in a different type of employment (e.g. a mason could be retrained to act as a site foreman, a loader could be retrained to become a salesman etc). This also indicates that the educational system must be geared to instil in everyone the importance of continuous professional development as a means for securing one's own competitiveness in the labour market.
- Government should offer assistance (fiscal incentives, financial assistance, consultancy and advice) to those employers who employ those working beyond the statutory retirement age and older retrained workers. Such measures could be similar to the current payment of half the national minimum wage for a definite period for each unemployed person recruited through ETC.
- In the case of stressful positions, employers and employees alike could be encouraged to opt for atypical work conditions with a view towards improving their work life balance.
- Flexible arrangements should also be marketed as an opportunity to increase the flexibility of one's business operations as these can service a business in uncommon hours and as an asset to an organisation in terms of the experience retained.

08.7 Pension Payouts

As a result of the change in the calculation of pensionable income to the average of 40 years accumulation contribution history the following impacts may result:

- a lower pension payout and therefore less disposable income in retirement due to fluctuations in wages throughout the working life, especially for those with lower incomes in the beginning of their career; and
- a greater impact on female employees as they normally take more breaks and consequently take longer to progress than male employees.

- The computation of the average salary for the basis of determining one's pension should not be based on a simple average of salaries earned over 40 years but these should be adjusted to their equivalent future value to permit a like for like calculation of the true present value salary earned by the employee.

- o If a scheme that allows owners of life endowment and profit related policies to convert such policies into the Pillar 2 Pensions Scheme is introduced, employees opting for this scheme and who are eligible to contribute in the Pillar 2 Pensions Scheme, would inject the Pillar 2 Pension with the capital already accrued within the insurance policy. This may mitigate against the lower average two-thirds pension under the proposed system.
- o In relation to the gender impact, Government should support the current initiatives being undertaken, particularly by the National Commission for the Promotion of Equality, to promote equality in pay, encourage new strategies to promote equality and ensure that there is a strong enforcement regime to make sure that legislation including the Equality for Men and Women Act (Cap.456) is being observed.
- o The mechanisms introduced should ensure that the salary taken for the years while credits are received would not decrease considerably the average pensionable income, for example in the case of credits for child bearing and rearing, the last salary before benefiting from the credit could be taken.

Under the proposed reform, it is being proposed that the contribution period is increased from 30 years to 40 years. The following impacts may result:

- o everybody needs to start working by the age of 25 years thus affecting decisions of travel or furthering one's studies after obtaining a first degree with a consequent impact on personal development and quality of life; and
- o a person who has completed his/her studies and started working at the age of twenty-six would not be eligible for a full pension since that extra year cannot be recouped in terms of credits.

- o Government may consider the introduction of a policy instrument that entitles the following persons for credits:
  - those persons who want to travel to acquire foreign work experience or to further their studies; and
  - those persons who have not completed their studies beyond the age of twenty-five.

A number of State controlled entities are known to either not having paid a number of employees' contributions or to have special arrangements for the payment of such. Situations have also arisen where private sector employers do not pay the required contributions for their employees. This poses a further problem in relation to Pillar 2 contributions from employers since a delay in contributions may jeopardise the size of the fund on which the employee would ultimately receive a Pillar 2 Pension.

- o Government needs to identify those entities, which are in default of their employees' contributions, and due diligence must be taken in order to safeguard the employees with respect to the credit they are given for contributions they have actually paid.
- o An education campaign targeted to inform the employees about all aspects of the pension system, including the duty of employers to pay their employees' contributions, may be considered. Government may also provide assistance to entities organising similar education and information campaigns or organise the campaign jointly with the social partners and the financial intermediaries.

The fluctuations of the financial markets, on which funds generated from Pillar 2 and Pillar 3 would be based, would give rise to concern on the worth of one's fund upon retirement. Cases have arisen where stock market crashes have taken the toll on individuals' pensions forcing them to continue to work after retirement age as the pension received was not sufficient to sustain their lifestyle.

- o Entrusting the regulation of Pillar 2 and Pillar 3 Pensions Schemes to the MFSA as is being proposed in the White Paper and applying strict criteria for the providers of such pensions schemes would protect future beneficiaries and would mitigate against feelings of insecurity. Moreover, through statements of deposits issued to them by fund managers, contributors would have proof of their contributions. Furthermore, as another mitigation measure to safeguard contributors' investment in Pillar 2, the White Paper is proposing that such funds are managed on the basis of the prudent-person principle, and diversification criteria to prohibit the speculation of such funds are established. "MFSA, as the regulatory authority, would be tasked to design investment management standards based primarily on the prudent-person pensions principle in order to, firstly, ensure the safety and security of these assets and secondly, to create an environment in which asset management can obtain the best returns at an acceptable level of risk". The White Paper also captures the main provisions of EU Directive 2003/41/EC 'Activities and Supervision of Institutions for Occupational Retirement Provision' which specifies the minimum safeguards and diversification criteria that need to be introduced.

- o The selection of funds should be based on a sound information platform in that the fund's exposure is adequately balanced between components that may compensate for each other during a particular sector's downturn.
- o Education campaigns aimed at informing interested parties of what products are available on the market and the risks associated with such products could be organised. Moreover, a practical approach should be adopted using real time data and real world scenarios.

The White Paper indicates that various models to protect the beneficiaries can be applied including an insurance scheme or a privileged pension credit or a Pensions Compensation Fund. However, for modelling purposes in the White Paper it is assumed that a Pensions Compensation Fund would be created. Should a portion of Pillar 2 contributions be used to service a Pensions Scheme Compensation Fund such portion would erode a portion of the contributions to Pillar 2 funds. Contributors may not appreciate this erosion of the own pension payouts.

- o It is important for Government to explain clearly to all stakeholders the perils that lie within the financial world and the risks associated therewith. Consequently, contributors should understand that the fund is an added measure of security offering peace of mind to contributors in their role as "investors".
- o The Compensation Fund should be set up and managed efficiently in order to guarantee a certain safety net.
- o To enable an additional safeguard to pension funds in the form of the Pension Scheme Compensation Fund without compromising too much on the erosion on contributions deposited, Government could, through the MFSA, regulate the maximum percentage amount that would be directed to the PSCF.

The White Paper proposes that persons over the age of 45 in 2010 would not be required to pay Pillar 2 contributions. On the other hand, the 44 to 40 age cohort, in relation to the others switching to a multipillar pensions system, would have the least Pillar 2 contributions. This may place such individuals at a disadvantage.

- o Government is urged to examine the mechanics of this Pillar considering alternative arrangements such as:
  - allowing those who can afford a higher contribution to commence their contributions immediately at the higher level (in this case 5%); and
  - allowing those who can afford to make a one time retro deposit equivalent to what they could have placed should the system have applied at the time when they started working.
- o Although it is true, that the lower the number of years of contributions that are made to the Pillar 2 fund, the less the lump sum and the annuities to be received, it is however important to note that the Pillar 1 Pension would only be inadequate in the long term and therefore those retiring in about 20 years time would still have a rather adequate Pillar 1 Pension.
- o As a new culture of self-help is introduced such individuals should be encouraged to initiate a Pillar 3 fund. Incentives such as increasing the capped amount for Pillar 3 tax-free deposits for such individuals to take into account their age bracket could further encourage the utilisation of this Pillar.

The 43 to 44 year old age group (in 2007) will be negatively impacted because their pension will be calculated on the average of the whole period of contributions, and they will not have a Pillar 2 pension to supplement their Pillar 1, as it is proposed that Pillar 2 will be mandatory only for those who are 42 or younger in 2007.

- The averaging of the whole period of contributions for pension calculation should not be applicable for this age cohort or the mandatory Pillar 2 should be applicable also to this age cohort.

The introduction of a tax upon the pensionable sum received upon maturity may be perceived to represent a further erosion of one's potential pension payout.

- The system clearly states that contributions made to Pillar 2 (and Pillar 3) would be tax-free. Consequently, the employee is being waived tax on contributed amounts, which would go wholly towards one's pension. Subsequently, tax would be levied upon the matured sum. In a worst case scenario, if the fund has not matured and yields an equivalent to the amounts deposited, then the employee would have in fact deferred the cost of tax to a later stage in life. On a net present value basis this would be beneficial to the employee as the future value of a Maltese Lira is much lower than its present value. On the other hand, if the fund appreciated, the employee would forfeit an additional small portion to tax but still benefit from an appreciation of his deposits. A quasi-cost neutral scenario to present day circumstances would be to tax the appreciated portion of the capital at the prevalent withholding tax rate (15%) mirroring it to a dividend that is paid at the end of a particular investment.

It is being proposed that upon maturity the bulk of the Pillar 2 Pension is placed as annuities. A number of risks are associated with annuities, mainly being:

- errors in mortality assumptions whereby, part of the benefits are lost mostly at the detriment of the survivors;
- mismatches in the degree of returns from financial instruments chosen to back the claim and the income stream;
- annuities may discriminate between male and female pensioners depending on whether unisex or gender specific mortality rates are used; and
- if the conversion of lump sums to annuities is voluntary, the uncertainty of the pace and possible extent of future mortality improvements is aggravated, since healthy persons would opt for annuities and unhealthy persons would choose another means of withdrawing their lump sums (ISSA report p.3). However, this risk is minimised since the White Paper proposes that the conversion to annuities is made mandatory.

Furthermore, there are various types of annuities available with different characteristics (e.g. profits annuities, inflation indexed annuities, wage index annuities, etc) each with different risks.

- The current Maltese legislation regulating annuities may need to be revised to ensure that there is proper regulation for the Pillar 2 requirements as also stated in ISSA report (p. 3) and to minimise gender discrimination as much as possible.
- Government is to explain to citizens that annuities play a key role in the assurance of retirement income in Pillar 2 schemes as they:
    - provide insurance against the non-diversifiable risk of outliving assets, which is feasible given the operation of the "law of large numbers" in a pool of annuitants;
    - remove inflation risk (by indexed annuities); and
    - eliminate investment risk.
- A system may be introduced whereby married couples are required to invest in a joint annuity.
- To minimise the difference in male and female pension payouts it is suggested that unisex mortality rates are used rather than gender specific rates.
- ISSA report (p. 3) states that indexing the annuities to wages would not only protect pensions against cost of living increases, but they would also participate in increases in productivity.

08.8 Employment

The portable aspect of Pillar 2 contributions could be perceived as creating additional administrative burdens in the following ways:

- o employers would have to deal with contributions to the various funds new employees bring with them; and
- o it would be more difficult for EU nationals to work in Malta and for Maltese nationals to work in the EU.

- o Portable pensions have the benefit of ensuring the continuity of one's contributions and ensuring that funds start maturing and appreciating upon deposit. It would make no sense to have the employee liquidate his Pillar 2 fund upon termination of employment with a view to depositing the proceeds received into the new employer's selected fund. Such a move could result in increased administrative charges as well as a depreciation in fund value should negative sentiment prevail within the financial markets at the time. Consequently, the portability aspect should be retained.
- o As regards the employer having to deposit contributions to different funds this should not be seen as hugely tasking in administrative terms for through simple banking procedures direct crediting to the fund can take place irrespective of the locus of such fund. This transaction could be considered similar to the administrative process involved in a direct crediting system of one's salary to one's chosen bank account.
- o Standardisation in the administration of Pillar 2 funds, including guidelines for employers, could reduce the administrative burden.
- o A targeted education campaign to inform those interested in working in foreign countries about all aspects of the pension system may be considered. Education brochures and websites such as the current initiative being taken by the Department of Social Security may also provide assistance to those foreigners interested in working in Malta.

The reaction of private employers to the proposed additional contribution to be paid as part of Pillar 2 might significantly outweigh that of Government as an employer. This reaction in a worse case scenario could be in the form of downsizing of organisations. In this context, private sector employees face a relatively higher risk in terms of job security when compared to public sector employees. Another impact that could result is the offering of "creative" contracts or incentives. Certain situations are arising whereby people are being offered self-employed contracts when they are clearly functioning as full time employees. Employers are therefore benefiting from their services without having to carry any of the responsibilities and duties for them including NI contributions.

- o As part of its mitigation strategies of the social conditions resulting from the reform in the pension system, Government may provide training to improve the negotiation skills of those trade unions that require such improved. A similar approach was adopted in Croatia[34].
- o Consequently, it is important for employment contracts to be subject to a regulatory regime that would offer employees some degree of protection.

08.9 Social Responsibility

With the proposed introduction of Pillar 2, the pension reform attempts to make a cultural change and incentivise self-help whereby people are encouraged to think for the future and start saving for their retirement. This may be seen as a move by Government to abdicate from part of its responsibility towards securing pensions. This may also lead to objection to the proposed reform.

- o This issue may be mitigated against through a focused education campaign that outlines experiences in other countries, how the proposed system would ensure that pensions are

[34] United States Agency for International Development (USAID). *Mitigation of Adverse Social Conditions & Trends.* Viewed February 17, 2005 from http://www.usaid.gov/policy/budget/cbj2005/ee/pdf/160-0340.pdf.

sustainable and which presents a few models of how pensions under the new framework can mature compared to the computation of pensions under the current scheme.

- Government should pursue its policy of containing public expenditure and ensuring that monies spent represent value for money.
- Government needs to undertake a “marketing” exercise in order to sell and drive this concept such that it becomes quickly ingrained in people’s attitudes.
- Government needs to influence people into a culture of saving and to limit the amount of assumed debt that people are entering into. This can be achieved through an education campaign aimed at promoting the concept of “saving for a rainy day” as well as revisiting the financial services regulatory framework in order to determine whether, in collaboration with financial institutions, the amount of debt currently afforded by such institutions can be reduced.

08.10 Family Friendly Measures

The increase in retirement age together with the incentives to increase the female participation in the labour market could change the childminding and care for the elderly pattern from one being provided by the extended family to a one entrusted in the hands of the private sector. This could lead to:

- higher expenses to parents associated with private childcare facilities; and
- increase in costs to the employer due to an obligation to provide childcare facilities and to an increase in investment in IT, monitoring and management systems required for the introduction of family friendly measures such as flexitime, teleworking and childcare arrangements.

- Government is currently in the process of actively pursuing policies aimed at encouraging the development of childcare centres and other family friendly measures. Government should consider the provision of assistance (fiscal incentives, financial assistance, consultancy and advice) to those employers who elect to implement family friendly measures. Importantly, if the Pensions Account demonstrates a surplus such funds may be used to this effect.
- Government is to pursue policies that address the increasing demand for elderly care such as by entering into joint ventures with private elderly care services and also by providing assistance that encourages elderly people to stay in the community rather than reverting to a elderly home such as meals on wheels, nursing services, maid services and financial assistance to alter the present house to accommodate any disabilities arising from physical illnesses.
- Credit system proposed for mothers taking care of their children could possibly be extended to:
  - grandparents who take care of grandchildren; and
  - family members who are capable of taking care of other elderly family members.
- The use of family friendly measures could be marketed as:
  - an opportunity to increase the flexibility of one’s business operations as those making use of such measures could service a business in uncommon hours;
  - measures that can be used by both the mother and father and not something pertaining to female employees only; and
  - an opportunity to increase the assets of the organisation in terms of the experience retained.
- In addition to the above, Government should encourage small to medium sized organisations to collaborate together in the provision of the necessary infrastructure required to support family friendly measures (e.g. sharing of employees for common tasks, financing of child care centres amongst a group of small businesses, etc.).

Although the new regulatory framework for pensions provides incentives for mothers to return to the labour force there can still be conditions that make the return to work financially unattractive. A case in point is the income tax framework for married couples and its implications on part-time work.

- Government should review and harmonise all elements that affect atypical employment for women in order to secure a tax regime that is favourable to their return to gainfully occupied status. The introduction of a minimum national framework of family friendly measures may also be warranted to support this initiative.

The introduction of family friendly measures and career break opportunities would increase the need for temporary workers, the employment of whom is not regulated. This could lead to employers taking advantage of the lack of regulation in this sector at the expense of temporary workers.

- Regulation of conditions of work for temporary workers should be considered, in perspective of conditions prevailing for similar workers, by reviewing legislation and administrative provisions.
- Collective agreements should be designed to take into account the participation of temporary workers in the workforce.

Appendix 01 – Review of Social Impact Assessment Methodology

Review of Social Impact Assessment (SIA) Models

The International Association for Impact Assessment defines a Social Impact Assessment (SIA) as "analysing, monitoring and managing the social consequences of development"[35]. A proactive approach is adopted in this discussion document, as the focus of SIA is not just seen as identifying the negative or unintended outcomes but also as minimising harm from the negative impacts. In effect the methodology applied is of a wide range of planned interventions that can also be undertaken on behalf of a wide range of actors. A SIA consists of most of the following activities:

- participates in the environmental design of the planned intervention;
- identifies interested and affected peoples;
- facilitates and coordinates the participation of stakeholders;
- documents and analyses the local historical setting of the planned intervention so as to be able to interpret responses to the intervention, and to assess cumulative impacts;
- collects baseline data (social profiling) to allow evaluation and audit of the impact assessment process and the planned intervention itself;
- gives a rich picture of the local cultural context, and develops an understanding of local community values, particularly how they relate to the planned intervention;
- identifies and describes the activities which are likely to cause impacts (scoping);
- predicts (or analyses) likely impacts and how different stakeholders are likely to respond;
- assists evaluating and selecting alternatives (including a no development option);
- assists in site selection;
- recommends mitigation measures;
- assists in the valuation process and provides suggestions about compensation (non-financial as well as financial);
- describes potential conflicts between stakeholders and advises on resolution processes;
- develops coping strategies for dealing with residual or non-mitigatable impacts;
- contributes to skill development and capacity building in the community;
- advises on appropriate institutional and coordination arrangements for all parties; and
- assists in devising and implementing monitoring and management programs.

Based on its work practice, the World Bank developed a Social Analysis Sourcebook[36] that describes good practice in the application of social analysis. The World Bank uses social assessment to analyse social issues and to obtain stakeholder views. Generally, a social assessment is initiated or continued during the implementation state. The choice of methodology depends on a number of factors such as the people and social issues under study, the availability of human resources, time constraints the information gaps that need to be filled by the social assessment. The Social Analysis Sourcebook

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[35] International Association for Impact Assessment. (May 2003). *Social Impact Assessment International Principles*. Special Publication Series No.2 Viewed January 17, 2005, from http://www.iaia.org/Members/Publications/Guidelines_Principles/SP2.pdf.

[36] World Bank. (December, 2003). *Social Analysis Sourcebook: Incorporating Social Dimensions into Bank-supported Projects*. Viewed August 5, 2004 from www.worldbank.org/socialanalysis.

puts forward the arguments made by Kumar on the appropriateness of qualitative methods. It is best to use qualitative methods when:

- descriptive information is sufficient on decision making;
- an understanding is required of the motivations and attitudes that may affect people's behaviour, in particular the behaviour of target populations or stakeholders in intervention;
- available quantitative data must be interpreted;
- the primary purpose of the study is to generate suggestions and recommendations; and
- the need is to develop questions, hypothesis and propositions for more elaborate, comprehensive formal studies.

Others are in favour of a mix of qualitative and quantitative research methods, although there may not be a one best mix of qualitative and quantitative tools.

In Appendix I, of the World Bank Participation Sourcebook[37], the World Bank indicates that Social Assessments involve consultations with stakeholders and affected groups and other forms of data collection and analysis. How a Social Assessment is designed depends on the complexity of the issues that are under study and on the degree of involvement of stakeholders.

The Interorganisational Committee on Guidelines and Principles for Social Impact Assessment[38] prepared a number of guidelines and principles for social impact assessment in May 1994. According to the Committee the steps outlined in **Table 1** should be followed in the SIA process.

Table 1: Steps in the SIA Process

Step in SIA		Methodology
1	Public involvement	Develop an effective public plan to involve all potentially affected publics.
2	Identification of alternatives	Describe the proposed action or policy change and reasonable alternatives.
3	Baseline conditions	Describe the relevant human environment/area of influence and baseline conditions by investigating a number of variables.
4	Scoping	Identify social impacts based on discussion or interviews with numbers of all potentially affected.
5	Projection of estimated effects	Investigate the probable impacts obtaining the information from data from project proponents, literature of records of previous experience, census and vital statistics, documents and secondary sources and field research (interviews, hearings, group meeting and surveys of the general population).
6	Predicting responses to impacts	Determine the significance to the identified social impacts by using previous assessments as a guideline, expert judgement and field investigations.
7	Indirect and cumulative impacts	Estimate subsequent impacts and cumulative impacts.
8	Changes in alternatives	Recommend new or changed alternatives and estimate or project their consequences.
9	Mitigation	Develop a mitigation plan.
10	Monitoring	Develop a monitoring programme.

37 World Bank. *The World Bank Participation Sourcebook: Appendix I Methods and Tools*. Viewed January 17, 2005, from http://www.worldbank.org/wbi/sourcebook/sba108.htm.

38 U.S. Department of Commerce National Oceanic and Atmospheric Administration National Marine Fisheries Service. (May 1994). *Guidelines and Principles for Social Impact Assessment.* Viewed January 17, 2005, from http://www.nmfs.noaa.gov/sfa/social_impact_guide.htm#sectV.

Review of Social Impact Assessment Variables

The International Association for Impact Assessment (IAIA) in an EIA Training Resource Manual[39] grouped the social impacts into five categories:

- o lifestyle impacts – the way behave and relate to family, friends and cohorts on a day-to-day basis;
- o cultural impacts – shared customs, obligations, values, language, religious belief and other elements which make a social or ethnic group distinct;
- o community impacts – infrastructure, services, voluntary organisations, activity networks and cohesion;
- o amenity/quality of life impacts – sense of place, aesthetics and heritage, perception of belonging, security and liveability and aspirations for the future; and
- o health impacts – mental, physical and social well being.

The IAIA, in a special publication issued later on after the manual, conceptualises social impacts in a slightly different way as political systems, the environment and the personal and property rights are added to the five categories. Social impacts are changes to one or more of the following:

- o people's way of life – that is, how they live, work, play and interact with one another on a day-to-day basis;
- o their culture – that is, their shared beliefs, customs, values and language or dialect;
- o their community – its cohesion, stability, character, services and facilities;
- o their political systems – the extent to which people are able to participate in decisions that affect their lives, the level of democratisation that is taking place, and the resources provided for this purpose;
- o their environment – the quality of the air and water people use; the availability and quality of the food they eat; the level of hazard or risk, dust and noise they are exposed to; the adequacy of sanitation, their physical safety, and their access to and control over resources;
- o their health and wellbeing – health is a state of complete physical, mental, social and spiritual wellbeing and not merely the absence of disease or infirmity;
- o their personal and property rights – particularly whether people are economically affected, or experience personal disadvantage which may include a violation of their civil liberties; and
- o their fears and aspirations – their perceptions about their safety, their fears about the future of their community, and their aspirations for their future and the future of their children.

The U.S. Department of Commerce National Oceanic and Atmospheric Administration National Marine Fisheries Service[40] suggests a list of variables that are to be used when conducting a social impact assessment, which are divided under 5 general headings:

- o population characteristics – present population and expected change, ethnic and racial diversity, influxes and outflows of temporary residents;

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[39] International Association for Impact Assessment. (Second edition 2002). *Topic 13 – Social Impact Assessment.* Viewed January 17, 2005 from http://www.iaia.org/Non_Members/EIA/ManualContents/Sec_E_Topic_13.PDF.

[40] U.S. Department of Commerce National Oceanic and Atmospheric Administration National Marine Fisheries Service. (May 1994). *Guidelines and Principles for Social Impact Assessment.* Viewed January 17, 2005 from http://www.nzaia.org.nz/iaia/siaguidelines.htm.

- community and institutional structures – size, structure and level of organisation of local government, historical and present patterns of employment, size and level of activity of voluntary organisations, religious organisations and interests groups, and how all these institutions relate to each other;

- political and social resources – distribution of power authority, interested and affected publics and leadership capability;

- individual and family changes – factors which influence the daily life of individuals and families including attitudes, perceptions, family characteristics and friendship networks; and

- community resources – patterns of natural resource and land use, availability of housing and community services.

Appendix 02 – International Social Security Association (ISSA) Feedback

Observations[*] on

"The Modernisation of the Pensions Framework:

Securing Sustainable Adequacy"

(Malta, Draft 4.0, 24 August 2004)

The Modernisation report is a thorough analysis of the current public pensions system in Malta and proposed reforms. It sets out a sound set of values on which the proposals are based. The following observations deal with selected sections of the report. The observations do not deal with proposed transition measures. References in parentheses are to pages in the report.

Background

Pensions are transfers of resources from active workers to inactive retired persons at the time the pensions are paid. Amounts paid in pensions, which pensioners then convert into goods and services that they consume, are equal to consumption (and investment) which workers forego. The goods and services which workers and pensioners share are all produced by workers at the time pensions are paid, and workers' disposable income is reduced by the amount of resources they transfer to retired persons. Thus, support of increasing numbers of retired persons is possible only if output grows - only if economic growth is sufficiently robust to generate the resources to be transferred to retired persons without unduly depriving active workers.[41]

A broader question is how in the future relatively smaller proportions of active workers can produce the goods and services which the entire population requires? Will productivity increases and capital investment fill the gap? Will immigration – in the numbers required – meet the shortfall? Clearly, everywhere, the retirement age will have to increase, not just to make public pension schemes sustainable, but to take into account both increases in the expectation of life at the higher ages and the need for workers to produce goods and services. Pension scheme provisions which encourage withdrawal from the labour force (e.g. through early retirement or disability retirement) must be removed from the schemes.

Pensions are long-term undertakings, and the political and economic perspective should be similarly long-term. Reforms to public pension schemes are difficult to agree (since they often involve decreases in benefits). Strenuous efforts are inevitable, but necessary, to obtain a political consensus on reforms. Reforms must be implemented over long periods so as not to disrupt plans of persons who will shortly become beneficiaries.[42]

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[*] These observations do not represent an official position of the International Social Security Association. They are based on the text of the Modernisation report. The appendices to this report and the 2004 World Bank report were not available.

[41] Support ratios refer to the number of potential active persons (workers) available to support other sectors of the population. The total support ratio is the number of persons aged 15 to 64 divided by persons at other ages. The aged support ratio is the number of persons aged 15 to 64 divided by those aged 65 and over. For Malta, according to *World Population Ageing 1950-2050* (Population Division, United Nations Department of Economic and Social Affairs (ST/ESA/Ser.A/207), New York), these support ratios are:

Support ratio	1950	1975	2000	2025	2050
Total	1.5	1.9	2.1	1.6	1.4
Old-age	10.3	6.9	5.4	2.7	2.1

While the total support ratio varies modestly over the century, there is a shift from support for (relatively inexpensive) youths to (costly) aged persons.

[42] The 1983 social security reform in the USA which raised the normal retirement age from 65 to 67 in 2027 is being implemented very gradually from 2000. The full effect of the increase in retirement age in 2027 will apply to persons who were born in 1960, i.e. who were age 23 in 1983.

Modernisation Report Proposals

The Modernisation report proposes:

- o Continuation of the non-contributory means tested scheme.
- o Pillar 1 – a mandatory contributory defined benefit social insurance scheme targeted at poverty avoidance.
- o Pillar 2 – mandatory (initially voluntary) occupational schemes which, along with Pillar 1, will ensure a 'decent standard of living'.
- o Pillar 3 – voluntary (tax sheltered) supplementary schemes.

Poverty Avoidance/Income Maintenance

It is sometimes held that a single public pension scheme which strives to achieve the dual objectives of poverty avoidance and income maintenance will not achieve either objective. Rather, the two objectives require different schemes.

It may be that the non-contributory (tax-financed) means tested scheme (p. 4) and the Pillar 1 minimum pension guarantee (p. 53) provide poverty avoidance protection.

Pillar 1 seems to be much stronger than a programme principally targeted at avoiding poverty. The current earnings cap for Pillar 1 contributions and benefit calculations is Lm 6,750 (78% higher than the average wage; partially adjusted for price inflation (p. 20)) giving a maximum pension (after 30 years of contributions) of two-thirds of this amount, Lm 4,500. The earnings cap is about one-half of the regular income of a senior public officer (which would result in a pension of about 1/3 of the public officer's remuneration, not an insignificant pension).[43] (p. 43)

Pillar 1 thus appears to continue to have an important income maintenance role.

Supplementary Protection

It is well-accepted that non-state provision of retirement protection should be encouraged through occupational schemes and private arrangements. In order for these schemes to be set up, there must be 'room' for them to operate. This can be achieved by having a low cap on earnings for calculation of contributions and benefits in the public defined benefit scheme[44] or a high cap, but with a low replacement rate.

One cannot be sure that mandatory (funded) occupational schemes will (along with Pillar 1) produce the expected 'decent standard of living' desired in the report. There are many variables which can affect this: type of scheme, extent of participation, level and continuity of participation, investment performance, [45] While governments should be encouraged to promote supplementary schemes, they cannot assume that they will absolve the government of responsibility for the financial circumstances of their retired populations.[46] For example, the report refers to a Pension Compensation Fund which would compensate participants in the event of insolvency of their funds and in certain other circumstances. (p. 30). Much more generally, if pensions fail to provide a decent standard of living, it is the government (i.e. taxpayers) which will – for political reasons – be called upon to be the ultimate provider.

The report deals with the regulatory and other arrangements which Pillar 2 will require. (p. 25) Pension schemes (public or private) which invest the schemes' reserves can only operate if there is proper

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[43] This assumes that actual pensions received are generally what the benefit formula indicates they would be. Presumably this has been investigated elsewhere.

[44] For example, in Canada, the UK and the USA.

[45] Projected replacement rates in defined contribution schemes are very sensitive to assumptions which are made regarding these factors. The actual replacement rates can vary greatly from those projected. (See p. 26.)

[46] It is curious that the report focuses to such an extent on setting up Pillar 2 arrangements when these are presently facing severe difficulties. See, for example, *The Economist* of 11 September 2004, p. 18 and 16 October, pp. 33-34 and the Turner report to which the articles refer.

regulation concerning recognition of property rights, securities markets, the banking system and accounting standards. Regulation of private pension schemes is in addition to these fundamental regulations. The cost of setting up a system and employing the highly-trained professionals necessary for pension scheme regulation is not negligible. A public social insurance scheme (operated by a government department or a statutory body reporting to the government) with a board of directors does not require regulation by an independent regulator. The state (i.e. the legislature) is the ultimate regulator of such a scheme

Arrangements for the transfer of acquired rights and the attributed funds when individuals move from one scheme to another (portability) can be complex. (pp. 27, 30). The issue of portability does not arise with a single public scheme (e.g. Pillar 1). Nor does the issue of possible liquidation of contributors' accounts in the event of changes of employment; an action which can render their retirement pensions inadequate. (pp. 31, 32).

The problems associated with conversion of lump sum benefits into annuities by multiple annuity providers should not be underestimated. (pp. 31, 32). The components of the price of an annuity are administration expenses and estimates of future mortality levels and investment income. Administration expenses should be negligible (but this is not always so). The pace and possible extent of future mortality improvements are uncertain. This uncertainty is exacerbated if conversion of lump sums to annuities is voluntary, since healthy persons will opt for annuities and unhealthy persons will choose another means of drawing down their lump sums. Indexation of annuities[47] means investments must be largely in indexed bonds and these are issued almost exclusively by governments; consequently annuity providers will all be investing mainly in the same securities.

The report refers to the investment of pension funds. (p. 26) The OECD has published guidelines for the investment of occupational scheme funds, and the ISSA has developed guidelines for the investment of social security funds (see www.issa.int). It is noteworthy how some partially funded public schemes have separated the administration and investment functions and taken advantage of private investment management expertise. (See, for example, the Canada Pension Plan Investment Board and the Government Pension Investment Fund in Japan.)

Clearly, Decision of Principle 16 (p. 34) is correct. Further studies must be undertaken to elaborate Pillar 2. For example, it is not entirely clear from the report in what proportions the PAYG Pillar 1 and funded Pillar 2 are expected ultimately to provide income maintenance for retired persons. This is obviously related to the contribution rates (and earnings caps) for the two pillars and the extent to which contributions to Pillar 1 are diverted to Pillar 2. It is also unclear which is preferred: multiple schemes or a single state Pillar 2 scheme? (p. 26).

An alternative which does not seem to be addressed in the report is: Would it be desirable to (a) redesign the defined benefit Pillar 1 and (b) partially fund this Pillar? The redesign could, for example, aim at a Pillar 1 replacement rate of 40% to 50% of actual earnings with the balance of income replacement provided by supplementary occupational or private schemes. This would imply an increase in the earnings cap (which would also expand the contributions base). Actuarial studies could indicate what alternative redesigns are sustainable within the pension scheme contribution rate desired.[48]

This leads to another question: If the basic (Pillar 1) scheme provided income replacement of 40% to 50%, would it be necessary to mandate Pillar 2? Or, would the manifest need to supplement the basic scheme along with tax benefits be sufficient to induce persons to voluntarily join supplementary occupational and private Pillar 2 schemes?

[47] The report (p. 32, Decision of Principle 13) refers to indexing annuities to wages. This means that the pensions of retired persons will not only be protected against cost of living increases, but they will also participate in increases in productivity. While retirement pensions should be indexed, this indexation often only takes into account changes in the cost of living.

[48] This alternative may be alluded to in parts of Chapter 01 of the report. Indeed, the question raised may be dealt with in part by the World Bank (ref. pp. 34,35), but this is not clear from the report. See also the remark at the top of p. 48.

Retirement Age

A public pension scheme can be made financially sustainable by increasing the contribution rate or reducing benefits. The former alternative is generally unacceptable.[49] In a contributory scheme, raising the retirement age is one means of reducing benefits since pensions will be paid for shorter periods and contributions received for longer periods. This measure can also contribute to maintaining national output. It is proposed in the report that pension age be raised (from 60 for females, 61 for males) to 65. (p. 37) Clearly, this is a desirable measure as the following table of life expectancies and normal retirement ages for public schemes in selected countries indicates:

Life Expectancy at 65 (in 2002-05) (males and females)	Normal Retirement Age		
	Males	Females	
17.4	61	60	Malta
18.0	65	60	Austria, Italy
18.7	65	64 (2005)	Switzerland
	Males & Females		
16.7-18.4	67		Denmark, Iceland, Norway, USA (from2027)
16.4-20.2	65		Canada, Germany, Japan, Netherlands, Spain, United Kingdom (females from 2020)
18.7	flexible from age 61		Sweden

Life Expectancy Source: *World Population Ageing 1950-2050*, Population Division, United Nations Department of Economic and Social Affairs (ST/ESA/Ser.A/207), New York.

In fact, many persons retire before the normal retirement age by opting for early retirement (p. 39) or acquiring a disability pension (p. 40). The effect of early retirement can be neutralized (and the attraction of this option reduced) by applying actuarial factors to calculate reduced pensions at ages lower than the normal retirement age which are equivalent to those acquired but payable at normal retirement age. The award of disability pensions can be controlled by strict application of rules governing the award of disability pensions (and possibly by strengthening the existing rules pertaining to the award of disability pensions). Inducements can be provided in the pension scheme to encourage workers to remain in the employed labour force after the normal retirement age.[50]

Another way of regarding the appropriate retirement age is to consider the ratio of the potential retirement period to the potential working period. At age 60, in Malta life expectancy of males and females combined is 21.5 years in 2000-2005 and is expected to rise to 25.9 in 2045-2050. When the social insurance pension scheme was set up in Malta in 1956, if life expectancy was, say, 17 years[51], then for a 40 years potential working career (age 20 to 60) the proportion of the average retirement period to the potential working period was 42%. In 2000-2005 this proportion had risen to 54% and it is estimated to be 65% in 2045-2050. To maintain the original 42% ratio the current retirement age would have to be raised to around age 65. (Combined life expectancy at age 65 in 2000-2005 is 17.4 years. Dividing this by a potential working career of 45 years (age 20 to age 65) gives 39%.). Another question, of course, is whether an average retirement period equal to around 40% of the potential working period is appropriate in the first place.

[49] But note that in Canada the contribution rate was raised to create a reserve fund.

[50] Fewer early retirements and a consequent increase in the actual age of retirement can be a result of defined contribution schemes which result in pensions at normal retirement age that are lower than participants expected. They then have no choice but to continue working (if they can and if employment is available).

[51] The true combined life expectancy at age 60 in the mid-1950s is unknown. Life expectancies in 2000-2005 and 2045-2050 are from *World Population Ageing 1950-2050.*

Many countries are facing rapidly declining old-age support ratios (see footnote 1), and are grappling with the issue of an appropriate normal retirement age. Clearly, the normal retirement age must increase, and it is desirable that populations be prepared for this certainty.

Contributions

Contributions are 10% of basic salary (subject to a ceiling) by employed persons and by their employers plus a State Grant of one-half of the total contributions.[52] The contribution income is applied to provide old-age, invalidity and survivors pensions, sickness and maternity cash benefits, work injury benefits and unemployment benefits. In addition, the State Grant is applied to pay for health care, social assistance and family allowances. (p. 21)[53]

It is intended that health care be separated from social security cash benefits. (p. 46) sound financing and management of social security programmes requires that contributions be allocated to separate accounts maintained for each benefit branch (e.g. pensions, work injury, etc). Otherwise, the performance of the individual benefit branches and underlying trends are obscured, and necessary remedial measures are deferred. (p. 47).

An income replacement scheme seeks to replace regular earned income from employment which is lost due to the occurrence of a contingency covered by the scheme. Unearned income is excluded from the benefit calculation and the contribution base. Alignment of the social security earned income contribution base and the earned income for income tax purposes simplifies reporting for employers, and improves compliance with the social security scheme contribution conditions. (p. 41).

Specific Observations

The **maximum Pillar 1 pension after 30 years of contributions** is 2/3 of the best three of the last ten years of earnings. This implies an accrual rate of 2.2% per year on earnings subject to contributions and for calculation of pensions. Clearly, contributors contrive to withdraw from the scheme or otherwise seek to cease contributing once they have reached the maximum contribution period which generates benefits. It is proposed that the contribution period for a 2/3 pension be increased to 40 years (p. 42) which would produce a benefit accrual rate of 1.7% per year. While this would largely alleviate this anomaly, if retirement age is increased there will still be some workers who will be expected to contribute during periods when they will not be acquiring benefits. An accrual rate of, for example, 1.25% per year could be applied without a maximum contributory period (assuming the earnings cap is revised). (pp. 41,42).

The **Pillar 1 best three of final ten years earnings basis** for assessing earnings on which the pension is calculated invites manipulation. This sort of final earnings formula was necessary before computers enabled records to be kept accurately over long periods. Pensions can now be based on full career average earnings adjusted for wage increases until the time pensions are awarded. Refinements such as dropping out years of low earnings and crediting earnings can be introduced.

[52] The contribution rate for self-employed persons is 15%. This means that self-employed persons are now subsidised by employed persons and/or the State Grant. It is proposed that the contribution rate for self-employed persons be raised to 20%. (p. 45)

[53] Except as an employer, the state usually does not make a specified contribution to a public pension scheme. The intention is that the scheme be financed by the potential worker beneficiaries and their employers without a transfer of resources from other taxpayers who may not be potential beneficiaries.

Health Care

The Modernization report deals with pension provision in Malta. It is important to remember that the ageing of the population portends major increases in the cost of health care, increases which may indeed be more difficult to deal with than those in the pensions scheme.

W.R. McGillivray, F.S.A.
Chief, Studies and Operations Branch
International Social Security Association
Geneva

October 2004

Mail

Received mail: ISSA - email

Sender: Gauci Jacqueline at MITTS
Recipient: Grech Marisa at MEU
Sent: 4/19/2005 9:17 AM

Warren McGillivray (19/11/2004 16:51):
>Dear Mr. Gingell,
>
>I have been informed that it is intended to release the White Paper
>during the week beginning 21 November, and that you would like my
>comments on the revised version I received on 11 November before then.
>
>I am sorry, but I have not had time to go through draft 6.0 carefully.
>In any event, I presume that you have considered the comments which I
>made on draft 4.0, and taken into account any which you deemed had
>merit.
>
>In my observations, I stressed the need for a strong DB Pillar 1
>(40-50% replacement rate) due to the risks of the DC Pillar 2; risks
>which are borne by the contributors, but which will ultimately devolve
>onto the government if Pillar 2 benefits are unsatisfactory.
>
>You mention that the average wage is Lm94/week, i.e. Lm4888/year. I
>calculate the MPI (Lm6750) to be 38% greater than this.
>
>In a DB scheme, one normally sets the earnings ceiling for
>contributions and benefits so that, say, 80%+ of the persons covered by
>the scheme will have earnings under the ceiling. In this way the income
>replacement is based on the entire earned income of most of the persons
>covered by the scheme. The earnings ceiling is adjusted regularly,
>ideally annually, in accordance with the rate of increase in wages.
>
>However, in Malta you are planning a DB Pillar 1 and a DC Pillar 2, and
>you have a legacy of providing a benefit of 2/3 of the MPI after a full
>career which I gather should be maintained. In order to maintain the 2/3
>MPI benefit, leave room for Pillar 2 and ensure a Pillar 1 benefit of
>40-50% of career average adjusted earnings, an MPI can be calculated
>(based on earnings data) such that 2/3 of the calculated MPI produces
>the 40-50% replacement rate for, say, 80%+ of the persons covered by the
>scheme.
>
>With reference to the MPI, the last part of the sentence in section
>4.6.2 is not entirely clear to me.
>
>The text of section 4.7(b) is well-considered. I suggest that the
>possibility of partially funding Pillar 1 rather than depend on PAYG
>financing be considered.
>
>Finally, when the White Paper is released, I would be grateful if you
>would mail four copies to the ISSA in Geneva.
>
>Yours sincerely,
>Warren McGillivray
>ISSA
>19/11/2004

Appendix 03 – Workings of Projections of Average Pension Income

Year	Average Replacement Rates (%)				Average Wage (Lm)		Average Pension (Lm)		Average Annual Expenditure (Lm)		% Average annual expenditure covered by average pension			
	Current Scenario	Reformed Scenario					Current Scenario	Reformed Scenario	Household 1	Household 2	Household 1		Household 2	
	ARR for Existing 2/3 Retirement pension	ARR from Pillar 1	ARR from Pillar 2	ARR for Existing 2/3 Retirement pension	3% annual real wage growth	5.5% annual nominal wage growth					Current Scenario	Reformed Scenario	Current Scenario	Reformed Scenario
2005	57.8%	57.7%		57.7%	4404.67	4511.6	2544.99	2542.40	3594.20	5188.21	71%	71%	49%	49%
2006	57.0%	56.4%		56.4%	4536.81	4646.9	2588.19	2559.22	3684.06	5317.92	70%	69%	49%	48%
2007	56.8%	55.2%		55.2%	4672.92	4786.3	2655.87	2579.01	3776.16	5450.86	70%	68%	49%	47%
2008	56.5%	54.0%		54.0%	4813.10	4929.9	2719.91	2601.18	3870.56	5587.14	70%	67%	49%	47%
2009	56.1%	53.0%		53.0%	4957.50	5077.8	2779.76	2626.03	3967.33	5726.82	70%	66%	49%	46%
2010	55.6%	51.9%		51.9%	5106.22	5230.2	2836.86	2651.71	4066.51	5869.99	70%	65%	48%	45%
2011	55.0%	50.9%		50.9%	5259.41	5387.1	2890.37	2677.00	4168.17	6016.74	69%	64%	48%	44%
2012	54.3%	49.9%		49.9%	5417.19	5548.7	2940.19	2701.95	4272.38	6167.15	69%	63%	48%	44%
2013	53.5%	48.8%		48.8%	5579.71	5715.1	2985.35	2724.29	4379.19	6321.33	68%	62%	47%	43%
2014	52.7%	47.5%		47.5%	5747.10	5886.6	3027.33	2731.79	4488.67	6479.37	67%	61%	47%	42%
2015	51.8%	46.5%		46.5%	5919.51	6063.2	3065.30	2750.92	4600.88	6641.35	67%	60%	46%	41%
2016	50.8%	45.4%		45.4%	6097.10	6245.1	3098.08	2770.38	4715.91	6807.38	66%	59%	46%	41%
2017	49.8%	44.4%		44.4%	6280.01	6432.4	3125.08	2790.65	4833.80	6977.57	65%	58%	45%	40%
2018	48.6%	43.7%		43.7%	6468.41	6625.4	3145.71	2828.91	4954.65	7152.01	63%	57%	44%	40%
2019	47.5%	42.7%		42.7%	6662.46	6824.2	3161.58	2846.89	5078.52	7330.81	62%	56%	43%	39%
2020	46.2%	41.7%		41.7%	6862.33	7028.9	3171.58	2860.78	5205.48	7514.08	61%	55%	42%	38%
2021	44.9%	41.0%		41.0%	7068.20	7239.8	3176.57	2899.72	5335.62	7701.93	60%	54%	41%	38%
2022	43.6%	40.4%	2.0%	42.4%	7280.25	7457.0	3176.37	3088.78	5469.01	7894.48	58%	56%	40%	39%
2023	42.3%	39.3%	2.4%	41.7%	7498.66	7680.7	3171.65	3127.85	5605.73	8091.84	57%	56%	39%	39%
2024	40.9%	38.3%	3.3%	41.6%	7723.62	7911.1	3161.61	3209.37	5745.87	8294.14	55%	56%	38%	39%
2025	39.6%	37.1%	3.1%	40.2%	7955.33	8148.4	3147.92	3200.91	5889.52	8501.49	53%	54%	37%	38%
2026	38.2%	36.1%	3.2%	39.2%	8193.99	8392.9	3129.31	3213.69	6036.76	8714.03	52%	53%	36%	37%
2027	36.8%	35.0%	3.2%	38.2%	8439.81	8644.7	3106.29	3226.12	6187.68	8931.88	50%	52%	35%	36%
2028	35.4%	33.6%	3.3%	36.9%	8693.00	8904.0	3080.24	3206.60	6342.37	9155.17	49%	51%	34%	35%
2029	34.1%	32.3%	3.4%	35.6%	8953.79	9171.1	3050.93	3188.58	6500.93	9384.05	47%	49%	33%	34%
2030	32.5%	31.0%	3.5%	34.5%	9222.40	9446.2	2999.70	3179.02	6663.45	9618.65	45%	48%	31%	33%
2031	31.1%	29.8%	3.6%	33.5%	9499.08	9729.6	2952.36	3179.02	6830.04	9859.12	43%	47%	30%	32%
2032	29.7%	28.8%	3.8%	32.6%	9784.05	10021.5	2908.70	3188.55	7000.79	10105.60	42%	46%	29%	32%
2033	28.5%	27.7%	4.0%	31.8%	10077.57	10322.2	2867.22	3201.66	7175.81	10358.24	40%	45%	28%	31%
2034	27.3%	26.8%	4.3%	31.0%	10379.90	10631.8	2829.76	3222.78	7355.20	10617.19	38%	44%	27%	30%
2035	26.1%	25.9%	4.5%	30.4%	10691.29	10950.8	2795.53	3250.32	7539.08	10882.62	37%	43%	26%	30%
2036	25.1%	25.0%	4.8%	29.8%	11012.03	11279.3	2764.53	3283.14	7727.56	11154.69	36%	42%	25%	29%
2037	24.1%	24.2%	5.1%	29.3%	11342.39	11617.7	2736.86	3325.49	7920.75	11433.56	35%	42%	24%	29%
2038	23.2%	23.5%	5.4%	28.9%	11682.67	11966.2	2711.63	3372.51	8118.77	11719.40	33%	42%	23%	29%
2039	22.3%	22.7%	5.7%	28.5%	12033.15	12325.2	2688.55	3423.48	8321.74	12012.38	32%	41%	22%	28%
2040	21.5%	22.0%	6.1%	28.1%	12394.14	12695.0	2668.08	3476.61	8529.78	12312.69	31%	41%	22%	28%
2041	20.8%	21.2%	6.5%	27.7%	12765.96	13075.8	2649.28	3538.00	8743.03	12620.51	30%	40%	21%	28%
2042	20.0%	20.6%	6.8%	27.4%	13148.94	13468.1	2631.79	3603.40	8961.60	12936.02	29%	40%	20%	28%
2043	19.3%	19.9%	7.2%	27.1%	13543.41	13872.1	2616.01	3673.73	9185.64	13259.42	28%	40%	20%	28%
2044	18.6%	19.3%	7.6%	26.9%	13949.71	14288.3	2601.43	3755.84	9415.28	13590.91	28%	40%	19%	28%
2045	18.0%	18.7%	8.0%	26.7%	14368.20	14716.9	2587.59	3843.30	9650.67	13930.68	27%	40%	19%	28%
2046	17.4%	18.2%	8.4%	26.6%	14799.25	15158.5	2574.83	3935.47	9891.93	14278.95	26%	40%	18%	28%
2047	16.8%	17.6%	8.8%	26.5%	15243.23	15613.2	2562.49	4034.05	10139.23	14635.92	25%	40%	18%	28%
2048	16.3%	17.1%	9.3%	26.4%	15700.53	16081.6	2551.40	4137.22	10392.71	15001.82	25%	40%	17%	28%
2049	15.7%	16.6%	9.7%	26.3%	16171.54	16564.1	2541.68	4250.81	10652.53	15376.86	24%	40%	17%	28%
2050	15.2%	16.1%	10.1%	26.3%	16656.69	17061.0	2533.68	4374.54	10918.84	15761.29	23%	40%	16%	28%
2051	14.7%	15.7%	10.6%	26.3%	17156.39	17572.8	2526.55	4513.18	11191.81	16155.32	23%	40%	16%	28%
2052	14.3%	15.3%	11.1%	26.4%	17671.08	18100.0	2520.26	4657.26	11471.61	16559.20	22%	41%	15%	28%
2053	13.8%	14.8%	11.6%	26.4%	18201.21	18643.0	2514.91	4809.36	11758.40	16973.18	21%	41%	15%	28%
2054	13.4%	14.4%	12.1%	26.5%	18747.25	19202.3	2510.59	4973.77	12052.36	17397.51	21%	41%	14%	29%
2055	13.0%	14.1%	12.6%	26.7%	19309.67	19778.3	2507.16	5148.28	12353.67	17832.45	20%	42%	14%	29%
2056	12.6%	13.7%	13.1%	26.8%	19888.96	20371.7	2504.36	5326.86	12662.51	18278.26	20%	42%	14%	29%
2057	12.2%	13.3%	13.6%	26.9%	20485.62	20982.8	2503.88	5517.82	12979.07	18735.22	19%	43%	13%	29%
2058	11.9%	13.0%	14.1%	27.2%	21100.19	21612.3	2504.76	5728.93	13303.55	19203.60	19%	43%	13%	30%
2059	11.5%	12.7%	14.7%	27.4%	21733.20	22260.7	2508.86	5953.81	13636.14	19683.69	18%	44%	13%	30%
2060	11.2%	12.5%	15.2%	27.6%	22385.19	22928.5	2513.67	6183.44	13977.04	20175.78	18%	44%	12%	31%
2061	10.9%	12.2%	15.7%	27.9%	23056.75	23616.4	2519.47	6422.68	14326.47	20680.17	18%	45%	12%	31%
2062	10.6%	11.9%	16.2%	28.1%	23748.45	24324.9	2525.95	6677.58	14684.63	21197.18	17%	45%	12%	32%
2063	10.4%	11.7%	16.7%	28.4%	24460.91	25054.6	2532.95	6935.73	15051.75	21727.11	17%	46%	12%	32%
2064	10.1%	11.5%	17.2%	28.6%	25194.73	25806.3	2540.86	7209.96	15428.04	22270.28	16%	47%	11%	32%
2065	9.8%	11.2%	17.7%	28.9%	25950.58	26580.4	2549.80	7496.87	15813.74	22827.04	16%	47%	11%	33%
2066	9.6%	11.0%	18.1%	29.2%	26729.09	27377.9	2559.85	7802.96	16209.08	23397.72	16%	48%	11%	33%
2067	9.3%	10.9%	18.7%	29.5%	27530.97	28199.2	2570.90	8130.82	16614.31	23982.66	15%	49%	11%	34%
2068	9.1%	10.7%	19.2%	29.9%	28356.89	29045.2	2582.87	8479.53	17029.67	24582.23	15%	50%	11%	34%
2069	8.9%	10.6%	19.7%	30.3%	29207.60	29916.5	2595.82	8852.17	17455.41	25196.78	15%	51%	10%	35%
2070	8.7%	10.4%	20.3%	30.7%	30083.83	30814.0	2609.48	9248.58	17891.79	25826.70	15%	52%	10%	36%
2071	8.5%	10.3%	20.9%	31.2%	30986.34	31738.4	2623.68	9669.30	18339.09	26472.37	14%	53%	10%	37%
2072	8.3%	10.2%	21.5%	31.7%	31915.93	32690.6	2638.35	10115.41	18797.57	27134.18	14%	54%	10%	37%

In this table, the term ARR refers to Average Replacement Rate/s.

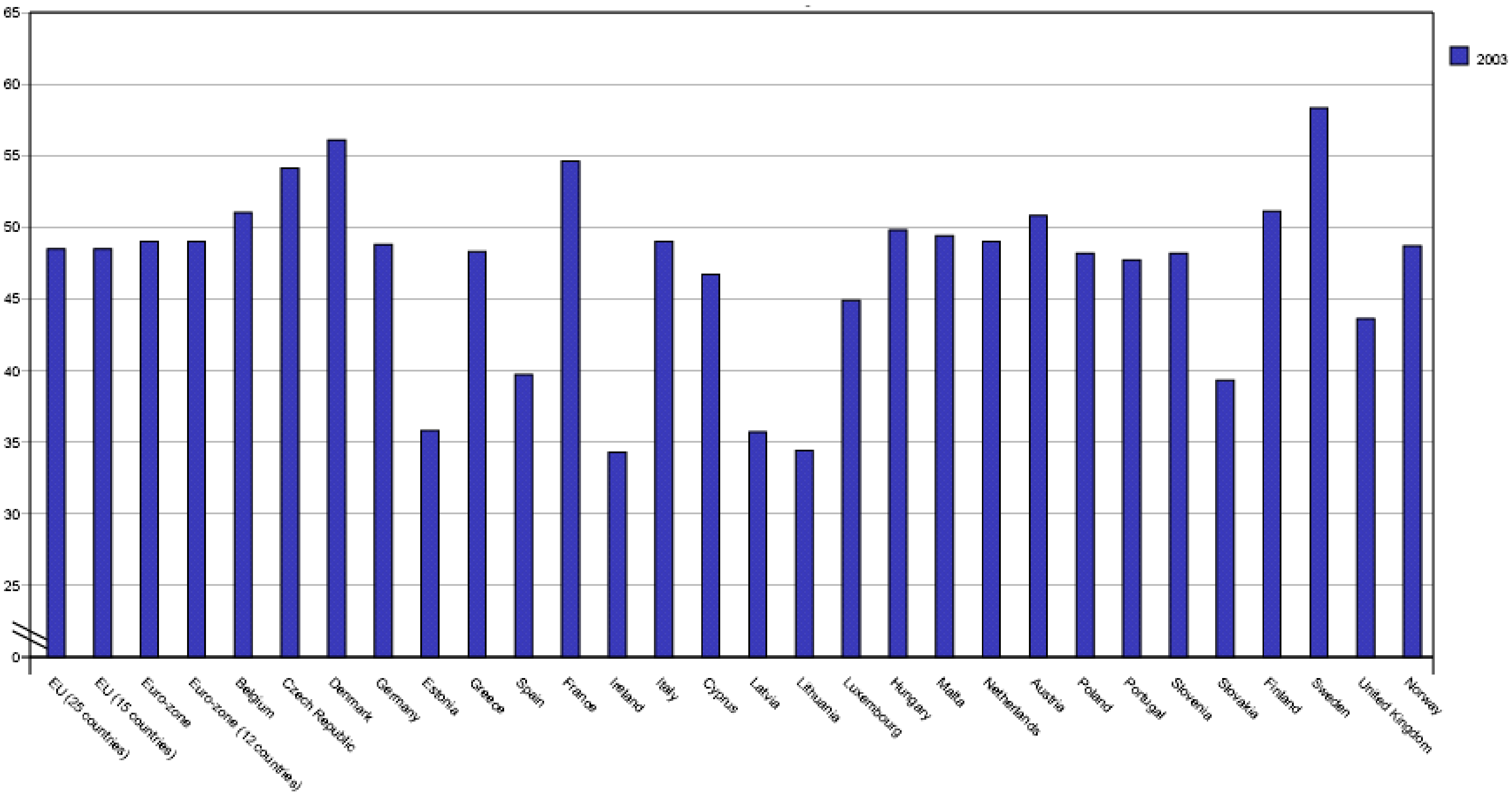
Explanatory Notes

Years	The Projection period considered covers the years 2005 to 2072.
Average Replacement Rates	These rates were derived from PROST output tables. The average replacement rates used are defined in the Glossary of this report.
ARR from Current Scenario	The Average Replacement Rate for Existing 2/3 retirement pension provided by PROST output tables (based on PROST file: Malta basec).
ARR from Pillar 1	The Average Replacement Rate for Existing 2/3 retirement pension of the reformed PAYG benefits (based on PROST file: Malta 2cp6750).
ARR from Pillar 2	The Average Replacement Rate if All Balance is Annuitised (based on PROST file: Malta 2cp6750). Although in the White Paper it is stated that the Pillar 2 Pension will be split into a lump sum and annuities since PROST 11 does not cater for the modelling of this mix, this replacement rate was taken.
ARR from Reformed Scenario	The addition of ARR from Pillar 1 and ARR from Pillar 2.
Average Wage	Average wage amounting to Lm4030 in 2002 was assumed (as per assumption in PROST file: Malta basec). Values of the average wage over the projected period were calculated using the 3% real wage growth assumption, taken in the White Paper, or alternatively a 5.5% nominal wage growth (taking assumption of inflation rate of 2.5% in White Paper).
Average Pension	Since the formula for the calculation of the Average Replacement Rate is equal to the ratio of average pension to average wage for each age cohort in year, the value of the average pension income was obtained by the multiplication of the Average Replacement Rate and the Average Wage for both the current and reformed scenarios.
Average Annual Expenditure	The Average Annual Expenditure of Household 1 and Household 2 for the year 2000 were taken from the Household Budgetary Survey (2000). The average annual expenditure of these two households for the projected period was calculated assuming an inflation rate of 2.5% as per the assumption taken in the White Paper.
% Average Annual Expenditure covered by Average Pension	The proportion of average annual expenditure of the two households covered by average annual pension earned by the households.

The calculations provided are based on the assumptions made in the White Paper, as specified in the Introduction of this report.

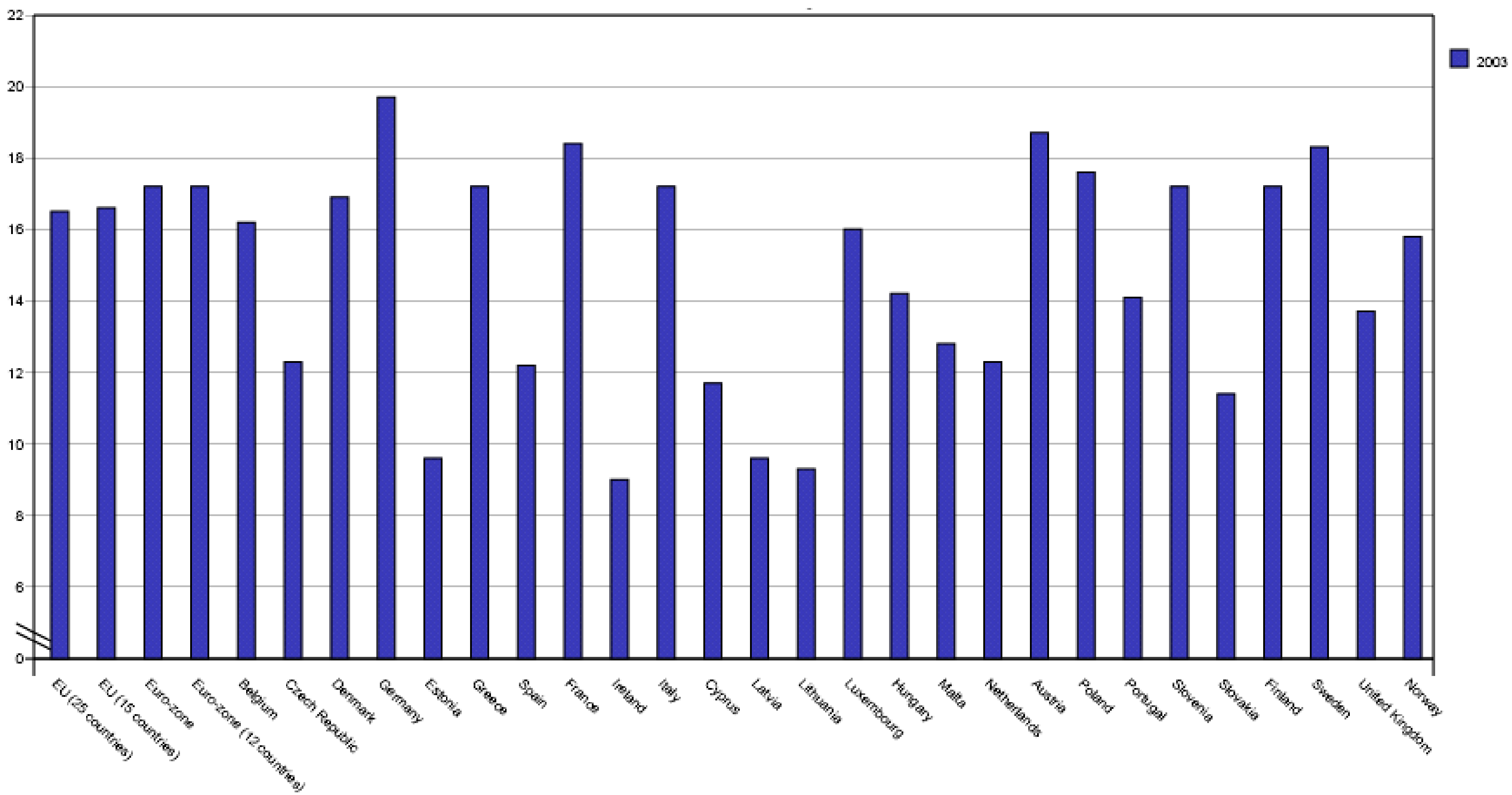
Appendix 04 – Graphical Analysis of Government Expenditure in EU Member States

Figure 1: General Government Expenditure as a % of GDP



Source: Eurostat

Figure 2: Social benefits paid by General Government as a % of GDP



Source: Eurostat