



**Report On the**

*Strategic Review*

*on the Adequacy, Sustainability and Social Solidarity of the*

*Pensions System*

*Prepared by the*

*2010 Pensions Working Group.*

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## **Introduction**

This report is an assessment of the latest recommendations on pension reforms contained in the Strategic Review on the Adequacy, Sustainability and Social Solidarity of the Pensions System published by the Pensions Working Group (PWG) in December 2010.

The first report by the Pensions Working Group entitled Pensions: Adequate and Sustainable was presented to Government on 30<sup>th</sup> June 2005 and contained 66 recommendations. The main reform actually undertaken by government since the 2005 PWG report was to gradually raise the pensions age to 65. The Mandatory Second Pillar and a Voluntary Third Pillar were never introduced

The 2010 PWG Report makes 45 recommendations. This GWU Report focuses on the primary recommendations made and gives the GWU's reactions and position on each of the recommendations **(in bold lettering)**.

## **EU Green Paper on Pensions**

The EU published a Green Paper on Pensions. Feedback closed in November 2010. The consultation process generated almost 1700 responses. The Green Paper provides the framework within which the local pension reform is to be understood and implemented.

The Commission launched this Green Paper because it believed that the European pension systems are under pressure from demographic ageing as a result of increases in longevity and declining birth rates. From 2012, the working age population in Europe will begin to shrink. The Commission's frame of mind is that "The choice we face is poorer pensioners, higher pension contributions or more people working more and longer".

At EU level the agreed objectives for pension systems are that they are adequate and sustainable, as well as being modern and transparent

The design of pension systems is largely the responsibility of Member States (the subsidiarity principle) and the Green Paper does not question this. The regulatory framework at the EU level covers four main points:

1. Cross border coordination of social security pensions to facilitate the free movement of workers and equal treatment for workers who change country.
2. Establishing an internal market for funded occupational schemes and the necessary minimum standards on prudential rules to protect scheme members and beneficiaries.
3. Minimum guarantees concerning occupational pensions and accrued rights in case of the insolvency of enterprises as sponsors.
4. Anti-discrimination rules apply, although with some differentiation, to both statutory and private pension schemes

The Green Paper favoured a legal-link between retirement age and longevity as this would "de-politicise" the issue. It claimed that later retirements did not hinder increased youth unemployment as "labour markets are not a zero-sum game" in which the number of jobs is fixed.

**While this is true for those economies capable of generating the necessary employment opportunities but not for those that struggle to create sufficient jobs. The first challenge for a pensions' reform is to ensure that the economy strives for full employment. It is ineffective to have employees working until the age of 70 years while unemployment rates hover around 10% or more. Moreover, the jobs created have to be of the right quality to provide decent living conditions.**

**If many employees are being offered work with precarious conditions (often part-time or obliged to register as self employed) then there is little scope to talk about adequate, sustainable and safe pensions in their retirement age.**

## Feedback to Green Paper

1. The introduction of reinforced EU policy coordination on public finances can help boost long-term fiscal discipline and support the sustainability of national pension systems.
2. A number of Member States affirmed that they will continue to base their systems primarily on a statutory public pension scheme and highlighted that the development of private pension systems ranked fairly low among their priorities
3. Some key stakeholders underlined the difficulties that young people have in breaking into the world of work due to the extensive use by companies of short-term contracts and part-time employment.
4. The need to ensure equal treatment of women and men in pensions.
5. No mention is made of the employers' willingness to engage employees beyond a certain age. At 60-70, response rates decline, and this has an impact on jobs such as construction workers, forklift operators and waiters.
6. The Green Paper on Pensions has furthered the debate about how pension funds should be regulated, including the solvency rules, and what role insurance companies should have in private retirement provision. Most conclude that insurance companies and pension funds offer different pension products and therefore they need different rules. Many respondents underscored that changes to the rules for funded pension schemes should not raise the costs of operating such schemes.

## Strategic Review: 2010 Pensions Working Group

- a. The macro-economic assumptions agreed by the Aging Working Group are less ambitious than those assumed by the 2005 Pensions Working Group. Real GDP growth is expected to be around 1.75% for the period 2010 to 2060.

The Report recommends that a calibrated reform of the pensions system is carried out every five years (as is presently mandated by the Social Security Act) and in doing so adopt incremental measures that will have a long term impact.

**The GWU feels that the analysis presented is static and no mention is made of Malta (and the EU in general) succeeding to achieve its socio-economic objectives as per the National Reform Programmes within the Europe 2020 Strategy and what impact this will have on future pensions. Moreover, trying to project a situation 50 years from now is an act of faith. Reviewing progress every five years as suggested by the 2010 Working Group makes sense.**

- b. Within the present PAYG system the median pension replacement rate will fall to 45% by 2060. This creates the need to bridge to the highest degree possible the quality of life to be enjoyed by a pensioner as compared to what s/he enjoyed during his or her employment.

**The GWU strongly maintains that a pension rate less than 60% average pension replacement rate would not be adequate to provide for a decent living. Therefore, the standard minimum pension that everyone reaching the pensionable age should be entitled to must be at least 60% of the national median income.**

- c. The PAYG system (referred to in the Report as the First Pension) is intrinsically tied to demographics and the active labour participation rate. Malta has an ageing population due to low fertility rates. It also has a low participation rate in the labour market. In 2010 this stood at 59%, which in itself provides an opportunity. The low activity rate stems primarily from two population cohorts. The first is the female population cohort and the second is retirees.

The Working Group recommends that Government should consider grafting onto the First Pension a retirement age-longevity indexation mechanism that would result in an automatic increase in the official retirement age every time there is an official increase in the longevity index.

**Government should commit itself in earnest to introduce pro-family measures not only so as to protect its key role in our society but also to foster and if need incentivise a higher fertility rate. Particular attention needs to be given so that the active promotion of female participation in our labour force will not lead to a further fall in the fertility rate.**

**Efforts should now be concentrated on increasing female participation rates and ensuring adequate pay and ancillary conditions for all work (including part-time work).**

**Increased female participation in the labour force tends, if left on its own, to lead to even lower fertility rates. Government should take all the necessary pro-family measures (childcare facilities, before and after School Care Programmes, flexitime, teleworking etc) to find a balance between the two objectives.**

- d. The 2010 Working Group recommends that the Minister responsible for Pensions should consider appointing a Working Group to assess by 2013 the:
- ❖ possibility of transforming the Two-Thirds Pension into a Notional Defined Contribution First Pension;
  - ❖ short to long term impact of such a reform on the adequacy, sustainability and solidarity of the pension system;
  - ❖ ability to migrate from a Two-Thirds Pension to Normal Defined Contribution First Pension; and the implementation issues that would have to be addressed.

**The GWU finds no problem with the First Pension evolving into a notionally Defined Contribution-based scheme. If anything this will ensure that government is increasingly aware of their commitment towards adequate pensions and the costs involved.**

- e. The Report also recommends that that the 'government should consider grafting onto the First Pension a retirement age-longevity indexation a mechanism that would result in an increase in the official



retirement age every time there is an official increase in the longevity index.'

**The GWU is contrary to retirement age being increased above 65 years. There is no need that the retirement age be automatically linked to longevity. Government has already recently increased (on a gradual basis) the retirement age to 65 years for men and women. As in certain occupations (i.e. construction workers, waiters etc) working beyond a certain age is not practical or even desirable.**

**Retirement age should be a "personal choice" provided that a certain amount of contributions have been paid. The GWU agrees that age should not be a barrier to work. It is up to the individual to determine when to retire (past the official retirement age). There should be no financial disincentives for those who chose to keep working beyond the retirement age.**

- f. The Report recommends that government should allow a widow who is aged 22 years and over when her spouse dies prior to retirement age to work and earn income from gainful activity that exceeds the yearly average of the National Minimum Wage without forfeiting her right to a widow's pension.

#### **The GWU agrees with this recommendation**

- g. The 2010 Working Group states that the provision of the 5/6th Survivors Pension is gender discriminatory as it fails to recognise the female's economic value and the contribution of her role as a family carer and should be replaced by the retention of the full retirement pension earned by her deceased husband.

**While 'in principle' agreeing with this measure, the GWU opines that caution needs to be taken so as it does not end up being a disincentive for women from taking up work in the formal economy.**

- h. The report states that "Work practices indicate that traditional work practices are changing. Increasingly, persons are no longer seeking a 40 hour week single employer relationship but rather a multiple employer relationship that will result in a 40 hour week".

Employees working on such a basis are to pay NI as full-timers.

**One can agree with the report that Work Practices are changing however a study should be conducted to determine whether this is a conscious choice or being imposed through the labour market.**

- i. The 2010 Working Group insists "that a decision to postpone further a Mandatory Second Pension would only exacerbate the issue relating to the adequacy of the average pension replacement rate and thereby requiring, potentially, more drastic measures in the near future. Thus, the PWG recommends that the government should seek to introduce a Mandatory Second Pension at the earliest possible".

The Group also suggests increasing protection by means of a Default Fund based on a lifecycle investment strategy. This should be grafted to a Mandatory Second Pension Framework so as to provide protection to those persons who do not or are unable to decide how to invest and to manage that investment over their working period.

The report does not state from when the mandatory Second Pension is meant to become effective. (The GWU has been informed that the Working Group is recommending that the effective date should not be later than 2016). The Report also recommends that in the interim the Government should introduce the Third Pension framework. Government should establish the appropriate fiscal instruments to incentivise savings for retirement and suggests that this could be a pathway into the Mandatory Second Pension. The third pillar should be designed so that people who make a conscious decision to save for pensions today are not compelled to pay an additional contribution on a Mandatory Second Pension once this is introduced.

**The GWU is against the introduction of a Mandatory Second Pillar in principle and in practice. This especially in view that a Mandatory Second Pillar under the present economic conditions will be an added and a heavy burden on both employees and employers. Besides, the recent financial and economic crisis has proved that even private pension schemes can go wrong.**

**Moreover, the 2010 Report fails to address a number of practical difficulties that arise out of the introduction of a mandatory Second Pillar. How will such a pension affect low-paid workers, unemployed people, and those who are unable to work because of health reasons?**

**The GWU therefore insists that rather than introducing a Mandatory Second Pillar, there should be a serious effort to restructure the First Pension so that it becomes sustainable. The First Pillar should be restructured so that it gradually moves from being PAYG-based to a funded one. Should the government be obliged to marginally up present contributions it should be bound at law that any additional revenue collected from such increases go into a pensions' fund.**

**In this context, the GWU strongly reiterates that the Fund should be specifically and strictly for Pensions so to properly address the pension problems and anomalies and to truly meet its proper aims and purposes. Therefore, such a Pensions Fund must be administered and strictly under the control of the social partners – employees, employers and government who after all are the main and sole contributors to the Pensions Fund.**

- j. The 2010 Report also recommends that 'the Government considers the introduction of schemes such as Home Equity Release schemes to allow people, should they wish to do so, to leverage their home ownership investment into income during the retirement phase of their life cycle.'

**The GWU realises the importance that the country saves more and is in favour of any measure that induces long-term savings, including pensions.**

**The Maltese over these last decades have invested much of their savings into real estate; it is important that such investments are diversified so as to balance interest with risk.**

**The GWU is not against Home Equity Release schemes which allow people, should they wish to do so, to leverage their home ownership investment into income during the retirement phase of their life cycle. However, the GWU is sceptical as to whether government will be able to operate such schemes on a commercial basis.**

- k. Invalidity schemes should be reviewed so that the focus changes from one whereby invalidity is seen as a result of a condition of disability to one that determines the degree of the invalidity to the person's ability to function. Support needs to be given for re-skilling, psychological support, etc.

The 2010 Working Group recommends that the pension awarded should change to one which reflects the degree of the functional incapacity whilst allowing a person to continue to participate in the labour market.

**Although the GWU agrees 'in principle' with such a measure, care must be taken that no person suffers injustices or is obliged to carry out work which he is unable to perform.**

- i. The Report recommends that government should strengthen the community care support infrastructure for the sick, disabled and elderly persons so as to alleviate the pressure on individuals, particularly females, from the responsibility of care.

**The GWU agrees with this measure and asks the Government to endorse and implement such recommendation.**

- m. Another suggestion made by the 2010 Working group is to reform the Children's Allowance benefits scheme so that a parent on a voluntary basis may request the Department of Social Security to open a Child Pension Account from which there will be no withdrawals, will become the child's property at the age of 18, the balance will automatically be transferred to a pension scheme of the owner's choice.

**The GWU disagrees with this proposal as such a measure would lose its very essence and scope of giving a family bonus in the form of children's allowances.**

- n. Government should launch a targeted immigration and residency policy to narrow skills deficits and inadequate labour supply that is or may constrain the economy from growing further.

**GWU is "in principle" in agreement with such a measure. However, it has to be tangibly ensured that Maltese employees are not being discriminated against in their own country. Government should not depend on such a measure to address a local deficiency of skills and know-how. Rather there should be better strategic planning especially with regards to education and manpower.**

- o. The Working Group recommends that the Government should consider inviting the Opposition and relevant representatives of both employers and employees to participate in the design and implementation of a Mandatory Second Pension.

**The GWU looks forward to a meaningful consultative process involving all the Social Partners whereby government is genuinely prepared to listen to what the Social Partners have to say on all aspects of the pensions' reform and not just the Second Pension.**

**In particular, the GWU is concerned that a number of its proposals to addressing the anomalies in the present pensions system continue to be ignored. The most urgent anomalies relate to the following:**

- 1. Revision of pensions**
- 2. Maximum national pension**
- 3. Early retirement/ invalidity benefit**
- 4. COLA. Full increase incorporated into pension**
- 5. Additional bonus. To be given in full**

- p. The Group recommends the setting up of a permanent Task Force on Financial Literacy. Its scope is to establish within the education curriculum the fundamental basics of financial management and literacy. This as part of a strategy to promote adult financial literacy in Malta.

**The GWU agrees in principle and therefore has no problem with the promotion of financial literacy. Incorporating it in non-tertiary curricula would however be taking the matter too far.**

## **Conclusions**

- 1. There is little doubt that pension reform is a serious issue that needs to be addressed. However, the analysis presented is often tainted black and underwritten by a neo-liberal ideology. The GWU believes that the primary scope of a national pension scheme is to provide a "safety-net" and an acceptable standard of living to pensioners from the weaker sections of our society**
- 2. Politically the Nationalist government has to take responsibility for the mess in pensions. The pensions issue is not just linked to demographic and its PAYG structure. It is also linked to the financial mismanagement of government finance. The unacceptably high national debt, the selling of all the country's assets (profitable or otherwise) and consistent structural fiscal deficits.**

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