The surprising conclusion is that if we leave things as they are, the problem will not be its sustainability from a govt finance point of view, but the diminishing value of the benefits "

# Chapter 1: The Pension System in Malta: Baseline Scenarios

## *1.0 Introduction*

The social security system (SSS) in Malta is a comprehensive one, covering a number of areas including retirement pensions. It operates on a Pay-As-You-Go (PAYG) basis administered by Government, whereby current contributions from employees, employers, and the State go towards the financing of current benefits. Benefits are broadly classified into contributory, whose award depends upon a minimum number of contributions being effected, and non-contributory, which are awarded upon the fulfilment of specific socio-economic criteria. Retirement pensions are awarded under a number of contributory and non-contributory schemes, but the principal one is the so-called "two-thirds" contributory scheme. By way of an accounting convention, government accounts set off health expenditure against contribution revenue, albeit health does not form part of the SSS. Details regarding the cost and number of beneficiaries of the SSS in Malta are presented in Table __ of this report. A description of the various benefits available and their rules, together with those pertaining to contributions, are presented in Section __ of this report.

Akin to systems in other countries, the SSS in Malta is increasingly coming under scrutiny regarding its cost and long term sustainability. This within the context of concerns regarding the local fiscal position and pre-occupation with the amount of resources that would be available to serve an ever-growing number of pension system dependants over future years. In particular, two prominent and equally important issues that are debated are

i) the impact of demographic shifts on the patterns of contribution revenue and social security expenditure, and hence, on the affordability of the system,
ii) the extent to which the current system will be able to afford a decent living standard to beneficiaries in future, given the nominal ceiling that applies especially to the two-thirds pension scheme.

This chapter contributes to this debate by focusing on the likely development of the current SSS. Findings of the more important earlier studies on this subject are first reviewed. The findings of a baseline scenario detailing the future development up to the year 2065 of the present SSS in terms of fiscal cost and individual retirement financing provision are discussed as well as the effects of an immediate removal of all caps on contributions and benefits.

## *2.0 Findings of Earlier Studies*

Among earlier studies on the future behaviour of the SSS in Malta, the principal ones are those compiled by Camilleri (1997) and the study presented with the Interim Report of the National Commission on Welfare Reform (2000).

A common characteristic of these reports is that they assume the present system of caps on benefits as being untenable in the future. Average benefits were thus modelled to continue to rise in line with wage growth or the COLA, whichever is applicable. Neither report, however, gives a clear description of how and when the lifting of the caps on benefits is to be effected. As regards the cap on contributions, the Camilleri Report assumes it to be lifted in line with that on benefits, while the Interim Report of the Welfare Reform Commission takes the view that the nominal cap will continue as at present. The two Reports also vary in terms of their scope, in that the Camilleri Report attempts to provide an analysis of all retirement pension schemes, while the Welfare Reform Commission Interim Report focuses only on the two-thirds pension scheme.

The two reports reach broadly similar conclusions in terms of identifying the potential for a significant funding problem. Total retirement pension expenditure estimated in the Camilleri Report stands at Lm720 million in 2025, while that in the Welfare Reform Commission Interim Report stands at Lm540 million, with the deficit between expenditure and revenue shown at between 11% and 18% of GDP in the same year.

The Welfare Commission Interim Report further states that the analysis presented therein was effected

*"In order to illustrate the use and potential results of PROST. It should be clarified at the outset that this exercise is still somewhat preliminary. The technical team is still at the early stages of using the model. Furthermore, the modelling of the pension rules and the data used can be refined further." (Appendix F of the Interim Report of the Welfare Reform Commission)*

The analysis was thus more of a technical exposition of the World Bank's Pension Reform Options Simulation Toolkit (PROST) model, rather than intended as a forecast or a base upon which pension reform decisions would be taken.

*3.0 The Baseline Scenario*

Subsequent to the publication of the Interim Report of the Welfare Reform Commission, the work of the Technical Team of the Welfare Reform Commission continued through the development of a detailed baseline scenario intended to project the current SSS into the future. The simulation was undertaken by means of PROST, which was however further developed and supplemented by other software to take into account the local pension rules, especially as regards the capping system.

The analysis of benefits was sub-divided by functional categories namely:

i) retirement
ii) widowhood
iii) disability/injury
iv) other, mainly of a non-contributory nature

Retirement, widowhood and disability/injury benefits are explicitly modelled in this exercise. Other benefits under the SSS are assumed to proceed in time at a constant proportion of the total of these three main benefit types, or indexed to the cost of living as appropriate.

Benefit expenditure was further sub-divided into the degree of financing to which the Department of Social Security would be committed, namely:

i) provision of full benefit;
ii) supplement to benefit received from another source (mainly service pensions), which would under no circumstance fall below the;
iii) minimum benefit.

In turn, contribution revenue was divided into that obtained from the employed, employers, self-employed and the State contribution, to reflect differences in contribution rates and other factors.

In all cases, full account was taken of the impact of nominal ceilings on SSS revenue and expenditure. Broadly speaking, this was undertaken in the following manner. For any specific benefit, the position of the number of beneficiaries split by age and benefit level was assessed as at the year 2000. As time was allowed to progress in the simulation, the following could take place:

i. the beneficiary could die or could age by 1 year, depending on demographic age-specific statistics;
ii. if the beneficiary survives, the beneficiary could:
   a) remain in the same benefit bracket, or
   b) move to a higher benefit bracket
   depending on the extent of annual revision of the benefit
iii. should a beneficiary reach the cap level of benefit, subsequent benefit revisions would reflect this, by typically awarding an increase equal to two-thirds of the COLA
iv. the amount of new beneficiaries and their benefit level in a particular year would be calculated either by reference to contributors reaching retirement age (as in the case of retirement benefits) or by reference to specific demographic statistics (as in widowhood and disability benefits).

The development of contributions was modelled in a similar manner, with contributors ageing, dying, or achieving retirement or some other benefit status. As contributors age, they would be modelled to either remain in the same or going to a higher contribution bracket until the cap is perhaps reached, in which case, only the COLA would be considered for the purposes of the increase in contribution revenue.

## 3.1 Assumptions

### *3.1.1 The Macroeconomy*

The main macroeconomic assumptions inherent in the PROST simulations are summarised in Table 1 below. Real GDP growth is in the model used to determine the increase in output which will in part accrue to wages and hence be reflected in contribution revenue. It is in the model set at 3.5% in the year 2000, a somewhat conservative growth rate that averages the estimates presented by the National Statistics Office and the Central Bank of Malta. The growth in GDP is assumed to slow down gradually during the forecast period as the economy develops further and eventually converges to the slower rates of growth of developed countries, until real GDP growth would stand at 2.5% by 2065. Of the increase in GDP growth, part can be attributed to an increase in productive resources while the other would be due to higher average productivity of already available resources. This distinction is important because it would show to what extent increases in wages are due to productivity as opposed to a normal drift of increases related with age.

| Table 1: Macroeconomic Trends | 1998 | 1999 | 2000 | 2065 |
|---|---|---|---|---|
| Real GDP Growth | 3.1% | 3.0% | 5.5% | 2.5% |
| Labour Productivity Growth | 1.5% | 1.5% | 1.5% | 1.5% |
| Inflation Rate | 2.4% | 2.5% | 2.2% | 2.5% |
| Minimum Wage as % of Average Wage | 52.5% | 51.6% | 50.2% | 40.0% |

Retail price inflation is in the model used to convert real data to nominal data, as the statistics of the SSS are initially in nominal values. Inflation, which stood at 2.2% in 2000, is assumed to converge to 2.5% over the forecast period, the level being determined at the inflation target of the European Central Bank. The minimum wage development is necessary in the model to determine such variables as minimum contribution and benefit levels. In relation to the average wage, it is assumed to drop gradually over the forecast period, to reflect increasing wage differentials that are typical of a developing economy and converging with its main trading partners.

*3.1.2 Demography and Labour Market*

Demographic developments are an essential component of a SSS projection as they would strongly influence the extent of contributors and beneficiaries within the system.

The principal inputs which PROST requires in terms of demographic developments are the present distribution of the population by gender and age, and the present and expected developments in fertility and in the probability of dying by age. Details regarding these assumptions are produced in Appendix A of this report. Broadly speaking, the rate of fertility by age was assumed to remain unchanged throughout the forecast period from the relatively low levels that were observed in 1998. The probability of dying by age, on the other hand, was assumed to continue declining throughout the forecast period, until it settles at around 75% of the present rates by 2065. This ratio is somewhat arbitrary, and indeed calls for close scrutiny in future in assessing the extent to which the projections presented here will mirror actual developments. To the extent that the decline in the probability of dying is underestimated, the baseline scenario would overestimate the affordability of the pension system. Migration patterns were ignored for the purposes of this study, an issue which may be studied in further detail at a later stage when more information about likely future developments in this respect would be available. Table 2 summarises the principal demographic developments that arise out of these assumptions.

Among the more interesting demographic statistics, it can be noted that the share of the population above retirement age is to rise from the present 16% to 26% by 2065.

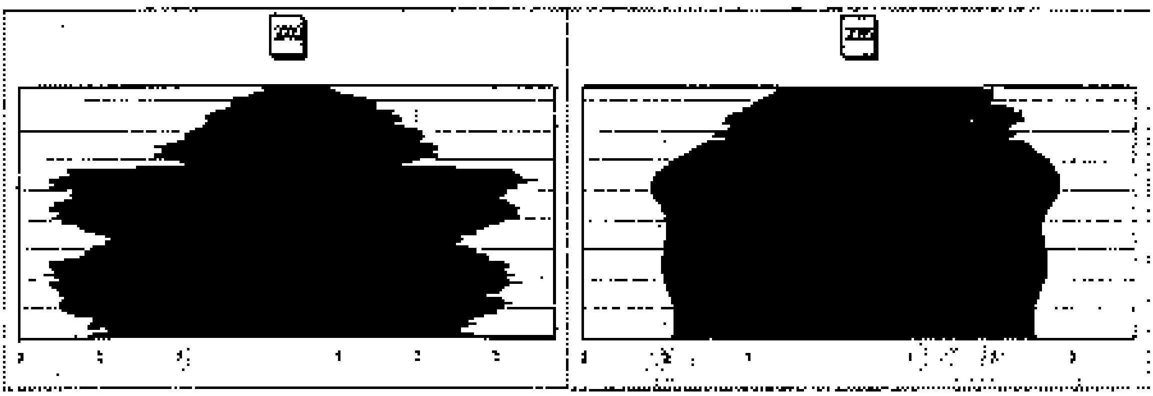
This implies that whereas each person of retirement age is currently supported by around 4 persons of working age, by 2065 this ratio will drop to 2.2. This is in part explained by an increase in the average life expectancy. Life expectancy at birth is expected to rise from the current 72.3 years to 75.5 years for males, and from 78.2 years to 81 years for females. For persons that actually attain retirement age, life expectancy would be expected to be higher, as Table 2 shows.

**Table 2: Demographic Trends**

| | Total Population (000s) | Population Growth Rate | Share of Population above Retirement Age | Persons of working age per person of retirement age | Life Expectancy at Birth Male | Life Expectancy at Birth Female | Life Expectancy at Retirement Male | Life Expectancy at Retirement Female |
|---|---|---|---|---|---|---|---|---|
| 1995 | 372.5 | | 16.1% | 3.9 | 72.2 | 78.7 | 75.0 | 81.3 |
| 1999 | 380.1 | .4% | 16.7% | 3.9 | 72.3 | 78.2 | 75.0 | 81.3 |
| 2000 | 381.6 | .4% | 16.5% | 3.8 | 72.4 | 78.3 | 75.0 | 81.3 |
| 2005 | 389.2 | .4% | 17.5% | 3.6 | 72.6 | 78.5 | 75.2 | 81.5 |
| 2010 | 396.5 | .3% | 20.0% | 3.1 | 72.8 | 78.7 | 76.3 | 81.6 |
| 2015 | 401.4 | .2% | 21.5% | 2.7 | 73.0 | 78.9 | 76.5 | 81.8 |
| 2020 | 403.1 | .1% | 23.2% | 2.5 | 73.2 | 79.1 | 76.7 | 81.9 |
| 2025 | 403.5 | 0.0% | 24.0% | 2.4 | 73.6 | 79.2 | 76.9 | 82.1 |
| 2035 | 400.2 | -.1% | 23.9% | 2.4 | 73.9 | 79.6 | 77.2 | 82.4 |
| 2045 | 394.6 | -.1% | 25.4% | 2.2 | 74.4 | 80.1 | 77.5 | 82.9 |
| 2065 | 380.5 | -.2% | 26.1% | 2.2 | 75.5 | 81.0 | 79.3 | 83.3 |

Developments in the demographic structure of the population can also be discerned from the population pyramids shown in figure 1. As the population ages, the age structure of the population is projected to become less of a conical shape and more of a cylindrical shape.

**Figure 1: Population Pyramids**



Developments in the labour market are essential to derive projections regarding contributors to the SSS. Among the more important assumptions, there are those relating to the participation rate, the unemployment rate and the typical progression of income throughout the working life of a person. As detailed in Appendix C, the participation rate of males is assumed to remain unchanged from the relatively high levels that already prevail at present. In the case of females, however, the participation rate of persons aged 25 and over is assumed to rise gradually until it grows by a factor of 50% by 2065, in line with the expected continued increase in the participation of females in the labour market. The participation rate of females aged under 25 is not expected to rise further from the already high levels at present. The unemployment rate is, somewhat simplistically, assumed to remain unchanged from present levels. This assumption could be revised in future reviews. The income progression pattern by age was discerned from the latest Census data, and assumed to remain unchanged throughout the forecast period.

### *3.1.3 The Social Security System*

In the baseline simulation, the rules of the SSS, in terms of eligibility, contribution and benefit rates, and nominal ceilings are assumed to be unchanged from the present system. This applies for all types of contributions and benefits.

This assumption has three important implications for the workings of the SSS, namely:

i. due to the nominal capping of contributions, the effective rate of contributions collected out of the average wage will fall over time in spite of the fact that the statutory rate will remain unchanged, as wages will reach and exceed the relevant nominal cap;
ii. due to the nominal capping of contributory benefits, the effective proportion of entry benefits received out of the average wage will also fall over time;
iii. as benefits reach the cap level, the effective method of indexing benefits will change from one which is predominantly wage-based to one which is mainly COLA-based – this, because benefits that reach the cap are COLA-indexed.

The effective rate of contributions out of wages, the effective replacement rate of entry benefits out of wages, and the effective benefit-indexing pattern were established on the basis of an exercise which simulated the evolution of beneficiaries/contributors and benefit/contribution levels over time, as described in section 3.0 above. The results are given in Table 3a.

The effective collection rate of contributions currently stands at just under 78%. This in part reflects the non-collection of contributions due because of administrative difficulties. More importantly, however, there is the fact that a number of workers in Malta are already earning a salary above the maximum considered for the purposes of levying contributions. This phenomenon is set to increase over time, until the effective collective rate is projected to fall to just over 30% by 2065. The basic entry benefit replacement rate currently stands at 58.5%, falling short of the statutory 66%, mainly because of retirees who had been earning a salary above the cap level. The basic entry benefit replacement rate is set to fall to around 20% by 2065, if the current system of capping remains in place. This effectively means that the SSS will be providing the average retiree with only one-fifth of the pre-retirement salary. Contributory benefits are at present predominantly wage indexed. Inflation (i.e. COLA) indexation of benefits that are already at the cap level is comparatively scarce. This situation is bound to change over time as a greater number of beneficiaries achieves the capped benefit level, beyond which the benefit would be only revised on the basis of the COLA. It is to be noted that since the COLA is awarded on the basis of the social wage, it is assumed that it accounts for around 80% of the decline in purchasing power of the average wage.

Table 3a: Social Security System Effective Rates

| | 2005 | 2010 | 2015 | 2020 | 2025 | 2035 | 2045 | 2065 |
|---|---|---|---|---|---|---|---|---|
| Effective Collection Rate from Employees and Employers | 77.6% | 75.8% | 75.8% | 69.0% | 61.2% | 45.8% | 36.9% | 30.4% |
| Basic Entry Benefit Replacement Rates | 58.5% | 46.7% | 43.6% | 40.1% | 36.6% | 32.2% | 25.7% | 19.7% |
| Benefit Indexation | | | | | | | | |
| To inflation | 2.7% | 16.4% | 26.9% | 39.3% | 50.4% | 70.4% | 77.2% | 79.8% |
| To wages | 95.6% | 79.5% | 66.3% | 50.8% | 37.0% | 12.1% | 3.4% | 2.2% |

Notes

1 The effective collection rate of contributions from employees and employers would be 100% if the statutory rate is collected out of the entire wage bill of the economy. In practice, this would not be the case because of

a inefficiencies and lags in collection and,

b more importantly, the fact that there exists a cap on the maximum contribution collectable from an individual worker, which will reduce the effective rate of collection of contributions as wages rise above the implied maximum wage level from which the maximum statutory contribution may be levied

2 The basic entry benefit replacement rates are the proportion which the first benefit received by a retiree bears to the last wage that the retiree had earned while in employment. At present, it is less than the statutory 2/3 ratio primarily due to the 3-year averaging mechanism used in the computation of the starting benefit. This ratio will fall further in future due to the existence of the maximum cap on a benefit that is receivable, which will render starting benefits ever smaller compared to the last wages earned by retirees

3 Benefit indexation relates to the mechanism used to compute increases in benefits from one year to the next. At present, benefits are primarily revised on the basis of wages, with the relatively few benefits which are at the cap level being revised on the basis of the COLA, which is associated with the rate of inflation. In future the benefits that will be revised on the basis of inflation will rise, while those revisable on the basis of wages will commensurately decrease, as more benefits will reach the cap level

## 3.2 Results and Implications

The results of the baseline simulation are categorised into three aspects. Firstly, the development of the number of contributors and beneficiaries by main benefit type are analysed. Secondly, the impact on public finances is assessed. Finally, the implications of the present SSS for individual retirement financing in future years are analysed

### *3.2.1 Contributors and Beneficiaries*

Following the functional distribution of benefits described in Section 3.0 above, the development of the number of beneficiaries over time is analysed in terms of invalidity, widows and the retirement pension beneficiaries which receive a full benefit from the SSS, and those that receive a top-up over a benefit from some other source, such as a service pension. Data for the projected development in beneficiaries together with contributors is shown in Table 3b.

The number of recipients of invalidity and widows benefits is projected to remain relatively stable, both in absolute terms and as a percentage of the population. This reflects the fact that the rate of inflows and outflows of beneficiaries in these categories were assumed to remain stable at present levels in future. Furthermore, although increased life expectancy should contribute to some reduction in the amount of widows and invalidity beneficiaries, this reduction is entirely reflected in the top-up category, that is in those who are already receiving a service pension, mainly from the military services or the local civil service

**Table 3b: Contributors and Beneficiaries**

| | Persons (000s) | | | | | %age of population | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year | Beneficiaries | | | | Contrib | Beneficiaries | | | | Contrib |
| | Invalidity | Widows | 2/3 retire | Top-up | | Invalidity | Widows | 2/3 retire | Top-up | |
| 2000 | 5.7 | 5.4 | 15.9 | 11.3 | 149.2 | 1.5% | 1.4% | 4.1% | 3.0% | 39.1% |
| 2005 | 6.6 | 5.5 | 18.4 | 10.4 | 156.0 | 1.7% | 1.4% | 4.7% | 2.7% | 40.6% |
| 2010 | 6.7 | 5.6 | 26.7 | 9.0 | 159.7 | 1.7% | 1.4% | 6.6% | 2.3% | 40.4% |
| 2015 | 6.8 | 5.6 | 34.0 | 7.5 | 158.5 | 1.7% | 1.4% | 8.5% | 1.9% | 39.6% |
| 2020 | 6.2 | 5.7 | 41.7 | 6.1 | 157.0 | 1.5% | 1.4% | 10.3% | 1.5% | 38.9% |
| 2025 | 6.2 | 6.1 | 47.7 | 4.4 | 157.1 | 1.5% | 1.5% | 11.6% | 1.1% | 38.9% |
| 2035 | 6.7 | 5.4 | 58.7 | 2.5 | 163.5 | 1.7% | 1.3% | 14.2% | 0.6% | 40.3% |
| 2045 | 6.4 | 6.5 | 65.7 | 1.4 | 159.8 | 1.6% | 1.5% | 16.6% | 0.4% | 40.7% |
| 2065 | 6.1 | 5.8 | 73.7 | 0.6 | 160.3 | 1.6% | 1.5% | 19.3% | 0.2% | 41.9% |

Beneficiaries under the two-thirds pension scheme are expected to rise significantly over the forecast period, from just under 16 thousand to almost 74 thousand. This reflects three considerations

i population ageing, that is increasing the population above retirement age, as discussed in section 3.1.2.

ii an increased female participation rate in the labour force, which would eventually results in an increased amount of pension beneficiaries;

iii a shift away from top-up retirement pension beneficiaries towards full two-thirds pension scheme beneficiaries, as service pensioners in the population are gradually replaced by other pensioners

In total, the number of beneficiaries of the two-thirds pension scheme is expected to more than double from the current 10% of the population to around 22% of the population by 2065

Owing to the assumed increase in female participation in the labour market, the number of contributors within the population is projected to rise by some 3 percentage points. Due to the stronger increase in the population of beneficiaries, however, the number of contributors per beneficiary is projected to decline from the current 3.9 to just under 1.9 by 2065.

### *3.2.2 Public Finances*

The projection of the current SSS in terms of its effects on public finances represents the interplay of the developments in the number of beneficiaries and contributors described above and the pension system rules that determine the amount of per capita benefit and its evolution. The modelling of the latter has been described in section 3.1.3. The principal results on public finances are shown in Table 4a, which details revenue from contributions (including the State contribution), expenditure on retirement pensions, expenditure on other contributory benefits such as widows pensions, and expenditure on all non-contributory benefits as derived by the exercise described above. The financial balance on the SSS is shown with State contributions included with revenue, and with state contributions excluded, which shows the true cost of the SSS to the Exchequer.

In 2000, the deficit on the SSS stood at around Lm12 million, if the State contribution is included with revenue, or Lm65 million if the State contribution is excluded so as to capture the underlying charge of the SSS against other fiscal revenue sources. Respectively, these amounted to 0.8% and 4.3% of the income generated by the country during that year.

The projections shown in Table 4a indicate that these deficits are expected to rise significantly over time. For instance, the deficit on the SSS excluding State contribution from revenue is projected to amount to Lm573 million by 2065. But in comparison to the output that is expected to be generated by the economy, these deficits are not expected to worsen to any appreciable extent from the 2000 level. For instance, the deficit on the SSS with the State contribution included in revenue is expected to peak at around 2.3% of GDP in 2035, and stabilise at 1.1% of GDP by 2065. Excluding the State contribution from revenue, the deficit is expected to peak at 4.5% of GDP by 2025, and stabilise at just over 2% by 2065.

Table 4a: Baseline Simulation

| | | | | | | | (Lm millions) | As percentage of GDP | |
|---|---|---|---|---|---|---|---|---|---|
| Year | Contributions | Expenditure | | | Balance | | Balance | | |
| | | 2/3 retirement | Other contributory | Non-contributory | With State contrib | Without State contrib | With State contrib | Without State contrib | |
| 2000 | 151.4 | 40.2 | 79.6 | 53.2 | -11.6 | -65.4 | -0.8% | -4.3% | |
| 2005 | 211.2 | 53.4 | 96.0 | 55.7 | 6.1 | -64.3 | 0.3% | -3.4% | |
| 2010 | 254.0 | 88.5 | 108.5 | 60.3 | -3.3 | -57.9 | -0.1% | -3.7% | |
| 2015 | 288.7 | 129.2 | 119.9 | 58.5 | -18.9 | -116.1 | -0.7% | -4.0% | |
| 2020 | 316.0 | 181.0 | 131.0 | 59.4 | -55.5 | -160.5 | -1.5% | -4.4% | |
| 2025 | 341.2 | 232.5 | 135.4 | 59.6 | -90.5 | -204.2 | -2.0% | -4.5% | |
| 2035 | 399.3 | 339.0 | 160.9 | 59.7 | -160.3 | -283.4 | -2.3% | -4.2% | |
| 2045 | 452.9 | 445.9 | 180.0 | 60.4 | -233.4 | -384.4 | -2.1% | -3.5% | |
| 2065 | 815.7 | 791.3 | 264.0 | 61.3 | -301.0 | -572.8 | -1.1% | -2.2% | |

It thus appears that the charge of the present SSS on the Exchequer is not expected to increase significantly in future compared to the size of the economy. This is primarily because the impact of demographic developments is viewed to be contrasted by the persistence of the nominal ceilings on benefit and contribution rates, that are progressively expected to shrink the size of the SSS in relation to the economy. This, however, does not automatically eliminate concerns about the cost of the SSS. This is because by effectively absorbing by way of deficit Lm4 out of every Lm100 earned in the economy in 2000, the SSS may already be imposing an unacceptable drag on fiscal performance with adverse implications for overall economic activity.

It is to be further noted that when converted to present value terms, that is taking into account the rate of inflation that is expected to occur, the deficit on the social security system is expected to widen by a maximum of approximately Lm60 million at current money values compared to the present deficit level around 2035-2045. This is shown in Table 4b. It may be thus concluded that in spite of the capping system, the deficit on the social security system will, in real terms, expand significantly under the pressures of demographic developments.

**Table 4b: Baseline Simulation (present values)**

| | | | | | | 1999 Lm millions |
|---|---|---|---|---|---|---|
| Year | Contributions | Expenditure | | | Balance | |
| | | 2/3 retirement | Other contributory | Non-contributory | with State contrib | without State contrib |
| 2000 | 157.4 | 39.2 | 77.7 | 51.9 | -11.4 | -63.8 |
| 2005 | 182.1 | 46.0 | 82.8 | 48.0 | 5.3 | -55.4 |
| 2010 | 193.6 | 67.5 | 82.7 | 45.9 | -2.5 | -67.0 |
| 2015 | 194.5 | 87.0 | 80.7 | 40.1 | -13.4 | -78.2 |
| 2020 | 188.1 | 107.8 | 78.0 | 35.4 | -33.0 | -95.7 |
| 2025 | 179.6 | 122.3 | 73.4 | 31.5 | -47.6 | -107.5 |
| 2035 | 164.2 | 139.4 | 66.1 | 24.5 | -65.9 | -120.6 |
| 2045 | 145.4 | 143.2 | 57.8 | 19.4 | -75.0 | -123.4 |
| 2065 | 159.9 | 155.1 | 51.7 | 12.0 | -59.0 | -112.3 |

*3.2.3 Individual Retirement Financing*

The system of capping on benefits not only restrains growth in overall fiscal expenditure but also carries important implications for the development of the benefits received by individual beneficiaries. As an example, Table 5 shows that due to the caps on benefits, the average per capita retirement benefit is projected to grow at a progressively slow rate, until the purchasing power of the average would start to decline after 2020. This indicates another element of potential unsustainability of the system, namely the fact that individual benefits would decline initially relative to the average wage earned in the economy, but eventually also in terms of their own purchasing power, implying an overall lower standard of living for beneficiaries. This would obviously bring pressures to increase benefits which, all else being equal, would adversely affect the negative balance between contributions and benefits.

**Table 5: Development in Per Capita Retirement Benefit**

| | | Lm | Average Annual Growth in | |
|---|---|---|---|---|
| Year | Per capita retirement benefit | | Per capita retirement benefit | |
| | Nominal | Real | Nominal | Real |
| 2000 | 2543 | 2543 | 3.1% | 0.7% |
| 2005 | 2901 | 2562 | 2.7% | 0.2% |
| 2010 | 3315 | 2527 | 2.7% | 0.2% |
| 2015 | 3800 | 2560 | 2.8% | 0.3% |
| 2020 | 4342 | 2585 | 2.7% | 0.2% |
| 2025 | 4674 | 2555 | 2.3% | -0.2% |
| 2035 | 5990 | 2458 | 2.1% | -0.4% |
| 2045 | 6786 | 2179 | 1.3% | -1.2% |
| 2065 | 10727 | 2104 | 2.3% | -0.2% |

*4.0 Implications of Baseline Simulation*

The main conclusions arising out of the baseline simulation are

i the cost of the actual SSS is expected to increase somewhat in the coming years in relation to the size of the economy.

ii the actual SSS will imply lower relative and absolute living standards for beneficiaries

iii the consequence of and hence the repercussions arising from (ii) will tend to make the position at (i) worse.

A reform proposal which maintains the costs at a level comparable to the present SSS while better safeguarding the living standards of beneficiaries has been sought. This will imply that the economy will get a better value for money in terms of benefits for the resources that it defrays towards this purpose. The reform concentrates mainly on pensions, and is a mix of changes to the main parameters of the present social security system combined with the introduction of a funded pillar for pensions.

*5.0 Immediate Removal of all Caps on Contributions and Benefits*

As explained above, the projection of the current SSS as it now stands will lead to reduced benefits without necessarily reducing costs. This would be an intolerable situation. On the other hand, if all caps are removed, there would obviously be a marked improvement in benefits but the cost of the scheme would also rise dramatically.

Appendix B shows the impact of the removal of the ceilings. The burden on public funds would almost double by 2015 and increase to four times the 2000 level ten years later. As a percentage of GDP, the cost would rise steadily to almost 7% [illegible] 2045. This would clearly be unsustainable

A reform proposal which maintains the costs at a level comparable to the [illegible] SSS while ~~which~~ better safeguarding the living standards of beneficiaries has to be found. This will imply that the economy will get better value for money in terms of benefits for the resources that it defrays towards this purpose. The reform to which reference is made in Chapters 2, 3 and 4 concentrates mainly on pensions, and is a mix of changes to the main parameters of the present SSS combined with the introduction of a funded pillar for pensions without however changing the rate of contribution by participants in the scheme.

**Chapter 2**

**Outline Pension Reform Scheme**

## I Objectives

1. The State is to retain control and remain responsible under the Social Security law for the provision of retirement pensions

2. The concept of a pension accruing to a person through his contributions during his working life will continue to hold

3. The current rate of contributions shall not be changed but shall be applied to higher salary/income levels than at present

4. The concept of a 2/3 initial pension linked to the salary/earned income shall also be
maintained

5. The Scheme is to provide opportunity for additional income on retirement over and above the statutory 2/3 pension through insurance pension funds arrangements and without increasing the rate of contributions

6. The statutory 2/3 pension shall continue to be part of the PAYG system

7. The Scheme will also encourage savings and promote the growth of financial services

8. The sustainability of the Scheme over the medium and long term must be assured

9. The Scheme must be simpler to administer and remove existing anomalies

10. The interests of current pensioners are to be safeguarded

11. While the Scheme is to be universally applied to all employed and self employed/occupied persons, special arrangements have to be made for those who are close to retiring age

12. Higher cost implications for higher paid employees/higher income earners and for employers must be introduced gradually so as to enable them to adjust to the new situation

## II The Reformed Pensions Scheme

### 1. *Applicability*

The new Pensions Scheme will be applicable to all persons who on date of introduction of the Scheme are employed or self employed/occupied as defined in the Social Security Act and who have not reached retirement age

### 2 *Retirement Age*

In line with current longevity trends, retirement age will be extended to 65 yrs for both men and women This limit will be reached within a period of 10 years by applying 3 months every 6 months, to the retiring age

In view of the fact that current retirement age for men is 61 while that for women is 60, an adjustment has to be made in the sense that retirement age for the latter will start six months after introduction of the new scheme say in 2002 while for men it will start two years later ie 2004. On this basis, the retirement age will gradually rise as follows

| Retirement Age Applicable | | |
|---|---|---|
| Jan/June 2002 | 60 years | Applicable to women |
| July/Dec 2002 | 60 1/4 years | Applicable to women |
| Jan/June 2003 | 60 1/2 years | Applicable to women |
| July/Dec 2003 | 60 3/4 years | Applicable to women |
| Jan/June 2004 | 61 years | Applicable to both men and women |
| July/Dec 2004 | 61 1/4 years | Applicable to both men and women |
| Jan/June 2005 | 61 1/2 years | Applicable to both men and women |
| July/Dec 2005 | 61 3/4 years | Applicable to both men and women |
| Jan/June 2006 | 62 years | Applicable to both men and women |
| July/Dec 2006 | 62 1/4 years | Applicable to both men and women |
| Jan/June 2007 | 62 1/2 years | Applicable to both men and women |
| July/Dec 2007 | 62 3/4 years | Applicable to both men and women |
| Jan/June 2008 | 63 years | Applicable to both men and women |
| July/Dec 2008 | 63 1/4 years | Applicable to both men and women |
| Jan/June 2009 | 63 1/2 years | Applicable to both men and women |
| July/Dec 2009 | 63 3/4 years | Applicable to both men and women |
| Jan/June 2010 | 64 years | Applicable to both men and women |
| July/Dec 2010 | 64 1/4 years | Applicable to both men and women |
| Jan/June 2011 | 64 1/2 years | Applicable to both men and women |
| July/Dec 2011 | 64 3/4 years | Applicable to both men and women |
| Jan + 2012 | 65 years | Applicable to both men and women |

Table IIa and Table IIb show how retirement for men and women respectively will be affected over the period when the retirement age is being increased from 61/60 to 65.

It will be statutory obligatory on the Social Security Commission (see definition below at IX) to review the retirement age after every period of 10 years from date of introduction of the scheme, taking into account demographic trends, improvement in health, social and economic conditions prevailing at the time

3. *Social Security Pension (SSP)*

a) (i) The 2/3 SSP will be calculated on the average of the wage/salary or income (as the case maybe) earned over the last 30 years ending on retirement **date** applicable PROVIDED that the wages/salary or income earned in each **calendar** year or part thereof **prior** to the year in which retirement occurs, shall for the purpose of the calculation be adjusted for cumulative inflation up to the end of the said year prior to retirement.

(ii) The rate of inflation applied shall be that last published by the Statistics Department for the period concerned and the application of such rate of inflation in each case shall, **in the case of doubt,** be solely determined by the Commission (see below) whose decision shall be final and must be given within four weeks of reference to the Commission by the Dept of Social Services or the person concerned

(iii) ***Transition condition:*** In the case of a person who on date of introduction of the Scheme was less than 45 years old and who on date of retirement will have less than 30 years service **from date of introduction of the New Scheme,** the average as above shall be worked out on the basis of the number of years served from the said date of introduction of the scheme PROVIDED that the condition at (b) shall also apply

b) To be entitled to a full pension, a person must satisfy the conditions of 40 contribution years and of an average of 50 contributions per annum over the said period. Where the resultant contribution average is less than 50, the pension ratio of 2/3 will be multiplied by the proportion that the resultant contribution average bears to 50. The minimum contribution average for a pension entitlement remains at 15.

c) No person shall receive less than the Minimum National Pension (equivalent to 4/5 of the National Minimum Wage in the case of a married man and 2/3 for any other person) Where the resultant contribution average is less than 50, the proportion of 4/5 or 2/3 as the case may be, will be multiplied by the proportion that the resultant contribution average bears to 50

d) There shall be only **one** category of pension arising from work, ie a 2/3 pension as outlined above. The only exception is a Minimum pension for the reasons given at (c) above

e) The pension entitlement will be strictly related to what a person **actually earned** during his/her working life and will be determined by the level and number of contributions paid as indicated above. Once the 2/3 SSP is determined, it will not thereafter be changed but the pensioner will have the additional benefit of:

i) an automatic cost of living increase per annum equivalent to 75% of COLA), and

ii) the proceeds of his/her maturing private insurance (see below at III)

f) There shall be no abatement of the 2/3 SSP by any service pension otherwise due to the person involved PROVIDED that **the right** to such service pension has been acquired **after 2001**

g) The limit of the 2/3 SSP at retirement shall be 2/3 of the statutory salary of the President of Malta PROVIDED that in the first calendar year starting from the date of the new Scheme, the said limits shall be Lm6750 plus the difference between the salary of the President as aforesaid and Lm6750, which difference shall be divided by a factor of 10 in the said first year and by a reducing factor starting from second year of 9,8,7,6,5,4,3,2, and ending in 1 in each of the consecutive subsequent years such that by the end of the tenth year from date of the introduction of the new scheme the limit shall be 2/3 of the salary of the President then prevailing

h) There shall be no bonus payments in June and December in view of (e) (i) and (ii) above

4 **Contributions**

a The rate of contributions shall remain at 10% each for the employer and employee and shall be 15% for self employed/occupied

b The contribution shall be applied as follows

(i) **Employment -**

| | |
|---|---|
| Employer | 7% towards Social Security + 3% Private Insurance |
| Employee | 7% towards Social Security + 3% Private Insurance |
| State | 7% towards Social Security |

(ii) **Self employed/Occupied -**

| | |
|---|---|
| Self Employed/Occupied | 10% towards Social Security + 5% Personal Insurance |
| State | 5% towards Social Security |

c The maximum amount of contribution by an employed or self-employed/occupied person in respect of any calendar year shall be equivalent to 10%/15% of the salary of the President of Malta as may be applicable at the end of the year preceding that calendar year PROVIDED that in the first calendar year starting from date of introduction of the said Scheme, the said maximum amount shall be Lm6541 plus the difference between the salary of the President as aforesaid and Lm6541, which difference shall be divided by a factor of 10 in the said first year and by a reducing factor starting from second year of 9,8,7,6,5,4,3,2, and ending in 1 in each of the consecutive subsequent years such that by the end of the tenth year from date of the introduction of the new scheme the limit shall be 2/3 of the salary of the President then prevailing

d The full contribution as in 4 (a) above and the *State* contribution shall be payable directly to the Social Security Department which is to exercise proper control and to be accountable for enforcement and collection Furthermore the Dept will be responsible for administrative control and for all payments on behalf of contributors relating to private insurance

In respect of what is stated above. it is noted (see Section 4.4 of the Commission's Interim Report of 2.3.2000) that in 1998 the responsibility to collect contributions was shifted to the Inland Revenue Dept from the Social Security Dept. It is understood that the transition is still not complete It remains the Commission's view that the functions of contribution collection, benefit payments and related exercise of control and enforcement should not be separated and should remain solely the responsibility of the SS Dept This becomes even more necessary with the introduction of the Reformed Scheme which introduces the concept of part of the contribution in respect of each employed/occupied person going to finance insurance premiums which are assessed, controlled and paid by the SS Dept on behalf of that person.

III **Mandatory Insurance**

1) The 3% contribution by employees and 3% by their employers as well as the 5% contribution by self employed/occupied persons are to be directed to a mandatory insurance policy in the name of the contributor

2) The mandatory insurance policy is to be flexible so as to allow for increase/ decrease in premium resulting from the 6% or 5% on variable wage/income over time and for possible suspension of premium payments

3) The mandatory insurance policy can be combined/amalgamated with an existing policy if the insured person so desires, and the insured person can also opt to pay a higher level of premium than the 6%/5% of wage/income so long as the policy conforms in all respects to the requirements of the mandatory insurance

4) The insurance policy cannot be pledged or cashed in except at retirement age (presently proposed at 65 years) or on death or disability of the policy holder

5) Consideration to be given to requirement of devoting say 6% of any unemployment benefit or invalidity pension (**granted after the commencement date of the New Pension Scheme**) to maintaining the insurance policy

6) Insurance is to be placed with insurance providers in Malta. Providers and the funds promoted by them are to be specifically licensed for the purpose of the Social Security Act by the MFSC and approved by the Commission (see below).

A number of providers will ensure competitive products amongst which an insured person can choose.

7) Initially insurance providers will be required to invest a proportion of their funds in Malta as may be determined by the Commission in consultation with the Central Bank of Malta. **The primary objective however will be security and adequate returns for the policy holders.** The Commission is to review the position every year.

8) Administrative costs and fees by insurance providers shall not exceed a limit to be determined by the Commission

9) Custodian services and fund managers of licensed insurance providers must be of international repute and are subject to approval of MFSC and Commission

10) Funds administered by insurance providers are to be properly audited against hidden charges and each provider is to offer different funds with varying risk profiles as may be specified by regulation on the advice of the MFSC in order to satisfy different portfolio needs of persons of different ages and income levels

11) Performance of the licensed funds is to be evaluated periodically by the MFSC using the performance of comparable reputable international funds as a benchmark and assessing actual performance against the claims originally made and the estimations and prospects originally given by the provider when selling policies relating to the said funds The MFSC is to report accordingly to the Commission which is to be empowered through the MFSC to do all is necessary to safeguard the policy holders' interests.

12) Advertising by insurance providers is to be effectively regulated and monitored by the MFSC on behalf of the Commission especially to ensure that no misleading claims are made

13) Receipt of benefit deriving from mandatory insurance is to be made on the basis of programmed withdrawals over a period of not less than 3 years which can be passed on to heirs of insured person in case of premature death of the latter. Lump sum payments immediately after retirement will not be allowed except as may be countenanced by the Commission in special circumstances at its discretion Receipt of benefit can otherwise be made by way of annuity

14) Any addition by an employee or employer to the 3% referred to in Sections (II (4) (b) (i) above for private insurance (which addition is made **after** the date of the introduction of the new Scheme) is to be Income Tax exempt up to a limit of Lm200

**IV Persons over 45 years**

1) Employed persons and self employed/occupied persons who are over 45 years on date of introduction of Scheme will be given the option either to accept the Scheme

as outlined in II (3), (4) and III above or to chose a modified version as provided under paragraph 2 of this Section IV

2) **Modified Scheme for persons over 45 years who have not reached retirement age**

(a) SSP to be 2/3 of average wage/salary or income adjusted for inflation as in Section II 3(a) (i) and (ii) above and subject to 3 (b), (c), (d), (f), (g) and (h) of the same section PROVIDED that the said average shall be based on the last three (3) years in the year when the New Pensions Scheme is introduced and will go up by one (1) year in each subsequent year up to the maximum of 20 years

b) The 2/3 SSP once determined on retirement age will not be subsequently changed except that the pensioner will have the further benefit of

(i) an automatic cost of living increase per annum equivalent to 75% of COLA, and

(ii) an increase in pension at the end of every four (4) years from date of retirement equivalent to one fourth of the COLA increases in the said four years

c) The contributions payable shall be as provided under Section II (4) above PROVIDED that there shall be no mandatory insurance and that the 3% and 5% contributions mentioned in (b) (i) and (ii) of the said paragraph (4) of Section II shall be retained by the SS Dept

3 An employed person or self employed/occupied person who is over 45 years old but has not reached retirement age and who opts to accept the New Scheme as outlined in Sections II (3), (4) and III above, must so notify the SSP Department on the prescribed form prior to the date of the introductions of the said New Scheme. The Director of the SSP Dept shall inform all persons concerned of the said date and the time limit within which a person as aforesaid must reply to the Department. A person who does not exercise the said option within the time set, shall for all intents and purposes be classified under the Modified Scheme

## V Existing Pensions on introduction of new Pensions Scheme

1) The conditions regulating pensions awarded prior to the introduction of the New Scheme shall remain unchanged. Thus pensions will continue to be revised within the limit of the existing cap (Lm6541), will be automatically increased by 2/3 COLA every year and will retain the Bonus benefit in June and December each year.

2) It is however proposed that in the case where the highest rate of 2/3 pensions has been reached such that no revision of pension can arise

a the automatic cost of living increase per annum shall be increased to 75% of COLA, and

b there shall also be an increase in pension at the end of every four years equivalent to one fourth of the COLA increases in the said four years

3) apart from the above, some anomalies as listed in Chapter 3 shall also be addressed

## VI Govt Employees and others entitled to a service pension

1 The new Scheme shall apply to all Government, public sector and public sector employees who are entitled to receive a service pension in terms of the Pension Ordnance or other similar enactment or other arrangement subject to (a) to (d) below

a) The 3% mentioned in (b) of paragraph 4 of Section II shall not apply and shall not be paid by the employee or the employer

b) The abatement of the 2/3 SSP Pension by the uncommuted service person shall be applicable **irrespective of when the right to such service pension was acquired subject however to (c) and (d) below**

c) Irrespective of what is stated at (b) above, the SS pension shall not be less than the National Minimum Pension **applicable on date of retirement**

d) The SS pension as at (c) above, shall be revised as may be necessary such that in any year it is payable, it shall not be less than the NMP applicable in that year

## VII General remarks

1. It is considered that the contribution by an employed person should be based on the total emoluments received which are of a permanent nature as part of the employment contract of that person and irrespective of how they are defined ie salary, wage or allowance but excluding an allowance which can vary, is temporary or not applicable to all persons in a particular grade. For this purpose it is proposed to amend the existing definition of "basic weekly wage" and "basic salary" in the Social Security Act as shown hereunder

**Draft Definition**

"Basic weekly wage" and "basic salary" mean the gross wage or salary that is payable to an employed person by or on behalf of his employer provided that such wage or salary as the case may be

a) Shall include any allowance paid in cash which is incorporated as a permanent feature of the contract of service of such person or which is statutarily paid, and the payment of which is regular and is not dependent on any other condition other than that of the person being employed, and

b) shall not include any remuneration for overtime, extra duty, entertainment, qualification, or house allowance or any extra allowance for shift work, dangerous work and other work which by its very nature is not necessarily permanent and/or can vary over time, or is not applicable to all employees of a particular class pertaining to the same employer, and

c) shall not include any form of variable bonus dependent on performance, profits or discretion of the employer, any remuneration in kind and any commission PROVIDED that the Director is satisfied that the basic wage or salary as defined above is not undervalued in relation to the responsibilities and skills required of the employee

2. It has become the practice whereby contract of service between an employer and employee is legally terminated on the reaching by the employee of the age of 61 in the case of men and the age of 60 in the case of women which is the current retirement age under the existing 2/3 Pension Scheme. In view of the proposed increase of the retirement age to 65, it is felt that a suitable amendment to the Conditions of Employment Regulation Act should be made to the effect that the attainment of any age, unless it is above the retirement age specified under the Social Security Act, is not by itself sufficient reason for termination of a contract of service

3. It is observed that in terms of Part II (3) of the First Schedule of the current SS Act, employment by any one employer for less than 8 hours in a calendar week, is not an insurable employment for the purpose of Section 5 of the Act, in other words a person falling under the said Part II (3) is not insured and does not pay any contribution On the other hand, any person who exceeds the said 8 hours, even if paid less than the National Minimum Wage has to pay the full contribution rate calculated on the said National Minimum Wage. This obviously deters those who would work part-time such as women - as their take home pay after paying SS contribution (and tax) would not be deemed to make it worthwhile for them to work.

It is proposed that (a) the limit of 8 hours be increased to 10 hours in a calendar week ie a person working less than 10 hours would be exempt from paying contribution and (b) that those who work more than 10 hours but whose pay is less than the National Minimum Wage, would pay 10% of whatever their gross pay is; in other words there would be no minimum contribution but the 10% would be applicable in all cases. However the concept of a minimum contribution could still apply for the payment of benefits such as sickness benefit and unemployment benefit so that in the case of those whose 10% contribution is less than 10% of the National Minimum Wage, their sickness/unemployment benefit would be reduced to the proportion which their actual weekly wage bears to the said National Minimum Wage

4. It is observed that for public sector employees who are entitled to a service pension under the Pensions Ordinance, it is customary that such pension is awarded at age 60 However Section 9 of the Ordinance says that it shall be lawful for the President to require an officer to retire **at any time** after the said officer attains 60 years provided that the retirement shall be **compulsory** on the attainment of age of 65 years.

The proposed new retirement age should therefore present no problem and it is suggested that Government could regulate itself accordingly In such case the commencement of the service pension and the SS pension would coincide On the other hand Government could concede voluntary retirement after **age 61** provided that the person concerned will not undertake any other employment and that the SS pension shall only become due at age 65 (or less during the period when SS pension age is increasing from 61 to 65 years)

5 The provision under current SS law, which says that a person who is over 65 years and who works shall pay no contributions and will receive his pension in full, should not be changed This is a reasonable and equitable requirement

6 Appendix provides a comparison between the provisions of the existing Act relating to the 2/3 Pension Scheme and the new provision as proposed

## VIII Sustainability

1 The principal features of the new Scheme which have a direct effect on the sustainability of the Scheme include

- the increase in pension age and periodic reviews thereof
- the removal of the previous cap and increasing it to the level of the salary of the President of Malta
- the introduction of a more realistic 40 years contributions period
- the introduction of a more realistic 2/3 SSP based on the average earnings over 30 years but adjusted for inflation
- the removal of the present cap on contributions up to the level of the President's salary
- the reduction in State contribution relating to the 3% and 5% for private pensions
- the new proposals for regulating SS pensions in the case of those to whom the State is already providing a 2/3 pension
- the proposal to limit pension benefits to the 2/3 SSP and Minimum pension
- the proposal to do away with the need for a revision of pension once this has been determined as a result of (a) private insurance and (b) special arrangements made for those above 45 years on date of introduction of scheme

2 The financial projections of the Scheme are provided in

3 It will be seen

a
b
etc

4 The Commission (see below) is to carry out a review every four years of the financial implications of the Scheme and to make suitable recommendations accordingly including revision of contribution rates after taking into account economic and social conditions and the deficit/surplus situation of State finances and to report on same to the Speaker of the House

## XIX Anomalies arising from current SS Legislation

1 The definition of anomalies in the present pensions scheme and even the the acceptance of their existence and therefore also the remedies that maybe advocated, can be highly subjective and often contentious given the conflicting interests, perceived rights or torts and lack of sufficient appreciation of the complexity of the system by some of the players involved. Objectivity which is an essential element in trying to resolve these issues, can be better achieved by the new SSP Scheme being proposed which aims

- to keep the Scheme relatively simple and more readily understandable by one and all
- to ensure that one receives a pension that is really representative of what one has contributed during his working life
- to maintain within nationally sustainable limits the purchasing power of retirement benefits over the period of one's retirement
- to maintain equitable and just treatment of beneficiaries and contributions

2 Many of the current so called anomalies are due to the complicated nature of the present scheme and to the fact that over the years, political/social/economic factors have contributed to the impairment of the original principles upon which the original two thirds pension scheme was based thus rendering it more complex. It is therefore essential to really understand the background of the current system and not to form hasty conclusions.

3 The Department of Social Services has been grappling with the problems involved in the current system for many years and has identified the possible solutions that can be chosen as well as the amendment to existing legislation which can be proposed to tackle the major issues and other changes which though not greatly material, should help in improving matters

4 Chapter 3 of this Report provides a background to the major anomolies identified and at the same time proposes solutions which should also help to improve efficiency in administration

## X Administration and setting up of Commission for Social Security

1 The administration of the Social Security legislation should remain in the hands of the SS Dept which should be also responsible for the collection and control of contributions. The department should have all necessary facilities to carry out its work efficiently including the setting up of a comprehensive data base which should be readily available and continually updated so that research on the system will be facilitated and proper assessment can be made within the shortest possible time to gauge the implications of any changes or modifications or additions to any legislation prevailing at any particular time.

2 The Department has drawn up a list of amendments which although minor, can improve work efficiency. These are listed in Appendix and should be quickly introduced.

3 In order to ensure that the social Security System including pensions works smoothly, is well monitored and reviewed from time to time, it is proposed that a National Welfare Commission should be set up as an independent body falling under the Ministry of Social Security.

4 The main functions of the commission would include

(i) to ensure that the social Security Scheme as provided in terms of the SS Act works smoothly and efficiently and is not abused

(ii) to act as arbiter between the Department and the public on disputes that may arise

(iii) to carry out such investigations on Social Security issues as the Minister and the Department may refer to it or as it may deem to be necessary, and on complaints as may be raised by the public in general if the Commission feels this is necessary

(iv) to ensure that all workers, as may be required by law, have an on-going and fully maintained insurance policy

(v) to ensure that insurance providers comply fully with the law especially with regard to security of funds held and safeguarding of interests of insured persons

(vi) to liaise with MFSC and other authorities as may be necessary on insurance issues arising from the SS Act

(vii) to impose effective sanctions through the Office of the Attorney General, for breach of law and enforce compliance with the provisions of the law

(viii) to collaborate closely with and advise the SS Dept as may be required

(ix) to report to Parliament on its activities once a year and every four years submit a review of the SS Scheme

(x) to report to Parliament on the feasibility and the medium and long term implications (financial, social and economic) of any changes/ modifications/cancellations or additions to the SS legislation which may be proposed by the SS Department or the Minister regarding contributions and benefits or any other matter arising from the law including sub-legislation and administrative orders. It will be a legal requirement that any material changes etc to the law which would increase the cost of social security or affects materially the Welfare Gap or contribution paid, must first be referred to the Commission before it is discussed in Parliament

5 The Commission should consist of 11 members as follows

1 nominated by Director of Social Services
1 nominated by Director of Finance
1 nominated by Director of Econ Policy
2 nominated by the Minister of Social Policy
2 nominated by the two largest Unions
1 nominated by Employers
1 nominated by the GRTU
1 nominated by the Association of Pensioners
1 nominated by the Prime Minister (in consultation with the Leader of the Opposition) to act as Chairperson who does not hold a public office or held such an office in the five years previous to appointment or was a Member of Parliament in the 10 years previous to appointment

(Alternative paragraph 5)

(An eleven member commission could be unwieldy. The Commission should really consist of professionally qualified experienced persons in the field of social security. An alternative solution could be as shown hereunder

The Commission should consist of 7 members as follows

3 members nominated by the MCED (other than official side members)
3 members nominated by the Minister of Social Policy and the Minister of Finance and the Minister for Econ Services
1 Chairperson appointed by the Prime Minister (in consultation with the Leader of the Opposition) who does not hold a public office or held such an office in the five years previous to appointment or was a Member of Parliament in the ten years previous to appointment

6 The Commission in carrying out its functions shall not be under the jurisdiction of any other authority

7 The Commission shall have the power to appoint working committees or appoint experts to carry such studies as it may require and to make recommendations on particular subjects. Committee members and experts can include public officers. (In this respect, particularly

in the first years, the Commission should have full access to the officers who served on the Technical Team of the Reform Commission)

8 The Commission shall have an Executive Secretary who shall also act as Secretary to the Commission and such support staff as may be necessary (It is proposed that the Commission's studies and research should be commissioned as stated at 7 above and it is therefore expected that its staff complement should be limited) The E S is to be appointed by the Minister for Social Policy from amongst senior officers in the Public Service with the necessary qualifications and experience in the social security field The post is to be on a full time basis and rank with that of the Secretary to PSC (scale 4).

**Table IIa**

**Male Retiring Age -** retirement age of 61 increasing from Jan 2004 by 3 months every 6 months

| Retiring Age | A person reaching Age 61 in (2002/3) | Will now retire in No Change | Retirement age increased by 0 | | | | |
|---|---|---|---|---|---|---|---|
| | (2004) | | | | 2007 | | |
| 61 | Jan | Jan 04 | 0 | 62 1/2 | Jan | Oct 09 | 2 3/4 |
| 61 | Feb | Feb 04 | 0 | 62 1/2 | Feb | Nov 09 | 2 3/4 |
| 61 | March | Mar 04 | 0 | 62 1/2 | Mar | Dec 09 | 2 3/4 |
| 61 | April | April 04 | 0 | 62 1/2 | April | April 10 | 3 |
| 61 | May | May 04 | 0 | 62 1/2 | May | May 10 | 3 |
| 61 | June | June 04 | 0 | 62 1/2 | June | June 10 | 3 |
| 61 1/4 | July | Oct 04 | 1/4 | 62 3/4 | July | Oct 10 | 3 1/4 |
| 61 1/4 | Aug | Nov 04 | 1/4 | 62 3/4 | Aug | Nov 10 | 3 1/4 |
| 61 1/4 | Sept | Dec 04 | 1/4 | 62 3/4 | Sept | Dec 10 | 3 1/4 |
| 61 1/4 | Oct | April 05 | 1/2 | 62 3/4 | Oct | April 11 | 3 1/2 |
| 61 1/4 | Nov | May 05 | 1/2 | 62 3/4 | Nov | May 11 | 3 1/2 |
| 61 1/4 | Dec | June 05 | 1/2 | 62 3/4 | Dec | June 11 | 3 1/2 |
| | (2005) | | | | (2008) | | |
| 61 1/2 | Jan | Oct 05 | 3/4 | 63 | Jan | Oct 11 | 3 3/4 |
| 61 1/2 | Feb | Nov 05 | 3/4 | 63 | Feb | Nov 11 | 3 3/4 |
| 61 1/2 | March | Dec 05 | 3/4 | 63 | March | Dec 11 | 3 3/4 |
| 61 1/2 | April | April 06 | 1 | 63 | April | April 12 | 4 |
| 61 1/2 | May | May 06 | 1 | 63 | May | May 12 | 4 |
| 61 1/2 | June | June 06 | 1 | 63 | June | June 12 | 4 |
| 61 3/4 | July | Oct 06 | 1 1/4 | 63 1/4 | July | July 12 | 4 |
| 61 3/4 | Aug | Nov 06 | 1 1/4 | 63 1/4 | Aug | Aug 12 | 4 |
| 61 3/4 | Sept | Dec 06 | 1 1/4 | 63 1/4 | Sept | Sept 12 | 4 |
| 61 3/4 | Oct | April 07 | 1 1/2 | 63 1/4 | Oct | Oct 12 | 4 |
| 61 3/4 | Nov | May 07 | 1 1/2 | 63 1/4 | Nov | Nov 12 | 4 |
| 61 3/4 | Dec | June 07 | 1 1/2 | 63 1/4 | Dec | Dec 12 | 4 |
| | (2006) | | | | (2009) | | |
| 62 | Jan | Oct 07 | 1 3/4 | 63 1/2 | Jan | Jan 13 | 4 |
| 62 | Feb | Nov 07 | 1 3/4 | 63 1/2 | Feb | Feb 13 | 4 |
| 62 | March | Dec 07 | 1 3/4 | 63 1/2 | March | March 13 | 4 |
| 62 | April | April 08 | 2 | 63 1/2 | April | April 13 | 4 |
| 62 | May | May 08 | 2 | 63 1/2 | May | May 13 | 4 |
| 62 | June | June 08 | 2 | 63 1/2 | June | June 13 | 4 |
| 62 1/4 | July | Oct 08 | 2 1/4 | 63 3/4 | July | July 13 | 4 |
| 62 1/4 | Aug | Nov 08 | 2 1/4 | 63 3/4 | Aug | Aug 13 | 4 |
| 62 1/4 | Sept | Dec 08 | 2 1/4 | 63 3/4 | Sept | Sept 13 | 4 |
| 62 1/4 | Oct | April 09 | 2 1/2 | 63 3/4 | Oct | Oct 13 | 4 |
| 62 1/4 | Nov | May 09 | 2 1/2 | 63 3/4 | Nov | Nov 13 | 4 |
| 62 1/4 | Dec | June 09 | 2 1/2 | 63 3/4 | Dec | Dec 13 | 4 |

**Table IIb**

**Female Retiring Age** - Retirement age 60 increasing from Jan 2002 by 3 months every 6 months

| Retiring Age | A person reaching Age 60 in | Will retire in | Retirement age increased by | Retiring Age | A person reaching Age 60 in | Will retire in | Retirement age increased by |
|---|---|---|---|---|---|---|---|
| | **2002** | | | | | | |
| 60 | Jan | Jan 02 | 0 | 61 3/4 | July | Oct 08 | 3 1/4 |
| | Feb | Feb 02 | 0 | | Aug | Nov 08 | 3 1/4 |
| | March | March 02 | 0 | | Sept | Dec 08 | 3 1/4 |
| | April | April 02 | 0 | | Oct | Apr 09 | 3 1/2 |
| | May | May 02 | 0 | | Nov | May 09 | 3 1/2 |
| | June | June 02 | 0 | | Dec | June 09 | 3 1/2 |
| 60 1/4 | July | Oct 02 | 1/4 | | **2006** | | |
| | Aug | Nov 02 | 1/4 | 62 | Jan | Oct 09 | 3 3/4 |
| | Sept | Dec 02 | 1/4 | | Feb | Nov 09 | 3 3/4 |
| | Oct | Apr 03 | 1/2 | | March | Dec 09 | 3 3/4 |
| | Nov | May 03 | 1/2 | | April | Apr 10 | 4 |
| | Dec | June 03 | 1/2 | | May | May 10 | 4 |
| | **2003** | | | | June | June 10 | 4 |
| 60 1/2 | Jan | Oct 03 | 3/4 | 62 1/4 | July | Oct 10 | 4 1/4 |
| | Feb | Nov 03 | 3/4 | | Aug | Nov 10 | 4 1/4 |
| | March | Dec 03 | 3/4 | | Sept | Dec 10 | 4 1/4 |
| | April | Apr 04 | 1 | | Oct | Apr 11 | 4 1/2 |
| | May | May 04 | 1 | | Nov | May 11 | 4 1/2 |
| | June | June 04 | 1 | | Dec | June 11 | 4 1/2 |
| 60 3/4 | July | Oct 04 | 1 1/4 | | **2007** | | |
| | Aug | Nov 04 | 1 1/4 | 62 1/2 | Jan | Oct 11 | 4 3/4 |
| | Sept | Dec 04 | 1 1/4 | | Feb | Nov 11 | 4 3/4 |
| | Oct | Apr 05 | 1 1/2 | | March | Dec 11 | 4 3/4 |
| | Nov | May 05 | 1 1/2 | | April | Apr 12 | 5 |
| | Dec | June 05 | 1 1/2 | | May | May 12 | 5 |
| | **2004** | | | | June | June 12 | 5 |
| 61 | Jan | Oct 05 | 1 3/4 | 62 3/4 | July | July 12 | 5 |
| | Feb | Nov 05 | 1 3/4 | | Aug | Aug 12 | 5 |
| | March | Dec 05 | 1 3/4 | | Sept | Sept 12 | 5 |
| | April | April 06 | 2 | | Oct | Oct 12 | 5 |
| | May | May 06 | 2 | | Nov | Nov 12 | 5 |
| | June | June 06 | 2 | | Dec | Dec 12 | 5 |
| 61 1/4 | July | Oct 06 | 2 1/4 | | **2008** | | |
| | Aug | Nov 06 | 2 1/4 | 63 | Jan | Jan 13 | 5 |
| | Sept | Dec 06 | 2 1/4 | | Feb | Feb 13 | 5 |
| | Oct | April 07 | 2 1/2 | | March | Mar 13 | 5 |
| | Nov | May 07 | 2 1/2 | | April | Apr 13 | 5 |
| | Dec | June 07 | 2 1/2 | | May | May 13 | 5 |
| | **2005** | | | | June | June 13 | 5 |
| 61 1/2 | Jan | Oct 07 | 2 3/4 | 63 1/4 | July | July 13 | 5 |
| | Feb | Nov 07 | 2 3/4 | | Aug | Aug 13 | 5 |
| | March | Dec 07 | 2 3/4 | | Sept | Sept 13 | 5 |
| | April | April 08 | 3 | | Oct | Oct 13 | 5 |
| | May | May 08 | 3 | | Nov | Nov 13 | 5 |
| | June | June 08 | 3 | | Dec | Dec 13 | 5 |

Chapter 3

**Anomalies**

1. Anomalies can for convenience of treatment be divided into

a) **General Social Security Scheme issues**

- Clear distinction between contributory and non-contributory benefits
- Scheme should not be controlled by politicians

b) **Contributory Pension Assessments issues**

- Contributory pensions average assessment
- Pensionable income (Assessment of and Capping)
- Annual Pension revision
- Issues related directly to self employed persons
- Gender issues, such as whether a wife has a right to part of her husband's pension or not; whether a "married" woman should have the same rights as a "married" man

1. **General Scheme issues**

The items raised are of a general nature and are directly related to the principles of the National Scheme. They are discussed below

2.1 **Benefits under the Scheme**

The claim is often made that any Scheme must clearly identify:

- **the benefits to be paid out of the scheme**
- **Distinguish those benefits that are contributory and non-contributory in nature**

It is argued that one cannot compare expenditure on social security non-contributory benefits with the revenue gained from contributions. The underlying argument is that what is defined as non-contributory in nature should not depend on the revenue from social security contributions. This arises because of the pressure and difficulties stemming from an increasing welfare gap. It is often therefore stressed that the contributory scheme as is, is still solvent and the expenditure of non-contributory benefits and health care should not be considered as a burden on the contributory scheme.

The above is however untenable in the light of a long standing public policy established in the 1979 budget speech which had clearly defined those benefits that are contributory in nature and these included the child allowance and Health Care even though the latter does not feature in the Social Security Act. It is pertinent to point out that the right to Child Allowance is not based on contributory conditions. Furthermore, health care in Malta is basically free for all Maltese citizens. In this context one has to understand the distinction that some benefits insofar as the quantum of the benefit is concerned, are directly linked to the frequency and level of contributions made (eg pensions), some to frequency only (ie sickness benefit) and others solely to the fact that one falls within a - so called - contributory welfare scheme.

## 2.2 Who should control the National SS Scheme

The new 2/3 SS Pension Scheme being proposed does not per se affect this issue. It is definitely a integral and essential part of the Social Welfare structure which successive administrations have built and which is in the national interest to maintain and improve within the limits set by the country's resources. These same successive administrations have maintained for more than 20 years that the Social Welfare structure which involves a substantial contributory element as well as a **substantial State subvention**, includes pensions and other benefits linked to contributions (in some cases strongly and in others loosely), relief payment and health. The essential point that must be kept into focus is that there must be a reasonable balance for the funding of the said social Welfare structure between contributory inputs and outputs coming from State. In other words the so called Welfare Gap cannot be allowed to become unmanageable given the resources available because otherwise the Social Structure so painfully built and expanded in the past would collapse with serious implications especially for those who can ill afford it.

There are obviously conflicting interests in maintaining the balance mentioned in the previous paragraph. It is strongly held that continuous and objectives reviews of the situation carried out periodically by technical experts in the field of social security, finance and economics, should be of great help to all sectors of the community in order to arrive at a reasonable consensus and compromise on all issues that may emerge. It will inevitably and finally depend on a political decision which will lead the country forward and as such, the objectives and technical reviews should be presented to Parliament and it will be up to the House to take appropriate action in the light of or in spite of the information laid before it. It is for this purpose that an ad hoc Commission has been proposed in Section IX of the main Report.

## 3 Contributory Pension assessment issues

The basic elements of any social security pension rate calculation are the insured person's:

1 Contribution average history
2 Pensionable income, and
3 The payment of any service pension

Reservations have often been expressed on the current system for the calculation of the contribution average, and the calculation of the pensionable income and its capping. In fact the anomalies indicated for contributory pensions can be categorised under the first 2 items, ie contribution average calculation and pensionable income assessment and revision. There have also been representations from pensioners regarding the definition of the term service pension in the Social Security Act (Cap 318). This will be dealt with also

## 3.1 Contribution average test

The contentions raised (which the SS Department supports) are that, as the current contribution average test stands for social security two-third pension, the system can at times be generous towards those who have contributed less. In fact, on average one would expect that a person on entering the scheme at the age of 18 at pension age would have contributed for approximately 43 years

The current contribution average test rests on a calculation based on thirty years (the last ten consecutive calendar years prior to retirement and any other 20 years). The situation is that a person with 30 contribution years gets the same pension as another with 40 contribution years or more. This means that full pensions are being paid for a relatively short period. Considering current longevity factors and normal working life practices this does not make sense and the system as is may be abused by those who know or have access to knowledge of how the system works

The contribution average test period should be increased to at least 40 years which should be further extended if subsequent reviews of pension age (as recommended in the main Report) will increase the latter beyond 65 years.

The new SS Pension Scheme being proposed caters for a contribution average assessment of 40 years contribution which would apply to all from date of its introduction. This amendment will provide some savings in cost and more important, will also curb possible abuse of the system apart from making the system equitable between contributors

## 3.2 Pensionable Income

This is one of the most heated and discussed issues that have been debated recently. It has been raised by both the National Association of Pensioners and the GRTU. In order to simplify, as far as possible, the issues involved are discussed under two headings. The first is the assessment of a pensionable income and then the revision of the pensionable income

### 3.2.1 Assessment of Pensionable Income - background

The main contention raised on this issue especially by the self-employed sector, is that the current system that distinguishes between self-employed/occupied and employed contributions, should be eliminated.

In order to understand the situation it is necessary to explain the calculation of pensionable income under the **current system.** Under present legislation, the pensionable income of an employed person is the average wage or salary of the **best three consecutive calendar years** during the **last ten consecutive calendar years prior to retirement.** On the other hand the pensionable income of a self-employed/occupied persons is the average of the **last ten calendar years net income (net earned income for self occupied) declared for income tax purposes.**

It is evident that the present system 'discriminates' between the two categories and whilst there may have been valid reasons in 1979 for this, a better system needs to be found.

Some have argued that an assessment based on the average of the last five years salary (for employed) or income-net earnings (for self-employed/self-occupied) should be introduced. It is however felt that for any assessment to award in a just and equitable manner a sum corresponding to what the insured had paid into the system, then the assessment should be spread over a larger period of time. This would not only curb abuses in the system but would also be truly representative of what the person had paid into the Scheme. In this way it would not only be socially just between contributors, but it would also ensure that a person would not be adversely affected if during the latter years of his insurable life there is a loss of income in his gainful activity (be it employment or self employment). In fact experience has shown that there have been a number of persons that have suffered in such a way.

The proposed new Scheme therefore is based on a thirty year assessment which should clear this anomaly once and for all. This should present no problem to the SS Department with regard to availability of data since the contribution rate reflects the income and such information should be available on the Inland Revenue Dept data base.

On the introduction of the New Scheme, the parameters as they now stand, will cease to exist and will no longer apply. The position of current pensioners will not of course be in any way effected.

### 3.3 Pensionable Income Revision

This is one of the most heated, delicate and discussed issue at the moment. Submissions on the subject have even been received from the Ombudsman who had considered a case brought before him. In his report, it is pointed out that in the cases examined, whilst the Department has not in any way misinterpreted the law as is, the system is resulting in 'perverse' pension revisions. Another issue is that raised by the self-employed. They are claiming that they should have 'a notional wage-indexation' similar to that of an employed person.

### 3.3.1 Ombudsman's case - Background

The case in question regards two persons who worked with the same company and in the same grades earning the same salary. One of the employees retired a year before his colleague. Due to the way pension revisions are carried out it is resulting that the person who retired first is getting a pension higher than his colleague who had retired a year late. This issue mainly affects 'employed' persons and is due to the mathematical calculation imposed by the relative legislation on revision of a pensionable income. The difference in pension rates depends mainly on the amount increase awarded in a collective agreement and how this increase is reflected in the employee's original pensionable income.

There have been several representations by Pensioners Associations and lately a committee set up representing pensioners from the Malta Drydocks has been requesting amendments to correct the situation.

### 3.3.2 Effect of new SS Pensions Scheme

The new scheme will eliminate this gross anomaly since it is based on a pensionable income based on what was contributed by the insured, eliminates wage indexing and instead guarantees cost of living awards and additional private insurance benefit to maintain the level of purchasing power of the pensioner. This will effectively eliminate the possibility of a person receiving a pension less than that being paid to a colleague of his who had retired before him. This system is simpler and more just between contributors than the current complicated procedures for revision.

### 3.3.3. Can similar amendments be introduced for current pensioners?

Although within the existing **limitations** of the current scheme the anomalous situation will tend to diminish over **the long term**, there are a significant number of pensioners who will still be affected in the immediate and medium term.

It must however be stressed that it is difficult to find a solution if the system of the pensionable income remains based on a three-year average assessment which is then subsequently **wage-indexed.**

Two possible solutions could be discussed. Either, assess all pension entitlements on the current salary and eliminate the pensionable average of three years OR eliminate completely the wage-index process. The former would increase expenditure by bringing everyone on to a current salary level which would have serious repercussions on the sustainability of the system. Furthermore it would not really reflect what a person would have contributed for during his insurable life. On the other hand the second solution ie elimination of wage indexing, would reduce expenditure and thus safeguard future benefits; it will however be removing a vested right of existing pensioners.

If neither of the above can be reasonably accepted, one would have to think of other possible rational solutions

a) One would be that the revision in any particular year in respect of any pension in any category, should not be more than that which would be applicable for a person in the same category who would or could be retiring in the same year

b) Another possible solution would be to offer all existing pensioners the possibility of an award of full cost of living less 10% contribution thereon (ie 90% of COLA) for elimination of wage indexing

If none of these solutions are deemed to be acceptable, then there would be no other alternative but to let things stand as they are. Indeed, in the same way as wage indexing is a feature enjoyed by pensioners under legislation in terms of which they retired, so is the method of calculations of revisions. In other words, one would have to accept the rough with the smooth

### 3.3.4 Annual revisions for self employed - Background

The self employed lobby argues that it is anomalous that pensions of employed are revised (wage linked) while pension for self employed are increased only by 2/3 of COLA. They feel that they also have the opportunity to augment their pensions to reflect rising wage levels. They argue this can be achieved if the system of "analogues" as applied to employed persons is applicable to "self employed" pensioners

It is true that the current system discriminates between employed and self-employed, ie it is biased in favour of the employed. However the essential point to consider is not really the question of discrimination but the fact that the concept of wage indexing in a developed economy could contradict the very nature of a so called contributory scheme. A contributory pension should really reflect the amount invested by an individual by way of contributions over the years. The current contributory system, it must be said, is also subsidised to the equivalent of 50% of what an employee and his employer together put in, and furthermore it does not incorporate only pensions but also secures against social risks such as unemployment, sickness, invalidity, etc. Given the ever rising trends in wages over time and in life expectancy as a result of improved health welfare which is also publicly funded, wage indexed pensions will tend also increasingly to bear a diminishing relationship to that part of the contributions which was made in the past to justify such a pension

Wage indexing is therefore necessarily costly and if not properly controlled could in time undermine the whole social security system and not only pensions. The current pensions system was devised at the time of a controlled economy because circumstances so required and when, therefore, it was relatively easier to control wages. The Maltese economy over the past 20 years or so has developed significally such that now it can open to become more market oriented. The circumstances which could have made indexing a reasonable proposition in 1979, are now substantially different

The issue is not therefore to escalate the problem by 'wage indexing' self-employed pensions but how to contain a possibly explosive situation. The proposed SS Pensions system excludes wage indexing but makes provision for improvement in pensions once awarded. It also attempts to provide relief to existing pensioners with or without continuation of wage indexation.

### 3.4 Pensionable Income Capping

#### 3.4.1. Background

The current maximum salary/income accepted for pensionable income assessment is Lm6750. This should not be mixed with the current maximum salary on which a social security contribution is paid. The current maximum salary on which a social security contribution is due is approximately Lm6541 per annum. The maximum two-thirds pension payable is 2/3 of the Lm6541 per annum (or Lm83.86 a week).

The maximum pensionable income at Lm6750 has remained constant since 1981 and was at that time linked to the salary payable to the President of Malta. The difference between the maximum salary and maximum pensionable income in 1981 was relatively large at the time. In those days it was argued that the maximum pensionable income should not be linked to the maximum salary on which a social security contribution was payable. Such a provision would make it impossible for a person in receipt of a service pension and who was paying the maximum rate of contribution to ever become entitled to a maximum social security two-thirds pension. This is mainly due to the fact that a service pension he was receiving was deducted from the two-thirds of his pensionable income. For justice sake it was decided to establish a pensionable income at a higher level than the maximum salary for contribution purposes in order to allow for the deduction of a service pension and a person's possible entitlement to a maximum rate pension.

The capping mainly affects those persons in receipt of a service pension, as they are the only ones to benefit from the increase in the capping system. Another category that could benefit would be those persons not in receipt of a service pension but who have a reduced contribution average. Increasing the capping would in effect increase their 'reduced' two-thirds pension, as the maximum rate payable is always 2/3rds of the maximum salary on which a contribution is payable.

In the process of change from a controlled to a market economy, it became evident that if not safeguarded the national pension system could get out of hand as wages in the private sector increased in leaps and bounds, pulling wage levels in the public and parastatal sectors with it. Subsequent governments followed a protectionist policy by freezing the maximum pensionable income level. In essence this capping is the only safety valve left in the current system against greatly soaring costs.

The main argument for lifting the cap is that the maximum pensionable income level is not realistic in this day and age. It has remained frozen for the last 19 years and it is argued that it is about time that this should change.

The view of the DSS and the government has always been that a maximum pension should always reflect the income on which a contribution was paid. Increasing the maximum pensionable income would result in pension increases to pensioners who had never really contributed towards such high salaries and the financial position of the scheme could not permit for such increases.

### 3.4.2. Does the proposed new SS Scheme cater for this?

The proposed scheme is eliminating present capping. In fact the maximum salary/income to be considered on the new system is equivalent to the President's salary, currently around Lm17,000 per annum. This would be applicable to both contribution payments and pension assessments. Such a scheme, with the 30-year pensionable income period will ensure that one receives a Social Security pension directly related to one's contributions at least over a 30 year period. It will also increase revenue through increased contributions and will encourage self employed/occupied persons to declare their true income. It must also be said that the SS pension will be augmented by one's private insurance payments.

No increase in present capping for existing pensioners has been proposed. However other measures to improve their situation have been suggested.

### 3.5. Service Pensions

Claims have been made on the ground of the fact that as the Social Security Act stands today certain people are having their service pension considered for social security purposes whilst others are not. Some background to this problem is given hereunder.

### 3.5.1 Background

From the 1st April 1978, for social security purposes any service pension was considered on an uncommuted basis for the establishment of a social security pension. As stated the entire service pension (even that part commuted) was taken into consideration when the rate of 2/3rds due was calculated. As time passed and following pressure by pensioners, decisions were taken at the political level as to the interpretation of the word service pension. The main lobby in the early years came from ex-British Service Pensioners. The latest interpretation of service pension is

**"... a pension or other allowance, other than a pension or other allowance which has been commuted in whole, or which does not exceed Lm200 per annum, net of increases in the amount payable of such Service Pension by way of cost of living increases awarded after the initial award of such Service Pension..." (Social Security Act (Cap 318) - Article 1 - definitions).**

It is pertinent to point out that the above definition was tailored in October 1997 to meet the requirements of ex-British Forces employees in receipt of a service pension. Furthermore, where a person is in receipt of two or more service pensions only the higher or highest is considered.

The end result of all this is that in their majority today, ex-British Service Pensioners are no longer having the service pension they received taken into consideration in the social security pension rate calculation. On the other hand other service pensioners (eg ex-Civil Servants and others) have either not benefited at all or else only minimally.

### 3.5.2. Should this anomaly be catered for?

There is no specific answer to this. The answer will obviously depend on what the country can afford financially. Estimates made by the SS Department have indicated that to accede to the requests to ignore service pensions completely would result in a substantial rise in expenditure on social security pensions - ie between Lm10 to 14 million in recurrent expenditure **annually**. In the circumstances it is impossible and unrealistic to satisfy one and all in this category.

Although the different treatment meted out and the discrimination involved in the latest revision of the law as aforesaid cannot be condoned, it is also unrealistic to turn the clock back. The benefits gained (as explained in the previous paragraph) by ex-British Service personnel cannot be withdrawn. At the same time it would be folly to advise for similar improvements for other service pensioners as this would increase substantially the pensions bill.

In the proposed SSP Scheme it is being suggested that service pension rights acquired before the introduction of the new systems will continue to be considered for pension entitlements. Any pension rights acquired after will not and this is being purposely done so as to encourage the provision of third tier pensions. In the case of existing pensioners, the best that can be done is at least to ensure that in the case of ex Government employees, the full commuted part of their pension be eliminated from the abatement of their SS pension on their reaching the age of 72 (against the half of the commuted part as at present). It is estimated that this will increase cost by approximately Lm1.07 million per annum. Obviously as more pensioners arrive at the 72 age group, the increase in expenditure could rise even when taking into consideration those pensioners who die out of the system.

On the other hand, if one is to partly restore the inequality of treatment between ex-civil service pensioners and others and therefore to ignore only the commuted part of civil service pensions, then the annual expense will rise to approximately Lm3.1 million in respect of existing pensions.

It is considered that if the proposal at (b) of paragraph 3.33 is found acceptable, the adjustment in the preceding paragraph could be introduced as all in all the expectations of existing pensioners could be deemed to have been well considered in the present circumstances.

With regard to wage indexing and the proposal made at (b) of paragraph 3.3.3. it is relevant to note the anomalous situation as shown in the Budget Speech for 2001 (Maltese version page 70) which shows that as a result of the recent collective agreement concluded for civil servants, millions of liri are being paid out of public funds in such a way that there is a substantial disproportion between the amounts to be paid to the 19.500 eligible pensioners. It results that

a) 6000 will benefit from increases varying from Lm300 to Lm800 per annum, and 3000 will benefit from increases varying from Lm200 to Lm300 per annum, but

b) 3000 will only have an increase varying from Lm100 to Lm200 p.a. while for 2400 the increase will be less than Lm100 per annum, and 5100 will get no increase at all

It would seem that a system which allocates **out of public funds** proportionately so much more to the few and so much less to the many, needs adjustment

## 4 Gender Issues

Representations have been made on gender issues in social security. These can be classified under two categories. The first are claims for identical conditions and rates of benefit for both sexes. There is no doubt that one cannot but agree to this

In the second category are claims for women to benefit from contributions paid by their husbands. In essence the arguments in favour of this is that a wife should have a right to half the benefits earned by the contributions made by her husband. The problems arise in the case of women when separation proceedings are started.

### 4.1.1. Background

Contributory benefits obviously depend on the payment of contributions. Married women who are housewives are exempted from paying social security contributions unless they are gainfully occupied. In the circumstances, and as the social situation was until recently, it was common for women to pay contributions prior to marriage and afterwards to continue as housewives. Upon retirement therefore in their majority women were not entitled to a pension in their own right and were (and still are) wholly dependant on their husband for a social security pension.

There are no difficulties when a couple are happily married. However where friction between the couple exists, problems arise. As the pension is paid to the husband on the contributions he paid, the wife could not be paid directly any share of her husband's pension unless her husband gave his consent or the law Courts provided for this by sentence.

In the circumstances in case of separation, wives are at a severe disadvantage and have to resort to claims for social assistance as they often do not have sufficient contributions in their own name to qualify for a contributory benefit. In many instances the husband refuses to have the wife paid any part of **his** contributory pension. This means that the wife will need to take her husband to court, spending money and time to try to obtain legally a share of her husband's pension.

This is a situation that has legal implications relating to the legal title of the contributions that were made by the insured. Do they form part of the community of acquests? Has the wife any legal right on the contributions paid by the husband? This is undoubtedly a complicated and delicate problem. It raises issues which are beyond the brief of the Commission appointed for Welfare Reform.

It is however felt that no woman should find herself in a situation where she is at the mercy of a separating husband after having contributed to the welfare of her family equally with her husband and in the process could not find it possible to be gainfully employed elsewhere outside her home so as to be entitled to SS benefits in her own right. It is not right that her only remedy is to take Court action which takes time and the outcome of which would not necessarily solve her difficulty since the benefit still goes to her husband who can always create difficulties in forking out part of his pension.

Legislation should make it clear that in the case of marriage when only one partner is insured, the insurance is for the purpose of the law to be deemed as being made equally by the two partners such that in the case of one of the partners living separately from the other (ie having different homes), the SS Department at the request of any of the partners and after satisfying itself on the facts of the case, shall automatically divide the benefit equally between the partners.

## Chapter 4: The Characteristics of the Proposed Reform

In chapters 2 and 3, details of the proposed reform have been given. For the purposes of simulation analysis, the main factors that are relevant are the following.

*4.1.1 Retirement Age*

The normal retirement age for eligibility for a retirement pension is to be increased by 3 months every six months until it becomes 65 for both males and females. The resulting patterns of retirement ages associated with different ages of individuals are shown in Tables2a,b of Chapter 2. 1

*4.1.2 Contributions*

The cap on contributions is to be raised gradually until it becomes permanently linked to and revisable with the salary of the President of the Republic, currently at Lm17,100. One tenth of the difference between the cap and the President's salary is to be removed in the first year of the reform by raising the cap, one ninth of the remaining difference is to be likewise removed in the second, one eighth of the remaining difference in the third and so on until the cap effectively becomes the President's salary from the tenth year. 2

Contributors aged under 45 are to pay 7% of their permanent cash salary subject to the new caps to the PAYG system. A further 3% is to be paid to a pension fund. Employers are to match these contributions, implying a total of 14% of the salary going to the PAYG system and 6% going to the pension fund. The State contribution is to be at 7%, totally going towards the PAYG system.

Contributors aged 45 years and over have the option to:

a. Contribute on the same basis as persons aged under 45, or
b. Pay 10% wholly to the PAYG system, to be matched by a further 10% contribution by employers and 7% in the case of the State contribution.

Contributors opting for (b) will have a larger PAYG benefit than those opting for (a), as explained below, but will not enjoy the returns from the pension fund.

*4.1.3 Retirement Pension Benefits*

The benefit conditions of persons in receipt of a pension benefit at the date of the reform are to remain unchanged except for pensions which are already at the cap level. Thus, pensions will continue to be revised according to developments in wages until the nominal cap is reached. Once the cap is reached, however, pensions will no longer continue to be upgraded by means of two-thirds of the COLA, but by means of three-fourths of the COLA. A further one-year's average COLA during the past four 3 years is to be received every four years. This effectively gives pensioners earning the maximum benefit a full COLA revision

For persons qualifying for a pension after the reform, the new applicable cap shall be equivalent to that on contributions as specified in section 4.1.2.

The entry benefit for these persons shall be, subject to the new cap, equivalent to two-thirds of the average salary of the past *three* years for persons reaching retirement within one year of the reform, two-thirds of the average salary of the past *four* years for persons reaching retirement in the year after, and so on until an average of thirty years' salary is achieved. Past salary levels used for the purposes of this computation shall be adjusted for inflation

The revision of benefit for pensioners who are contributors aged under 45 at the date of the implementation of the reform, and who will therefore have contributed to the pension fund, shall be 75% of the COLA. The same shall apply for contributors aged over 45 at the date of the implementation of the reform who opt for the pension fund. For contributors aged over 45 at the date of the implementation of the reform who do not opt for the pension fund, the benefit shall be additionally revised by means of one-year's average COLA during the past four years to be received every four years

The foregoing is essentially a blueprint which would be reflected across the entire spectrum of benefits offered under the SSS.

Apart from the financial aspects considered further on, the principal effects of this reform are

i it maintains intact the rights of current pensioners, actually improving the pensions of those who are currently at the cap level;
ii it substantially lifts the cap levels, thereby increasing the relevance of the SSS in the economy;
iii it introduces more fairness and less incentive for abuse by linking new pension benefits more closely to contributions paid during the working life;
iv it effectively protects acquired pension rights under the PAYG against inflation;
v it provides future pensioners with an additional source of income arising out of the pension fund.

4.2 Simulation Assumptions

The financial effects of this reform are simulated under the following assumptions:

i Macroeconomic performance is assumed to be the same as that specified for the baseline simulation. This adopts a conservative approach, because there exists evidence that the introduction of pension funds improved macroeconomic performance in a number of countries by stimulating saving and investment.

ii Demographic assumptions are retained unchanged from the baseline simulation

iii Labour market developments are bound to be affected by this reform, particularly by the increase in retirement age which could impinge on the labour supply, and hence on unemployment, wage rates and skills availability. In particular it is assumed that while unemployment rates will remain unchanged, half of the persons who had been expecting to retire at an earlier age but are not allowed to during the period while the retirement age is being increased will seek some form of early retirement including claiming disability

iv The lifting of the caps on contributions and benefits affects the collection rate, replacement rate and benefit indexing parameters discussed in Chapter 1, section 3.1.3. Table 1 gives the new values for these parameters under the reform proposals, comparing them with the values under the baseline simulation. Under the reform proposal, the collection rate of contribution increases significantly due to the lifting of the cap on contributions. In the long run, it is projected to achieve a 90% rate, which would solely reflect lags and inefficiencies in the collection of revenue due. The basic entry benefit replacement rate is projected to remain unchanged throughout the forecast period because of the lifting of the caps. It must be remembered, however, that this constant percentage is applied to an average income that would progressively include an increasing number of years in the computation. Under the reform proposal, the switch away from wage indexation to inflation indexation occurs at a much quicker pace, as the only benefits which will remain wage indexed are those received by current pensioners who are under the cap. As all benefits will be COLA indexed, and the COLA is calculated as a percentage of the social wage, this may imply that pensions will be more than 100% inflation indexed, especially when the social wage would be relatively high compared to the average pension benefit

**Table 1: Social Security System Effective Rates**

| | 2000 | 2010 | 2015 | 2020 | 2025 | 2035 | 2045 | 2055 |
|---|---|---|---|---|---|---|---|---|
| Baseline Simulation | | | | | | | | |
| Effective Collection Rate from Employees and Employers | 77.8% | 75.8% | 73.9% | 66.0% | 51.2% | 46.5% | 36.9% | 30.4% |
| Basic Entry Benefit Replacement Rates | 55.5% | 46.7% | 43.8% | 40.1% | 36.6% | 32.2% | 23.7% | 19.7% |
| Benefit Indexation | | | | | | | | |
| To inflation | 2.7% | 15.4% | 26.5% | 39.3% | 52.4% | 70.4% | 77.5% | 79.5% |
| To wages | 96.9% | 79.5% | 65.3% | 50.6% | 37.0% | 12.1% | 3.4% | 0.2% |
| Reform Proposal | | | | | | | | |
| Effective Collection Rate from Employees and Employers | 77.6% | 91.9% | 92.4% | 91.8% | 90.0% | 90.0% | 90.0% | 90.0% |
| Basic Entry Benefit Replacement Rates | 55.5% | 55.5% | 55.5% | 55.5% | 55.5% | 55.5% | 55.5% | 55.5% |
| Benefit Indexation | | | | | | | | |
| To inflation | 2.7% | 70.4% | 100% | 112% | 111% | 99.5% | 91.8% | 91.8% |
| To wages | 96.9% | 66.3% | 50.9% | 37.0% | 12.1% | 3.4% | 0.2% | 0.0% |

See Notes to Table 3a in Chapter 1

## 4.3 Results and Comparison with Baseline Scenario

The results of the simulation of the reform proposal are presented in comparative terms to those of the baseline scenario. It will be shown that whereas the costs of the two systems are comparable, the reform proposal should afford an improved standard of living to the beneficiaries.

### *4.3.1 Public Finances*

Table 2 presents the simulation for the fiscal cost of the reform proposal. Due to the lifting of the caps, both contribution revenue and expenditure should increase significantly. However, the deficits, as a percentage of GDP, are projected to be quite close to those estimated for the baseline simulation, albeit the reform proposal could cost somewhat more in the early years of the reform. This takes place due to the fact that the higher cost of initial benefits and benefit revision are projected to exceed the gains from increasing the retirement age and removing the cap on contributions. In later years, expenditure is projected to be moderated by the higher number of income years considered in the computation of the average for the purposes of the calculation of the entry benefit. Moreover, the system will in the initial years be affected by the reduction in the PAYG contribution rate to 7%. Contribution revenue will in later years be positively influenced by the lifting of the cap.

**Table 2: Simulation for Reform Proposal**

| Year | Contributions | Expenditure | | | Balance | | Balance | |
|---|---|---|---|---|---|---|---|---|
| | | 2/3 retirement | Other contributory | Non contributory | With State contrib | Without State contrib | with State contrib | Without State contrib |
| | Lm millions | | | | | | As percentage of GDP | |
| 2003 | 161.4 | 40.7 | 79.6 | 53.2 | -11.8 | -65.4 | -0.5% | -4.3% |
| 2005 | 179.2 | 41.5 | 99.8 | 55.7 | -17.6 | -77.5 | -0.9% | -4.1% |
| 2010 | 229.6 | 61.8 | 120.0 | 60.3 | -12.4 | -93.0 | -0.5% | -3.6% |
| 2015 | 254.1 | 107.1 | 128.5 | 59.5 | -41.0 | -129.0 | -1.4% | -4.4% |
| 2020 | 310.1 | 162.8 | 159.8 | 59.4 | -72.0 | -175.3 | -2.0% | -4.6% |
| 2025 | 364.9 | 230.0 | 173.2 | 59.8 | -98.1 | -215.7 | -2.2% | -4.5% |
| 2035 | 560.9 | 363.5 | 209.5 | 59.7 | -71.7 | -258.5 | -1.0% | -3.7% |
| 2045 | 817.9 | 567.0 | 260.7 | 60.4 | -70.2 | -342.9 | -0.6% | -2.1% |
| 2065 | 1780.9 | 1454.7 | 425.1 | 51.3 | -170.2 | -753.8 | -0.6% | -2.9% |

Figure 1: Balance including State Contribution (% of GDP)

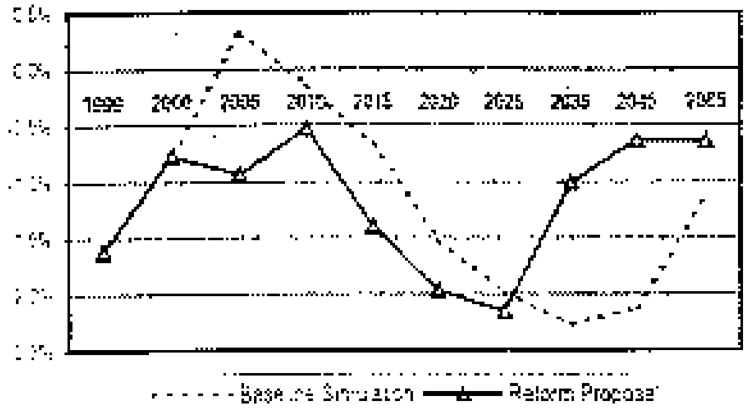
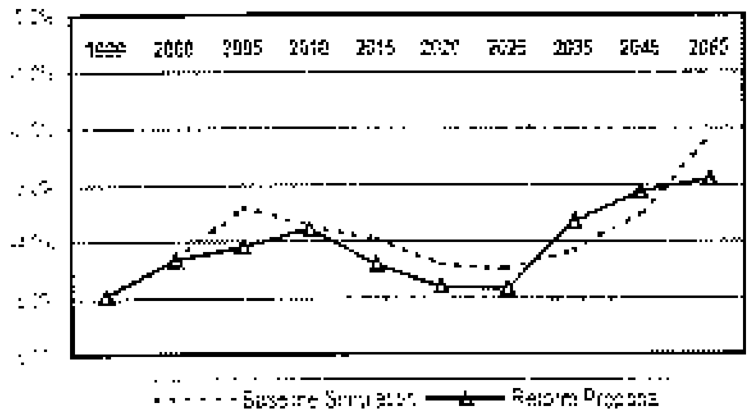



Figure 2: Balance excluding State Contribution (% of GDP)




*4.3.2 Individual Retirement Financing*

Figure 4: Development in Nominal Per Capita Benefit from PAYG system

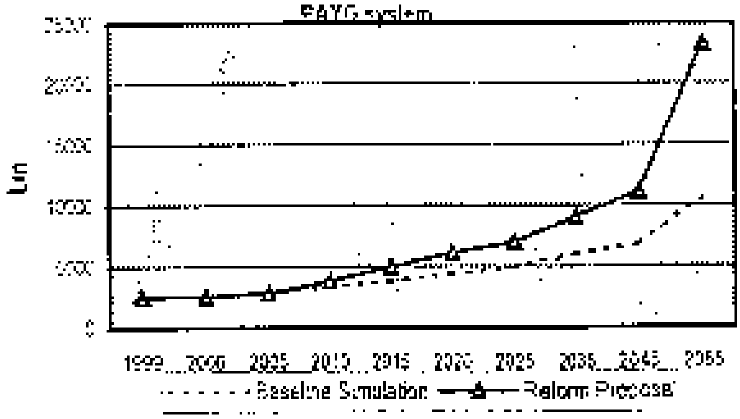
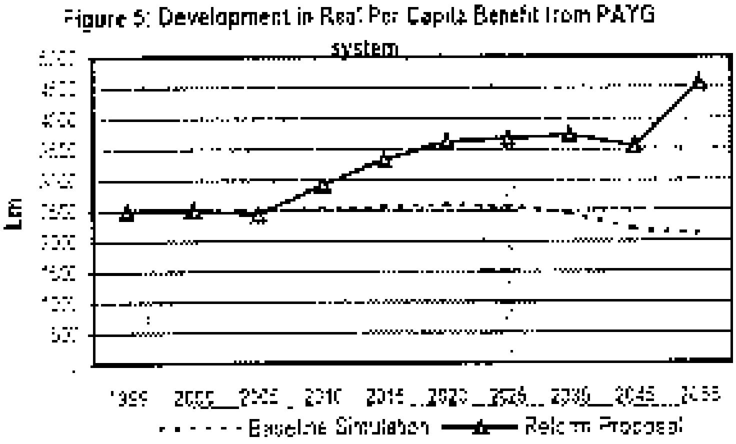


**Table 3: Development in Per Capita Retirement Benefit Under the Reform Proposal**

| Year | Per capita pension benefit | Lm | Average Annual Growth in Per Capita Retirement Benefit | |
|---|---|---|---|---|
| | Nominal | Real | Nominal | Real |
| 2000 | 2572 | 2505 | 3.2% | 0.7% |
| 2005 | 2826 | 2437 | 1.9% | -0.5% |
| 2010 | 3815 | 2908 | 6.2% | 3.6% |
| 2015 | 4936 | 3325 | 5.3% | 2.7% |
| 2020 | 6076 | 3618 | 4.2% | 1.7% |
| 2025 | 6970 | 3668 | 2.8% | 0.3% |
| 2035 | 9064 | 3728 | 2.7% | 0.2% |
| 2045 | 11032 | 3543 | 2.0% | -0.5% |
| 2055 | 23286 | 4554 | 3.6% | 1.3% |

One of the main tenets of the reform proposal is that it will effectively eliminate the caps on benefits that result in a significant drop in the relative and absolute purchasing power of benefits in the baseline scenario. Furthermore, it is intended to supplement PAYG benefits with pension fund benefits. Table 3 details the average per capita benefit that is expected to accrue to beneficiaries out of the PAYG system.

**Figure 5: Development in Real Per Capita Benefit from PAYG system**




Figures 4 and 5 compare the development in nominal and real per capita benefit arising out of the PAYG system under the baseline scenario and the reform proposal. It is to be noted that fluctuations in this statistic may reflect changes in the distribution of "new" and "old" beneficiaries. One may thus expect that the growth in average benefit levels would be curtailed in periods when there is a substantial inflow of new beneficiaries at relatively low benefit levels.

Contributors aged under 45 at the time when the reform is implemented would contribute towards a pension fund and would therefore supplement their PAYG benefit with the proceeds from the funded pillar. Table 4 details illustrative replacement rates for a period of 20 years for a situation where 6% of the salary is transferred to a pension fund under different assumptions of financial market returns and years of contributions. For instance, 35 years of contributions invested at a 5% per annum return would result in 20.4% of the final salary being received as a pension for a period of 20 years. This would be added to the replacement rate arising out of the PAYG system. Under the reform proposal the effective replacement rate of the entry benefit to the final salary is projected to develop as shown in Table 5.

**Table 4: Illustrative range of wage replacement rates under different investment conditions**

Inflation-indexed replacement rate on retirement

| | | | | |
|---|---|---|---|---|
| | Combined Contribution rate at 6% of salary | | | |
| | Years of Contributions | | | |
| Financial Market Real Returns | 45 | 35 | 25 | 20 |
| 4% | 25.5% | 16.6% | 11.2% | 9.2% |
| 5% | 27.6% | 20.4% | 13.2% | 10.3% |
| 6% | 37.8% | 25.4% | 17.2% | 12.0% |
| 7% | 50.4% | 34.4% | 21.0% | 15.4% |

**Table 5: Inflation-Indexed Replacement Rates on Retirement from reformed PAYG**

| 2005 | 2010 | 2015 | 2020 | 2025 | 2035 | 2045 | 2065 |
|---|---|---|---|---|---|---|---|
| 51.7% | 46.0% | 45.5% | 44.2% | 43.1% | 37.6% | 35.5% | 35.1% |

Thus, the average replacement rate under the PAYG system is projected at 52% in 2005, progressively declining to 35% by 2065. From 2025 onwards, however, the PAYG benefit replacement rate out of the final salary would start to be complemented by proceeds from the funded system as persons aged under 45 at the time of the implementation of the reform would start to retire. These persons, would have contributed say for a period of 20 years, and can therefore expect to supplement their 43% PAYG replacement rate with a further 9% to 15% replacement rate from the funded pillar. By 2065, the 35% PAYG replacement rate would be supplemented by a funded pillar replacement rate of between 20% and 52%. This analysis shows that pension proceeds would be quite susceptible to financial market risks and effective returns on investment, which are in turn dependent on such factors as pension fund management costs. This notwithstanding, the PAYG system will continue to provide for a basic replacement rate intended to act as a safety net.

## *5.0 Social Security Financing and Health*

As was pointed out in the Commission's Report of 2000, the official published figures relating to the so-called Welfare Gap includes expenses in connection with Health recurrent expenditure (but excludes non-contributory pensions and social assistance). In fact, the terms of reference of the Commission are concerned solely with services arising from the Social Security Act Cap 318.

Nevertheless, it may be useful in discussing State-funded welfare in general to illustrate the effect of adding Health recurrent costs to the disbursement of public funds. The Commission has no knowledge as to how Health services can expand in future and has necessarily to be guided solely by the present level of expenditure. What is state hereunder could, therefore, be grossly underestimated if there will be substantial growth in health services and costs in future.

Appendix D provides estimates of the increased burden when Health recurrent expenditure is included under the different scenarios that have been discussed in this report, namely under the baseline simulation, the lifting of all caps, and the new reform proposal. In all cases, the proportion of resources that have to be allocated out of current national income shows an increase. The most sustainable position overall would remain that under the reform proposal.

## *6.0 Conclusions*

This principal findings of this report may be summarised as:

i. The present SSS is projected to increase the fiscal funding cost by around Lm60 million at present money values by 2025, albeit as a percentage of GDP, this cost would be expected to remain more or less stable. These developments are the interplay of demographic shifts and the operation of the capping mechanism which reduces the size of the SSS relative to the economy.

ii. Due to the capping mechanism the present SSS is expected to result in a reduction in the relative and absolute purchasing power of social security benefits.

iii. A simple removal of the caps on benefits and contributions would results in an unsustainable burden on the fiscal position.

iv. A reform proposal is presented which maintains the fiscal cost at a level comparable to that in the baseline simulation while engendering an increased benefit, to arise from a basic PAYG system supplemented by a funded component.

v. The reform proposal also aims at equity and simplicity by:

a) retaining the two-thirds replacement rate concept
b) linking the entry benefit to career-long earnings
c) protecting benefits against inflation

# Appendix A: Assumptions on Demography and the Labour Market

| Age (cohort) | Population (000) 1995 Male | Population (000) 1995 Female | Fertility (%) Female 1995 | Fertility (%) Female 2065 | Probability of dying (%) Male 1995 | Probability of dying (%) Male 2065 | Probability of dying (%) Female 1995 | Probability of dying (%) Female 2065 |
|---|---|---|---|---|---|---|---|---|
| [illegible] | [illegible] | [illegible] | | | 0.60% | 0.60% | 0.50% | 0.45% |
| [illegible] | [illegible] | [illegible] | | | 0.20% | 0.15% | [illegible] | 0.04% |
| [illegible] | [illegible] | [illegible] | | | 0.12% | 0.09% | 0.04% | 0.02% |
| [illegible] | [illegible] | [illegible] | | | 0.06% | 0.05% | 0.04% | 0.03% |
| [illegible] | [illegible] | [illegible] | | | 0.04% | 0.03% | 0.03% | 0.02% |
| [illegible] | [illegible] | [illegible] | | | 0.02% | 0.02% | [illegible] | 0.01% |
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| [illegible] | [illegible] | [illegible] | | | 0.06% | 0.04% | [illegible] | 0.01% |
| [illegible] | [illegible] | [illegible] | | | 0.25% | 0.04% | [illegible] | 0.01% |
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| 65 | [illegible] | [illegible] | | | 3.84% | [illegible] | [illegible] | [illegible] |

| | | | | | | |
|---|---|---|---|---|---|---|
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| [illegible] | [illegible] | 1.38 | [illegible] | 3.07% | 2.29% | 1.72% |
| [illegible] | [illegible] | 1.49 | [illegible] | 3.07% | 2.29% | 1.72% |
| [illegible] | [illegible] | 1.44 | [illegible] | [illegible] | 2.29% | 1.72% |
| [illegible] | [illegible] | 1.36 | [illegible] | 3.07% | [illegible] | 1.72% |
| [illegible] | [illegible] | 1.40 | [illegible] | 3.07% | 2.29% | 1.72% |
| [illegible] | [illegible] | 1.16 | [illegible] | 4.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | 4.64% | [illegible] | 2.52% |
| [illegible] | [illegible] | 1.14 | [illegible] | 4.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | 1.05 | [illegible] | 4.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | 1.07 | [illegible] | 4.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | 2.09 | [illegible] | 6.64% | 3.97% | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | 6.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | 1.56 | [illegible] | 6.64% | [illegible] | [illegible] |
| [illegible] | [illegible] | 1.54 | [illegible] | 6.64% | 5.40% | [illegible] |
| [illegible] | [illegible] | 1.50 | [illegible] | 6.64% | 6.64% | 4.69% |
| 85+ | [illegible] | 2.50 | [illegible] | [illegible] | [illegible] | [illegible] |

| Age | [illegible] | | | | [illegible] | | | | [illegible] | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Male | | Female | | Male | | Female | | Male | | Female | |
| | 2000 | [illegible] | 2000 | [illegible] | 2000 | [illegible] | 2000 | [illegible] | 2000 | [illegible] | 2000 | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
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| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
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| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
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| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
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| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
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| 45 | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 9% | 9% | [illegible] | 3% | 148% | 148% | 110% | 110% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | 3% | 148% | 148% | [illegible] | [illegible] |
| 62 | 10% | 12% | 3% | 5% | 5% | 5% | [illegible] | 3% | 148% | 148% | 110% | 110% |
| 63 | 10% | [illegible] | 3% | [illegible] | [illegible] | [illegible] | 3% | 3% | 148% | 148% | 110% | 110% |
| 64 | 11% | 11% | 3% | 6% | [illegible] | 6% | 3% | 3% | 148% | 148% | 110% | 110% |
| 65 | 11% | 11% | 4% | 6% | 5% | 5% | 3% | 3% | 148% | 148% | 110% | 110% |

## Appendix B: The Impact of Removal of Ceilings on Contributions and Pensions

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Lm millions | | As percentage of GDP* | | Lm | |
| Year | Contrib | Expenditure | | | Balance | | Balance | | Per capita retirement benefit | |
| | | 2/3 retirmnt | Other contrib | Non-contrib | with State contrib | Without State contrib | With State contrib | without State contrib | Nominal | Real** |
| 2000 | 161.4 | 40.2 | 79.7 | 53.2 | -11.7 | -65.5 | -0.8% | -4.3% | 2543 | 2481 |
| 2005 | 215.8 | 55.4 | 94.7 | 55.7 | 10.0 | -61.9 | 0.5% | -3.3% | 3011 | 2596 |
| 2010 | 267.9 | 93.9 | 107.6 | 60.3 | 6.1 | -83.2 | 0.3% | -3.5% | 3517 | 2690 |
| 2015 | 315.8 | 147.5 | 121.5 | 59.5 | -12.7 | -118.0 | -0.4% | -4.0% | 4338 | 2922 |
| 2020 | 363.2 | 232.0 | 137.9 | 58.4 | -66.1 | -187.2 | -1.8% | -5.1% | 5554 | 3312 |
| 2025 | 425.0 | 335.2 | 151.2 | 59.8 | -121.2 | -262.8 | -2.7% | -5.8% | 7027 | 3699 |
| 2035 | 638.7 | 612.4 | 187.9 | 59.7 | -221.3 | -434.2 | -3.1% | -6.2% | 10801 | 4440 |
| 2045 | 936.5 | 1063.2 | 230.6 | 60.4 | -417.7 | -729.9 | -3.8% | -6.7% | 16183 | 5197 |
| 2065 | 2063.0 | 2381.5 | 433.5 | 61.3 | -813.3 | -1501.0 | -3.1% | -5.7% | 32313 | 6333 |

Balance excluding State Contribution (% of GDP)

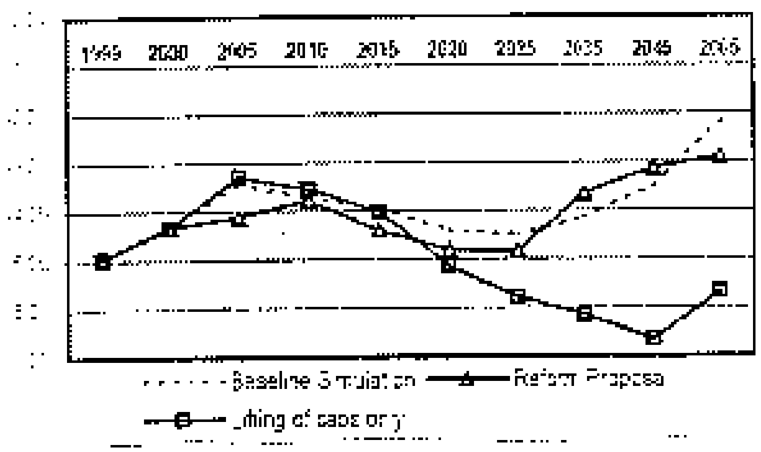
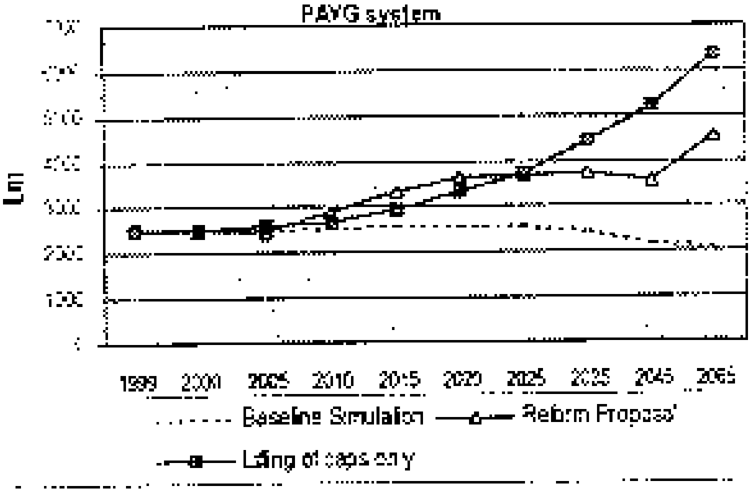



Figure 5: Development in Real Per Capita Benefit from PAYG system




The above data and charts indicate that while the lifting of caps will result in a significant per capita benefit to pensioners, it will impose an unacceptable burden on public finances in terms of the deficit of the SSS which is close to 7% of GDP

## Appendix D: Social Security Accounts Including Expenditure on Health

The following tables detail the balances of SSS including expenditure on health, under the assumption that health expenditure is to remain constant in real terms into the future.

| Year | Recurrent Expenditure on Health | | | Baseline Simulation: Balance with State contribution | | | Baseline Simulation: Balance without State contribution | | |
|---|---|---|---|---|---|---|---|---|---|
| | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP |
| 1999 | 55.7 | 55.7 | 3.9% | -79.2 | -79.2 | -5.5% | -127.5 | -127.5 | -8.8% |
| 2000 | 57.3 | 55.9 | 3.8% | -68.9 | -67.3 | -4.6% | -122.7 | -119.7 | -8.1% |
| 2005 | 71.2 | 61.4 | 3.8% | -65.1 | -56.1 | -3.5% | -135.6 | -116.6 | -7.2% |
| 2010 | 80.6 | 61.4 | 3.4% | -83.5 | -63.5 | -3.6% | -166.5 | -126.4 | -7.2% |
| 2015 | 91.1 | 61.4 | 3.1% | -111.0 | -74.6 | -3.8% | -207.2 | -139.3 | -7.1% |
| 2020 | 103.1 | 61.4 | 2.8% | -158.5 | -94.4 | -4.3% | -253.9 | -151.1 | -7.2% |
| 2025 | 115.7 | 61.4 | 2.6% | -207.1 | -109.0 | -4.6% | -320.9 | -168.9 | -7.1% |
| 2035 | 149.3 | 61.4 | 2.1% | -309.6 | -127.5 | -4.4% | -442.7 | -182.0 | -6.3% |
| 2045 | 191.2 | 61.4 | 1.7% | -424.6 | -136.4 | -3.3% | -575.6 | -184.8 | -5.0% |
| 2065 | 313.2 | 61.4 | 1.2% | -614.2 | -120.4 | -2.3% | -895.1 | -175.7 | -3.4% |

| Year | Recurrent Expenditure on Health | | | Lifting of all caps: Balance with State contribution | | | Lifting of all caps: Balance without State contribution | | |
|---|---|---|---|---|---|---|---|---|---|
| | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP |
| 1999 | 55.7 | 55.7 | 3.9% | -79.2 | -79.2 | -5.5% | -127.5 | -127.5 | -8.8% |
| 2000 | 57.3 | 55.9 | 3.8% | -69.0 | -67.4 | -4.6% | -122.6 | -119.8 | -8.1% |
| 2005 | 71.2 | 61.4 | 3.8% | -61.2 | -52.7 | -3.2% | -133.1 | -114.6 | -7.1% |
| 2010 | 80.6 | 61.4 | 3.4% | -74.4 | -56.7 | -3.2% | -163.7 | -124.6 | -7.0% |
| 2015 | 91.1 | 61.4 | 3.1% | -103.9 | -70.0 | -3.5% | -209.1 | -140.9 | -7.1% |
| 2020 | 103.1 | 61.4 | 2.8% | -169.2 | -100.7 | -4.6% | -290.3 | -172.8 | -8.0% |
| 2025 | 115.7 | 61.4 | 2.6% | -237.8 | -125.2 | -5.2% | -376.5 | -198.2 | -8.4% |
| 2035 | 149.3 | 61.4 | 2.1% | -370.6 | -152.3 | -5.3% | -553.6 | -225.9 | -8.2% |
| 2045 | 191.2 | 61.4 | 1.7% | -608.9 | -195.5 | -5.5% | -921.1 | -295.8 | -8.4% |
| 2065 | 313.2 | 61.4 | 1.2% | -1126.8 | -220.8 | -4.9% | -1814.2 | -355.6 | -8.8% |

| Year | Recurrent Expenditure on Health | | | Reform Proposal: Balance with State contribution | | | Reform Proposal: Balance without State contribution | | |
|---|---|---|---|---|---|---|---|---|---|
| | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP | Lm millions | Present value | % of GDP |
| 1999 | 55.7 | 55.7 | 3.9% | -79.2 | -79.2 | -5.5% | -127.5 | -127.5 | -8.8% |
| 2000 | 57.3 | 55.9 | 3.8% | -66.9 | -67.3 | -4.6% | -122.7 | -119.7 | -8.1% |
| 2005 | 71.2 | 61.4 | 3.8% | -86.5 | -75.7 | -4.7% | -145.7 | -128.2 | -7.9% |
| 2010 | 80.6 | 61.4 | 3.4% | -93.0 | -70.9 | -4.0% | -169.5 | -129.2 | -7.3% |
| 2015 | 91.1 | 61.4 | 3.1% | -132.1 | -89.0 | -4.5% | -220.2 | -148.3 | -7.5% |
| 2020 | 103.1 | 61.4 | 2.8% | -175.1 | -104.3 | -4.8% | -278.5 | -165.5 | -7.6% |
| 2025 | 115.7 | 61.4 | 2.6% | -214.6 | -113.0 | -4.7% | -336.4 | -177.0 | -7.4% |
| 2035 | 149.3 | 61.4 | 2.1% | -221.0 | -90.9 | -3.1% | -409.0 | -167.7 | -5.8% |
| 2045 | 191.2 | 61.4 | 1.7% | -261.4 | -83.9 | -2.4% | -534.0 | -171.5 | -4.9% |
| 2065 | 313.2 | 61.4 | 1.2% | -483.4 | -94.7 | -1.6% | -1077.1 | -211.1 | -4.1% |