

***COMMENTS ON THE WHITE PAPER***

***“PENSIONS: ADEQUATE AND SUSTAINABLE”***

***ALTERNATTIVA DEMOKRATIKA – THE GREEN PARTY***

***ECONOMIC POLICY WORKING GROUP***

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## EXECUTIVE SUMMARY

Pension reform is one of the most serious challenges that our country faces, and one that will be met with considerable resistance and scepticism. Whilst there exist a vast array of solutions as to how our pension system can be reformed to remain adequate and sustainable, arriving at a decision as to which solutions are to be adopted and implemented is one that has serious economic and social implications and in our opinion requires a political mindset that our country does not, as yet, have.

Our report first deals with a number of issues that should be tackled in order to mitigate the effects of the reform. In particular we recommend that,

- ❑ Social policy in regard to families is designed to contain and perhaps reverse demographic trends; particularly the serious fall in the birth rate.
- ❑ A serious system of checks and balances is in place to ensure compliance and tackle fraud and evasion.
- ❑ Economic policy is devised to lower the level of public service / public sector employment so that more public funds can be released for welfare programs.
- ❑ Measures are taken to contain the increase in housing costs, which costs are not allowing many young families to save, and could effectively prevent them from contributing to a mandatory second pillar contribution scheme.
- ❑ A proper functioning, efficient and reliable public transportation system will enable less investment in private transportation. Funds released can be applied to second pillar contributions.
- ❑ Should there be the need, properly regulated financial methods are explored to enable pensioners to supplement their pensions through the release of equity on their real estate in the form of cash sums.
- ❑ The participation rate in the labour market of women must be increased in order to alleviate the growth in the welfare gap.
- ❑ Government should engage in a constructive dialogue in order to establish a socially sustainable and economically sound immigration policy that is aimed primarily at filling various skills-gaps in the labour market.
- ❑ Government should explore the possibility of establishing a fund at the outset of the reform in order to have a “cash cushion” to cope with unforeseen changes in demographics. We recommend that the funds should be made available from part of the sale of government’s agricultural land to tenant farmers for agricultural use only.

- A reform in the country's rent laws will re-build a rent market and provide supplementary rental income to landlords. The receipt of a market or close-to-market rent by landlords will make a significant portion of the country's population less dependent on state pensions.

In regards to the recommendations made in the White Paper, we comment as follows:

- As a pre-requisite to our further participation in the debate on pension reform, government and opposition must declare that the state will remain the ultimate guarantor of decent standard of living for all pensioners. We wish to see this principle enshrined in Malta's constitution.
- Until the age of 65, persons should be obliged to contribute to the welfare state, including pensions, via social security contributions. The de facto retirement age will gradually rise to 65 as delineated in the White Paper.
- However an option to take early retirement at age 63 for all, and at age 60 for those whose trade entails significant manual effort will be available. However first pillar contributions must be paid until the attainment of age 65.
- The basis of full entitlement to pensions should be 35 years, not 40 as in White Paper.
- We agree with the gradual introduction of second pillar contributions, except for those persons earning below an established amount, whose income is too low to enable mandatory savings. Supplementary pensions for these people are to be paid out of the consolidated fund and should be financed through an increase in Value Added Tax on certain luxury goods.
- For extraordinary cases in which there is a risk of poverty, drawdowns from the second pillar pensions funds should be allowed.
- We agree with inflation indexing in order to maintain the value of pensions, however we suggest it would be wise to work this out on an inflation index that is particular to the life-style and spending patterns of pensioners, in order to give more weighting to particular items of expenditure like medicines that are prone to high levels of inflation
- The contributions of the self-employed should be equalized to those of the employed at 20%, and in order to ensure parity in the fiscal effects of such contributions, half the contributions paid by the self-employed should be tax deductible.
- We agree that part of the social security contribution is allocated to healthcare.
- We agree that people should be allowed to work beyond retirement age without their pension entitlements being effected.
- We recommend the immediate abolishment of excessive and heavily punitive bureaucracy that sometimes denies people their pension due to late or faulty application.

# 1. INTRODUCTION

*Alternattiva Demokratika* – **The Green Party** recognises that due to changes in demographics, lifestyle and longevity, as well as other factors primarily arising from the effects of globalisation, a reform in the country’s pensions is required in order to ensure a sustainable and adequate level of pension funding for future generations. It is for these reasons that we are desirous to participate in the reform, to which we are presenting our comments to the White Paper entitled “Pensions: Adequate and Sustainable.”

Our report is structure in two sections. The first, entitled “Mitigating Factors” is an analysis of a number of policy issues that are either not addressed or insufficiently addressed in the White Paper. We believe that development of policy on these factors can lead to containing or reducing the overall economic, financial and social effects emanating from pension reform.

The second section contains a number of comments and recommendations on the proposals outlined in the White Paper. We do not consider our recommendations to be, in any way, exhaustive or complete. However we feel that our initial contribution is sufficient to build a structured and constructive dialogue on a reform of this importance and magnitude.

*(We welcome the White Paper presented to Parliament in November 2004 prepared by the Pensions Working Group (PWG). Despite the reservations we have to a number of recommendations made in the report and some omissions to which we have made mention to in our report, we appreciate the restrictions faced by the same PWG due to the limitations imposed on it due to its terms of reference as well as the inherent uncertainties faced when attempting to chart a future which can only be forecast. In all other respects we congratulate the PWG for their efforts and look forward to further cooperation with the Group in order to attain a reform that is not only adequate and sustainable, but also politically acceptable and socially equitable)*

## **2. RESERVATIONS**

The Green Party wishes to express a number of reservations:

### **2.1 Political**

At the outset we wish to express our concern that at the date of presentation of this report to the Pensions Working Group (30<sup>th</sup> April 2005) it seems that neither the Nationalist Party (PN) nor the Malta Labour Party (MLP) have presented their formal reactions to the White Paper. We believe that this behaviour is irresponsible in view of the magnitude of the challenge presented by pension reform.

Despite this state of affairs, the Green Party in keeping up with its tradition of policy openness and political correctness, as well as sticking to our unconditional belief in collaboration, consensus and consultation, has still chosen to publish its initial reaction to the White Paper. We take full political responsibility for our comments and suggestions

### **2.2 Limitation of Scope**

Whilst we appreciate the terms of reference of the Pensions Working Group, we take note of the fact that it is difficult for anyone to make comprehensive and balanced commentary on the proposed reforms in pensions presented in the White Paper, without knowledge as to how Healthcare will eventually be reformed. In the light of such we are making our suggestions on the assumption, albeit unlikely, that apart from Pensions' reform, other major welfare programs like Healthcare (as well as Education) are to remain static.

### **3. MITIGATING FACTORS**

The Green Party is hereunder outlining a number of issues as well as related suggestions that will have a mitigating effect on the social and economic consequences of the proposed pensions' reform. We are making these suggestions not as a substitute to the reform in pensions but in addition to. We believe that if these recommendations are taken up, the eventual economic and financial consequences of the reform can be better met, thus improving the well being of individual pensioners as well as the country's finances.

#### **3.1 Demographics**

The report delineates the expected changes in demographics that will consequentially have a significant impact on the sustainability and affordability of our current pensions system. The Green Party notes that in recent weeks conflicting reports have been quoted in local newspapers indicating that Malta's population is actually set to increase to half a million, contrary to the Pensions' report that quotes a declining population. Such confusion must be clearly ironed-out in the short term to remove any doubt as to whether the country's population is set to increase or decrease. The Green Party believes that the Pensions' report is correct in assuming that at current trends Malta's population will decrease.

Having said this the Green Party believes that both social and economic policy should be directed to tackle these expected shifts in demographic patters. We note, that apart from other factors, the rationalising of the "children's allowance benefit" could have contributed to the shrinkage of the average size of the Maltese family. The Green Party advocates a more thorough review of social policy regarding families and children in order to reduce the severe constraints people are facing to both have and raise children. We note further that the country's tax system does not operate in a way as to provide direct fiscal benefits to tax payers with children.

Apart from a general review of the country's welfare provision regarding child rearing, the Green Party specifically advocates that Malta's welfare system should

provide an immediate cash benefit to families who have just had children, which benefit is aimed at meeting the costs of early rearing as well as providing a “cash cushion” to mothers who choose to give up employment permanently or temporarily. The benefit, which could be subject to means testing, should increase for larger families.

Further we encourage more investment in child-care facilities so that having children becomes more of a personal choice rather than a financial decision. If Malta is able to reverse even a little of the demographic trend that continental Europe is expecting in the next 50 years, the reforms thence needed will be less onerous on the population and the state. **Demographic trends can be affected through social, economic and fiscal policy.**

### **3.2 Compliance / Anti-Fraud / Tax Compliance / Means Testing**

All welfare reform must be based on the principles of equity, solidarity and reciprocal duty. Without a reliable enforcement system any reform will not win the support of the public. The political goodwill to stamp-out abuse is a pre-requisite towards building a modern welfare system that is efficient, reliable and trustworthy.

We note, with satisfaction, that the White Paper makes due mention of the need to combat abuse. The Green Party has time and time again made reference to the importance of eliminating abuse and fraud of our welfare systems, particularly in areas like children’s allowance, sick leave and disability benefits. We also note that retirement pensions are the area of welfare in which there is least abuse, however retirement pensions are just one area of a larger and more complex welfare system that needs to have a proper checks and balances system to ensure fairness, efficiency and effectiveness. The Green Party believes that compliance procedures should be able to work into the past of an abuser – back investigations are necessary in order to determine the correct number of people entitled to each particular benefit. **No amnesty should ever be granted to welfare abusers.**

Further, government's current drive to improve tax compliance should be strengthened and consolidated in order to ensure that the progressive element in our tax system is maintained. However we cannot over-emphasise the importance of the practice of value-for-money principles and outright thrift in government ministries so that the burden of taxation does not grow more than the forecast nominal growth rate of the Maltese economy.

Means-testing mechanisms for the evaluation of entitlement to welfare benefits (apart from pensions) should be further explored, in order to rationalise and efficiently allocate resources. In particular we refer to cases of wealthy welfare beneficiaries who have managed to escape the payment of high national insurance contributions throughout their working life apart from the last ten years.

### **3.3 Public Sector Employment**

Public expenditure in Malta unfortunately carries the weight of an over-burdened public sector. This situation has been brought about mainly due to the absurd level of political patronage fostered by the two large political parties over the past 35 years. This major item of expenditure, totally over Lm 200 million, has meant that the amount of resources going to welfare programs is clearly limited.

Government should endeavour to reduce the level of public employment in certain sectors through measures that are not limited to the type of early retirement schemes witnessed recently in a number of public sector enterprises. In order to reduce public sector employment the growth rate in the private economy must increase substantially, so that employment gradually shifts from public to private sector. When less public funds (as a percentage of both government expenditure and Gross Domestic Product) are required for public employment, more funds can be channelled into welfare, particularly to finance retirement pensions.

### **3.4 The Cost of Housing and Transportation**

The Green Party notes that the cost of private housing and private transportation in Malta, "eat away" a very significant portion of personal disposable income; in some

cases up to 25% and 15% of disposable income respectively. This situation has come about because whilst earnings in Malta remain much lower than those in Western Europe the cost of housing has risen to levels in many Western European towns. Further the absence of an efficient, comprehensive and reliable public transport system means that at least one motor vehicle (and in many cases 2) per family is an essential. These items of expenditure are ever on the rise, and should the correct policies be in place, it will be possible to contain (if not lower) the burden of these two categories of expenditure so that more funds can be put aside for retirement pensions through the second pillar system.

### **3.5 Patterns of Savings and Stores of Wealth**

The White Paper does not deal in sufficient manner with the nature of savings of the Maltese. The Green Party notes that many families have channelled a significant portion of their savings into their home in the form of bank loan repayments. As a result, a large portion of people's wealth is maintained in real estate that simply cannot release any liquidity except on disposal. In the light of such and recognising the economic and cultural realities faced by the pensions reform, the Green Party encourages government to explore various financial instruments that could allow pensioners to draw-down cash sums on the basis of their home equity in order to allow them to supplement their pensions. We stress the importance of building a rigid and reliable regulatory regime to monitor these financial schemes in order to protect people from ruthless speculation and/or outright abuse.

### **3.6 Participation Rates**

Together with much of civil society we recognise the importance of increasing workers' participation rates within the labour market – in particular the participation rate of women that is still very low particularly in relation to other countries within the European Union. The importance of raising these participation rates cannot be over-emphasised; therefore social policy in this regard must be strengthened and consolidated.

### **3.7 Immigration Policy**

We encourage government to establish an economically sustainable and socially inclusive policy on immigration both for persons within the European Union and without. As expressed in other countries within the European Union, immigration is one solution to containing the shifting demographic trends expected over the next fifty years, particularly to reverse the decline in birth rates and specifically to fill existing and prospective skills gaps within our workforce. The absence of a workable policy in this regard is contributing to a growth in the black economy, rampant abuse of the rights of illegally employed workers and a shortage in social security contributions since many illegal workers do not contribute to state coffers.

### **3.8 Establishing a Fund**

It may be wise at the reform state to re-establish an initial pension fund that can be tapped into in order to cater for shifts in demographics that are not being forecast at this stage. As stated in various other fora, the Green Party believes that a stock of wealth exists in agricultural land in Malta a substantial portion of which is still owned by government. We have recommended, time and time again, that this land be sold off to tenant farmers for agricultural purposes only. A portion of the proceeds can be allocated to the establishment of this fund.

### **3.9 Rent Reform**

As stated many-a-time by the Green Party a reform in the country's rent laws will enable a more efficient and more equitable use of the country's resources. In particular, the reform of the law will allow a fairer yield to be received for many rented properties. The receipt of a market or close-to-market rents by landlords, will make a significant portion of the country's population less dependent on state pensions.

## **4. RECOMMENDATIONS**

Our comments on the proposal of the Pensions' White Paper are as follows,

### **4.1 Guarantor of Pensions**

Whilst agreeing with the principle of self-help and the need to split the responsibility for pensions between individual and state, the Green Party demands that the ultimate responsibility for the protection of pensioners from the risk of poverty must remain that of the state. We wish to see this principle enshrined in Malta's constitution.

### **4.2 Retirement Age**

We recognise the need to increase the age at which one is entitled to retire and receive a pension. However we are making the following recommendation that introduce some changes from the proposals made in the White Paper.

- The principle that we wish to expound is that rather than 65 being the age of retirement, 65 should be the age until when everyone is obliged to contribute to the welfare state through social security contributions. This principle will obviously not apply to persons on disability benefit or the un-employed, however it will certainly apply to those who have the means and chose to take early retirement and live on their savings or from other un-earned income.
- The statutory retirement age is to increase to 65 gradually over a given period of time in similar fashion to that recommended in the White Paper.
- However the law will permit early retirement on a voluntary basis at age 63 for all and at age 60 for those whose trade entails significant manual effort that makes it physically and/or mentally impossible to continue working to age 65. However the payment of social security contributions out of these early retirement pensions will still be mandatory until the attainment of age 65.

## **4.4 Contribution Period**

The White Paper recommends that the basis for calculating the retirement pension be increased to a full 40 years of contributions. We agree that in order to reflect the full amount of contributions payable throughout one's life and to remove the opportunity for abuse by basing pensions on the last ten years of gainful employment, it is wise and equitable to take into consideration contributions payable over the length of one's working lifetime. However we consider a period of 40 years to be too onerous. We recommend a period of 35 years, and suggest that the last ten years should be given a "heavier" weighting in the computation of pension entitlement to reflect the standard of living of a pensioner towards the end of the working life when presumably earnings tend to be higher than the average spread over a full working life.

## **4.5 Second Pillar Contributions**

We agree with the introduction of mandatory second pillar contributions with the following exceptions:

- ❑ Those earning below a pre-defined amount should be exempted because otherwise their standard of living will be eroded to the point where there is a serious risk of poverty. It is worthy to note that in the UK, the Stakeholder Pensions for those on low income proved to be unsuccessful.
- ❑ Supplementary pensions in lieu of those paid from second pillar contributions to those on low incomes (as explained above) must be paid out of the consolidated fund. We recommend that these benefits be funded through an increase in Value Added Tax on luxury goods.
- ❑ Full transferability from pre-existing life insurance policies and similar financial instruments should be facilitated.
- ❑ Sufficient flexibility must be built into the system to cater for periods of inactivity due to situations such as unemployment, further education, disability and child rearing.
- ❑ For extraordinary cases in which there is a risk of poverty, drawdowns from second pillar pension funds should be allowed.

- We agree that contributions under the second pillar should be tax deductible up to a certain limit, however we believe that any early drawdowns and pension receipts should be totally tax-free.

## **4.6 Inflation Indexing**

The White Paper makes reference to the maintenance of pensioners' spending power by linking the same pensions to the Retail Price Index. Whilst this measure will maintain spending power, we believe that a separate inflation index relating to the typical spending patterns of pensioners should be used. This index should be properly devised in order to take due regard and give proper weighting to expenditure items like medicines that typically bear inflation rates much higher than the average. Without such an index there exists a severe risk of a drop in the standard of living of pensioners.

## **4.7 Contributions of the Self-Employed**

There currently exists a significant difference in the national insurance contributions payable for the employed (10% + 10%) versus for those that are self-employed (15%). In order to render the system more equitable we advocate that the contributions are equalised at 20%, and thereafter the tax deductibility of half the contributions for the self-employed is allowed. This measure, which will increase contributions, should be introduced over a staggered period.

## **4.8 Healthcare Apportioning**

We agree that part of national insurance contributions is split and allocated onto healthcare, as this will ensure more transparency, clarity and accountability in the system. However, until the reform in Healthcare is presented we refrain from any further comment in this regard.

## **4.9 Working Beyond Retirement**

We agree that pensioners should be able to work beyond the retirement age without losing their entitlement to their pension, and we agree that First Pillar contributions should still be paid.

## **4.10 Eliminating Bureaucracy**

The current practice of denying people their right to a pension due to late or faulty application should be removed with immediate effect. All the existing complexity should be ironed-out in order to make pensioners independent of the client-patron system.

## **CONCLUSION**

The reform of a pension system is never any easy job, and in Malta where political partisanship is a fact of everyday life, the task promises to be formidable. We encourage the Pensions' Working Group to strive to build broad national consultation and consensus, through regular and frank communication with all stakeholders. Without such the reform will be short-lived, perhaps as short as one legislature. There is certainly no option to ignore the issue, and no luxury to delay it for too long. The country has an interest in the Group's success, because their failure is the country's loss. We wish them well!