Ensuring a fair balance between contributions and benefits across generations

A supplementary paper prepared for the 2025 Pension Strategy Group (PSG) report

Reference: Paper 3

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Introduction

One of the main principles of the pension system is to provide a fair balance between contributions and benefits across generations and to be able to evolve, particularly to respond to long term developments. A clause in the Social Security Act in 2006 had introduced the concept of five yearly strategic reviews. In 2016 this clause 64B (1) specified that the review would include "recommendations, if any, with a view of achieving further adequacy, sustainability and social solidarity in such manner that a stable proportion is kept between the contribution periods…and the periods of time during which it is expected that the pension will be paid".

This clause was utilised to justify an increase of the contribution period to 41 years in the 2016 pension reform and to 42 years in the Budget for 2025. These increases had been introduced with an advance notice of at least 15 years to enable affected persons to make appropriate adjustments. The 2016 pension reform had instead increased the contributory period to 41 years just for those born in 1969 or after. This gave a notice period of 18 years. The increase announced in the Budget for 2025 affected those born in 1976 or after, which gives an advance notice of 17 years.

In line with the dispositions of the Social Security Act, given the publication of updated longevity projections following the previous pension reform, this report will assess whether a further increase in contribution requirements is warranted.

Recent developments in life expectancy projections for Malta

Table 1 shows successive rounds of life expectancy projections prepared for Malta by Eurostat. This indicates that over a period of 10 years, the projected life expectancy at 65 for a Maltese man living in 2060 has been revised up from 21.4 years to 23.1, while for women the upward revision was from 24.8 years to 26.3.

	2010	***2013***	***2016***	***2019***	***2020***	***2023***	***2030***	***2040***	***2050***	***2060***
EUROPOP 2008										
Male	16.1				17.2		18.3	19.4	20.4	21.4
Female	19.4				20.5		21.7	22.8	23.8	24.8
EUROPOP 2010										
Male	17.0				18.1		19.2	20.3	21.3	22.2
Female	20.2				21.3		22.4	23.4	24.4	25.4
EUROPOP 2013										
Male		18.1			18.8		19.7	20.7	21.6	22.4
Female		21.3			22.0		23.0	24.0	24.9	25.7
EUROPOP 2015										
Male			19.3		19.6		20.6	21.5	22.3	23.1
Female			22.2		22.5		23.5	24.4	25.3	26.1
EUROPOP 2019										
Male				19.6	19.5	**19.8**	20.5	21.4	22.3	23.1
Female				22.4	22.4	22.7	23.4	24.4	25.3	26.2
EUROPOP 2023										
Male						19.6	20.3	21.3	22.2	23.1
Female						22.6	23.4	24.4	25.3	26.3

Table 1: Life expectancy at 65 – successive Eurostat projections for Malta.

Whereas the Europop 2008 projections had envisaged that between 2030 and 2060 longevity at age 65 for men would improve by 3.1 years, or 17%, the most recent projections indicate an improvement of 2.8 years, or 14%. For women the Europop 2008 projections had foreseen a lengthening of the life span at 65 of 4.3 years, or 21%, while the Europop 2023 projection suggests an improvement of 2.9 years, or 12%. Therefore, the rate of anticipated future improvement is being revised downwards, particularly for women.

Table 1 indicates that actual life expectancy improvements over the past decade have surprised significantly demographers. While Europop 2008 had projected life expectancy at 65 for men to reach 20.4 in 2050, Europop 2023 indicates that this life span may already be achieved by men living in 2030. A similar development was observed for women. Women aged 65 in 2023 had the life expectancy that Europop 2008 had projected for women aged 65 in 2040. That said, the most recent set of projections, Europop 2023 like Europop 2018, differs from previous projection rounds in that upward revisions in life expectancy estimates are limited to just women. For men the projections, in fact, suggests a small decline in longevity.

Chart 1 depicts estimates of life expectancy at 65 between 2003 and 2022. These estimates are based on actual mortality rates, rather than assumed ones as in the Europop projections. While it is clear that there is an upward trend in longevity, there is considerable volatility. For instance, in the last decade, life expectancy at age 65 fell or remained stable in four out of ten years. In the preceding decade, life expectancy was less likely to decline. Since 2003 male life expectancy at age 65 has improved by 3.6 years, whereas that for women has gone up by 3.4 years, but over the last decade the increases were just 0.9 and 0.6 years respectively. Over two decades, the gap between male and female life expectancy at age 65 in 2017 has fallen slightly and now stands at 2.8 years.

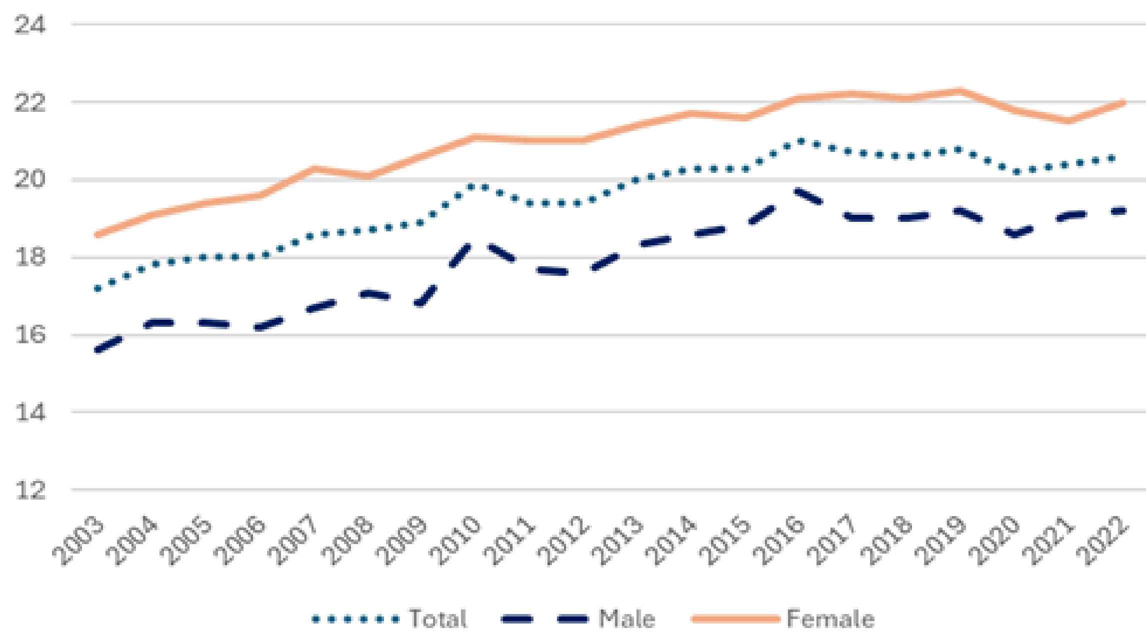

Figure 1: Life expectancy at 65 years.

While the projected improvement in life expectancy may have started to be partially reassessed, there is no denying that since the two-thirds pension scheme has been established the demographics underpinning the scheme have changed dramatically. Back in 1979, nearly 20% of men did not live to pension age, while 11% of women did not reach this age. In 2022, the proportions of those not surviving to pension age had fallen to 11% for men and to 6% for women. The proportion of a particular birth cohort that died at pension age in 1979 today survives till age 70. Moreover, while in 1979 those men who survived to pension age could look forward to 13.6 years receiving this benefit, on average, in 2022 the period in receipt of state pensions had risen to 22.3 years. For women the increase was from 16.9 years in 1979 to 23.7 years, and this despite that the pension age in 2022 was 3 years higher than in 1979.

Higher survival rates and longer life expectancy have also been accompanied by a better health status, till the pandemic struck. Chart 2 shows Eurostat data on healthy life expectancy at age 65 based on individuals' self-perceived health status. Based on individuals' own assessments of health, healthy life expectancy rose by over 3 years in the decade to 2019. This exceeds the improvement in life expectancy of around 2 years. However, following the pandemic healthy life expectancy fell by just under 3 years, on average. In fact, the proportion of life expectancy beyond age 65 that is spent in good health has decreased from 65% in 2005 to 64% in 2016 for men, and from 57% to 55% for women during the same period.

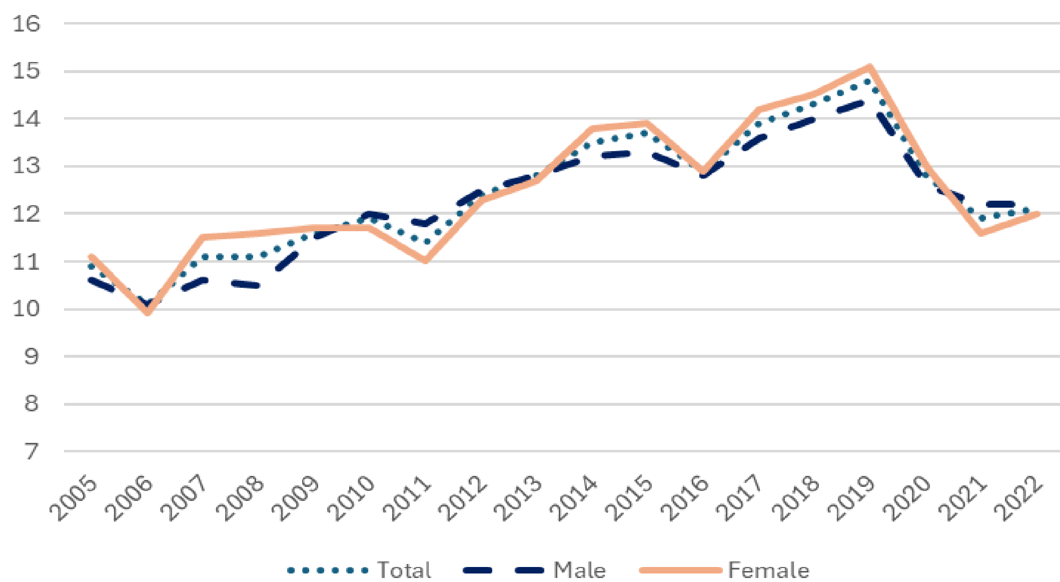

Figure 2: Healthy life expectancy at 65 years, based on self-perceived health.

The balance between years spent contributing and those receiving benefits

Given the increase in life expectancy, if the pension age is kept unchanged while the contribution requirement is held constant, the balance between years spent contributing towards and those receiving pension benefits inevitably drops. Table 2 presents estimates of how many years different cohorts of pensioners will have contributed for each year they can expect to receive a pension. Note that the data in the Table pertain to men (with data for women presented as an appendix to this report). The analysis is carried out till those born in 1978, as these would reach pension age in 18 years, meaning that they would get a 17-year notice period if a change affecting them were to be announced in the Budget for 2026.

Birth year	***Contribution years***	***Life expectancy at pension age***	***Pension age***	***Reached in***	***Balance of years***
1959	35	20.4	64	2023	1.72
1960	35	20.5	64	2024	1.71
1961	35	20.6	64	2025	1.70
1962	40	20.0	65	2027	2.00
1963	40	20.1	65	2028	1.99
1964	40	20.2	65	2029	1.98
1965	40	20.3	65	2030	1.97
1966	40	20.4	65	2031	1.96
1967	40	20.5	65	2032	1.95
1968	40	20.6	65	2033	1.94
1969	41	20.7	65	2034	1.98
1970	41	20.8	65	2035	1.97
1971	41	20.9	65	2036	1.96
1972	41	21.0	65	2037	1.95
1973	41	21.1	65	2038	1.94
1974	41	21.2	65	2039	1.93
1975	41	21.3	65	2040	1.92
1976	42	21.4	65	2041	1.96
1977	42	21.5	65	2042	1.95
1978	42	21.5	65	2043	1.95[1]

Table 2: Balance of years spent contributing vis-à-vis receiving a pension (Men).

Those born before 1962 were required to contribute for 35 years to qualify for a full pension. They also had a lower pension age compared to those born after them. Consequently, these individuals will have contributed, on average, for just above 1.7 years for each year they can expect to be in receipt of a state pension. Following the increase in the contribution period to 40 years, the balance between contribution and pension receipt years was increased to very close to 2. This brought the ratio back to the conditions that had prevailed in 1979. In fact, when the two thirds pension

[1] Table is based on author's calculations using EUROPOP 2023 life table.

scheme was introduced, men who reached pension age could expect to live for 16.1 years, and since the contribution requirement at the time was of 30 years, this implied a ratio of 1.9 years contributing for every year receiving a pension.

The 2016 reform raised the contribution requirement for a full pension to 41 years for those born after 1968. As can be seen from Table 2, as a result this restores the balance of contribution years to pension receipt years to 1.98, nearly equivalent to the ratio seen for the first birth cohort with a pension age of 65. For those born in 1976, the ratio will be 1.96, following the decision to increase the contribution requirement to 42 years. For women, the ratio (refer to Appendix) will be 1.74 for those born in 1962, and to 1.72 for those born in 1969, and finally 1.71 for those born in 1976. Essentially every 7 years the contribution requirement has been increased by one year to maintain the balance between the period drawing a pension and the period contributing to it.

As can be seen from Table 1, if one keeps the contribution requirement at 42, it starts to fall for those born in 1977 and 1978. The legislation does not specify a precise ratio between contribution and pension receipt years but based on past practise this is a ratio that remains above 1.9. Current projections suggest that given the typical notice period given, there is no need in this pensions strategy review to announce a change in the contribution requirement.

Conclusion

The 2016 pension reform established a very important concept to ensure that Maltese state pensions remain adequate and sustainable across generations. Without embedding an explicit automatic mechanism in the legislation, it introduced a requirement that policymakers look at a very important system parameter – namely the ratio between the number of years one must contribute to qualify for a full pension and the number of years one can expect, on average, to receive a state pension. Thus, while allowing individuals to continue retiring at the same pension age, this provision ensures that to get a full pension, individuals will have to contribute in a similar proportion as earlier cohorts.

The 2006 pension reform had raised the contribution requirement for a full pension back to the proportion found in 1979, when the two-thirds pension scheme was introduced. Essentially to qualify for a full pension, one must contribute for just under two years for each year one can expect to get a pension. This was reaffirmed in the 2016 reform and in the Budget for 2025, in view of the rise in life expectancy.

This paper, while reviewing more recent life expectancy projections, finds that every seven years one needs to increase the contribution requirement by one year. However, given the recent changes, and the necessity of having a notice period close to that of previous reforms, there is no need to announce any changes in contribution requirements.

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Appendix

Birth year	*Contribution years*	*Life expectancy at pension age*	*Pension age*	*Reached in*	*Balance of years*
1959	35	23.5	64	2023	1.49
1960	35	23.6	64	2024	1.48
1961	35	23.7	64	2025	1.48
1962	40	23.0	65	2027	1.74
1963	40	23.2	65	2028	1.72
1964	40	23.3	65	2029	1.72
1965	40	23.4	65	2030	1.71
1966	40	23.5	65	2031	1.70
1967	40	23.6	65	2032	1.69
1968	40	23.7	65	2033	1.69
1969	41	23.8	65	2034	1.72
1970	41	23.9	65	2035	1.72
1971	41	24.0	65	2036	1.71
1972	41	24.1	65	2037	1.70
1973	41	24.2	65	2038	1.69
1974	41	24.3	65	2039	1.69
1975	41	24.4	65	2040	1.68
1976	42	24.5	65	2041	1.71
1977	42	24.6	65	2042	1.71
1978	42	24.7	65	2043	1.70[2]

Table 3: Balance of years spent contributing vis-à-vis receiving a pension (Women).

[2] Table is based on author's calculations using EUROPOP 2023 life table.