

Pensions and the Youth



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Outline

2

- Why do pensions matter?
- Providing income for retirement:
 - The Role of the State
 - The Role of Private Provision
- Attitudes of Youth and Pensions
- Evolution of Pension Adequacy over a lifetime
- Role of Education and Labour Market Policies

Why do pensions matter?

3

Objectives of Pension Systems

4

- **Consumption smoothing**
 - One central purpose of retirement pensions is to transfer consumption from the productive middle years to the retired years;
- **Insurance**
 - A pension based on individual savings faces the person with the risk of outliving those saving or consuming very little. Voluntary pension arrangements are likely to be insufficient in view of concerns regarding the abilities of individuals to make the best out of market opportunities. Hence role for Government involvement.

Objectives of Pension Systems (2)

5

- **Poverty Relief**
 - Targets people who are poor on a lifetime basis and thus unable to save enough;
- **Redistribution (several forms)**
 - Lifetime redistribution: pay pensions to low-earners that are a higher percentage of their previous earnings;
 - Towards families: pay higher pension to a married couple than a single person;
 - Across generations: reduce contributions of present generations requiring future generations to pay higher rates.

Types of Pension Arrangements

6

- **Fully-funded schemes**

- Pensions are paid out of a fund built over a number of years. Based on savings as contributions are invested in financial (or other) assets and the return is credited to the scheme's fund;
- Can take many forms but in principle they always have sufficient reserves to pay all outstanding financial liabilities.

Types of Pension Arrangements (2)

7

- **Pay-as-you-go (PAYG) Pensions**
 - They are contractarian in nature – based on a promise from the state that if individual pays a contribution today, he will receive a pension in future. The state taxes the working population to pay the pensions of the retired generation;
 - With an ageing population, the revenue from social security contributions falls creating an upward pressure on the contribution rate, the level of pensions, or both.

Why do Pensions Matter?

8

- **Summarising:**
 - Societal Perspective: An Instrument of Social Solidarity
 - Individual Perspective: Provision for the twilight years

Providing income for retirement

9

Role of the State

10

- The State plays a strong role in pension provision around the world though the form and the extent of state participation varies from country to country;
- The Social Security scheme was introduced in Malta in the post-war period and is regulated under the Social Security Act, Cap 318 of the Laws of Malta.
- Provides for two basic schemes:
 - The contributory scheme entitles persons ensured to social security benefits conditional upon fulfilling certain contributory conditions;
 - The non-contributory scheme provides assistance through a process of targeting.

The Contributory Scheme

11

- **Main Features**

- Contributions payable by all gainfully occupied persons between the age of 16 and their pension age;
- Contributions are paid on earnings subject to a ceiling (maximum pensionable income). In 2010 it stood at €17,115 i.e. around 20% higher than average wage;
- Relatively high coverage among labour force participants.

Main Features of the Contributory Scheme

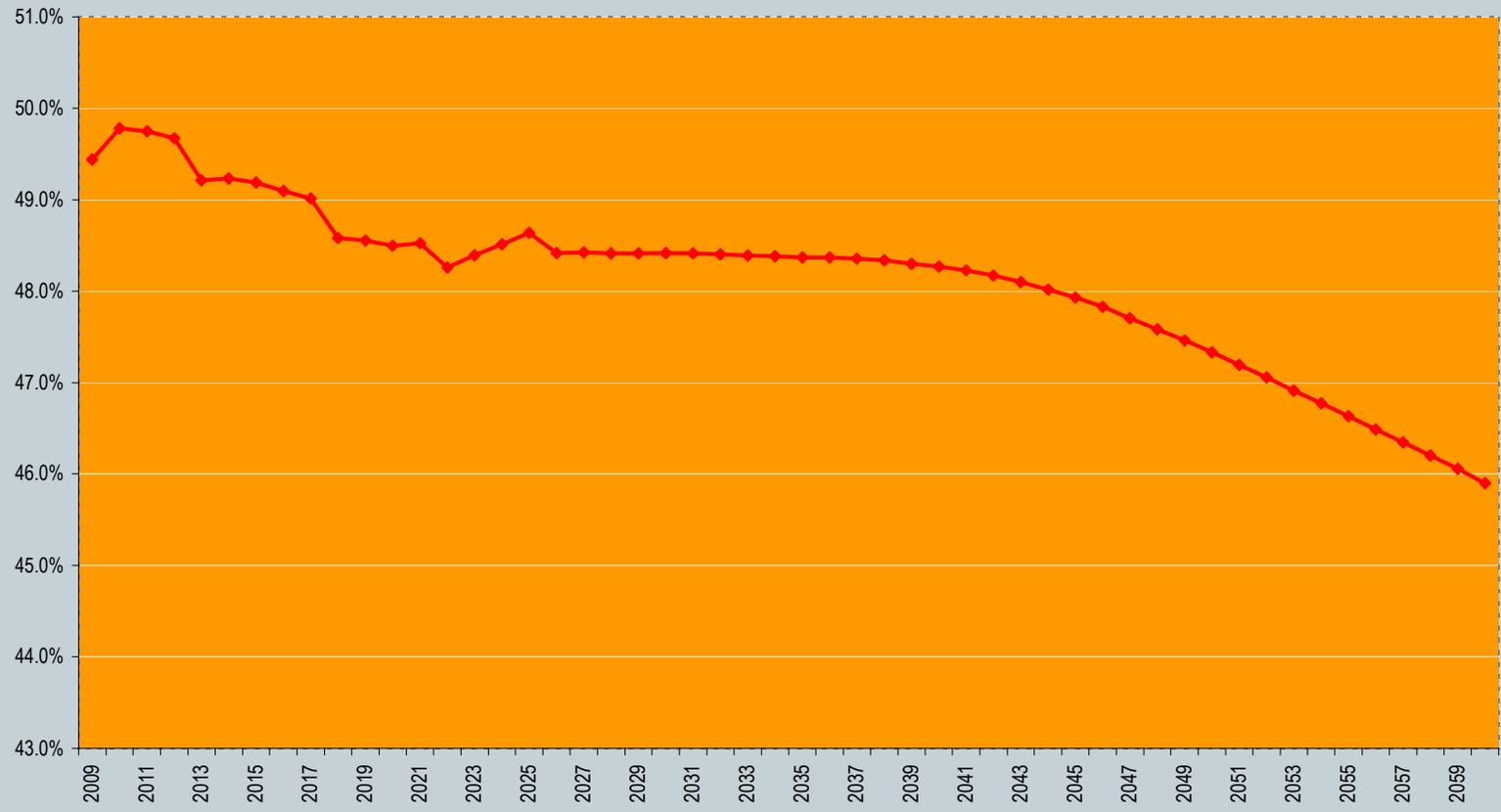
12

- Main features

- Persons employed under a contract of service pay Class One contributions. This consists of a tripartite contribution where the employee, the employer and the state each pay 10% of basic salary;
 - Self occupied persons are insured under the Class Two scheme and pay 15% of their annual income while the state tops-up by 7.5%.
- The House of Representatives formally adopted a series of parametric reforms in December 2006 (Act No XIX of 2006);
 - The reform reflected concerns affecting both adequacy and the sustainability of the pension system. These included changes to the pension age, pension formula, evolution of the maximum pensionable income, the guaranteed national minimum pension and pension indexation.

Current State of the PAYG Pension Scheme

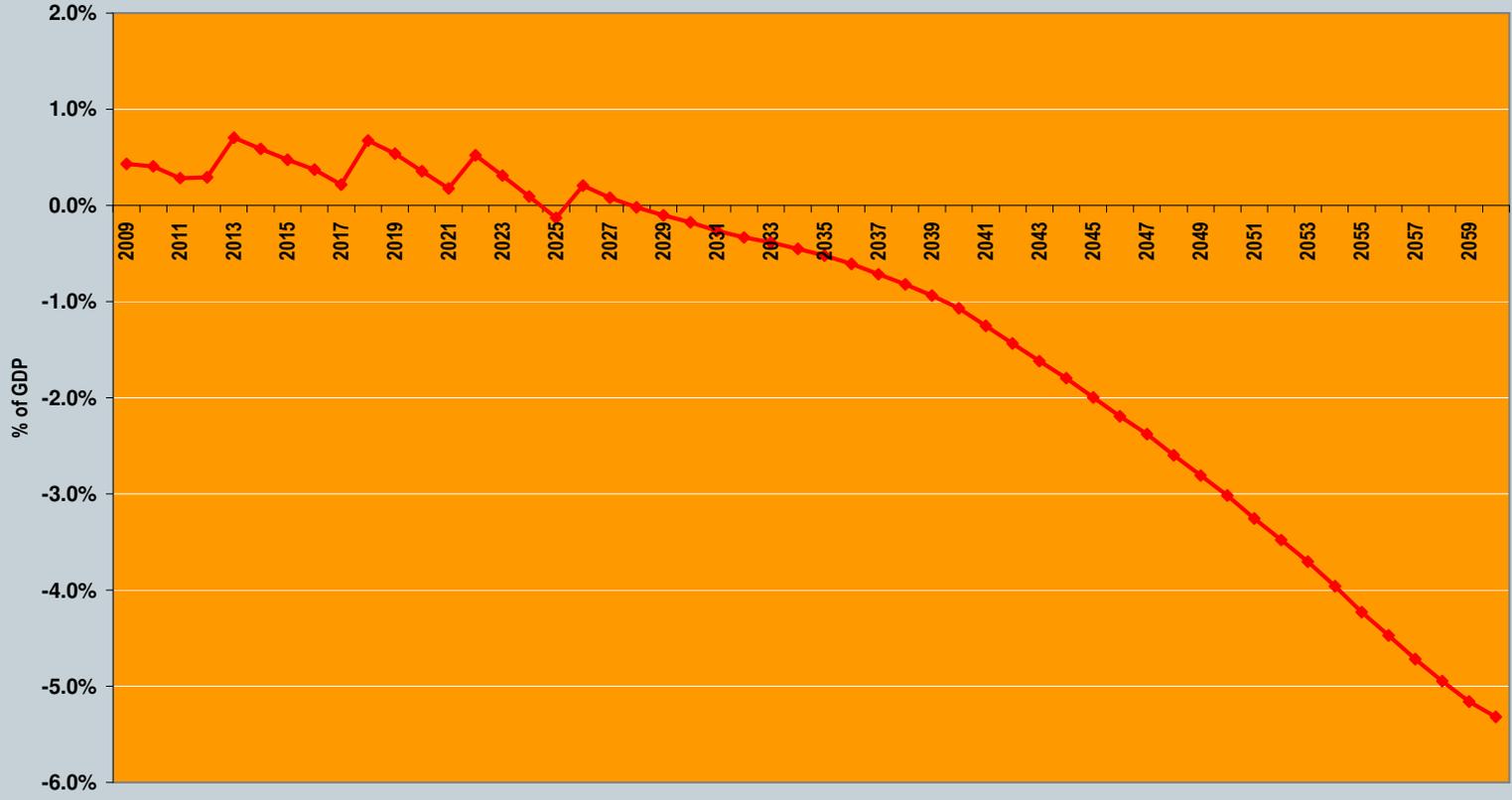
Avg Repl Rate for Existing 2/3 retirement pension



Source: PWG, World Bank

Current State of the PAYG Pension Scheme

PAYG Current Balance



Source: PWG, World Bank

Role of Private Provision

15

- In its report, the Pensions Working Group recommended that the minimum average replacement rate from the pension system should be *no less than 50%*;
- Consequently in view of the evident negative impact of the ageing on the balance of the state PAYG scheme, the PWG recommended that the Government should seek to introduce a Mandatory Second Pension at the earliest possible;
- Various forms of private provision
 - Occupational Pensions
 - Second Pillar, Defined Contribution Pension Schemes (Mandatory)
 - Third Pillar Products (various savings schemes)

Attitudes of Young People to Pensions and Retirement

16

Attitudes of Young Persons

17

- The Pensions Working Group commissioned the National Statistics Office (NSO) to carry out a survey directed to obtain an understanding of the public's perception of the pensions system;
- Survey carried out in September 2010;
- The target population for this survey consisted of Maltese residents living in private households aged 18 to 63.

Profile of Sampled Persons

18

Table 09: Distribution of Respondents by Sex and Age Group

Age group	Male		Female		Total	
	No.	%	No.	%	No.	%
18-24	57	17.6	49	15.9	106	16.8
25-34	63	19.8	60	19.2	123	19.5
35-54	137	42.6	138	44.6	275	43.6
55-63	64	20.0	63	20.4	128	20.2
Total	321	100.0	311	100.0	632	100.0

Table 10: Distribution of Respondents by Educational Level and Age Group

Age group	No schooling, pre-primary or primary		Secondary		Post secondary		Tertiary		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
18-24	-	-	48	17.2	49	32.0	10	9.5	106	16.8
25-34	4	4.2	48	17.4	28	18.2	43	42.0	123	19.5
35-54	37	36.8	136	49.1	62	40.8	40	39.2	275	43.6
55-63	59	59.0	45	16.3	14	8.9	10	9.4	128	20.2
Total	100	100.0	277	100.0	152	100.0	102	100.0	632	100.0

Percentage of persons expressing dissatisfaction rises as retirement age approaches.

Table 19: Potential Pensioners by Age Group and whether the Total Income from Pensions and other Investments will be Enough for them to Live Comfortably

Income from pensions and other investments sufficient for a comfortably living	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	30	30.4	22	19.5	42	20.9	11	22.2	105	22.8
No	44	44.4	66	59.3	118	58.9	31	62.1	259	56.2
Don't know	25	25.2	24	21.2	41	20.2	8	15.8	97	21.0
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Younger cohorts are attaching less weight to Government pension as a source of income provision, in contrast to older cohorts.

Table 25: Potential Pensioners by Age Group and Possible Sources of Income after Retirement

Sources of income	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Government pension	54	55.1	65	59.0	161	80.0	41	83.1	322	70.0
Private pension	13	13.3	20	18.4	14	7.2	1	1.3	49	10.5
Interests and other income from investments	12	12.2	6	5.8	4	2.1	2	4.7	25	5.5
Income from part time employment	9	9.4	5	4.2	4	1.9	1	2.0	19	4.1
Income from selling of property	-	-	1	1.1	7	3.3	-	-	8	1.7
Other	2	2.1	4	3.8	4	2.1	-	-	11	2.3
Don't know	8	7.9	9	7.7	7	3.3	4	8.9	27	6.0
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Preparedness for retirement

Table 29: Potential Pensioners by Age Group and whether they are Paying for a Life Assurance and / or Private pension which Covers them Personally

Paying for life assurance and/or private pension	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	20	20.2	53	47.6	88	43.9	16	32.3	177	38.4
No	79	79.8	58	52.4	113	56.1	34	67.7	284	61.6
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Table 35: Potential Pensioners by Age Group and whether they are Preparing Sufficiently for their Retirement

Preparing sufficiently for retirement	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	25	25.4	36	32.5	70	34.8	28	56.7	159	34.6
No	74	74.6	75	67.5	131	65.2	22	43.3	301	65.4
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Young persons and the retirement age

Table 43: Potential Pensioners by Age Group and whether they Agree that a Person should Retire from Work once he/she Reaches Retirement Age

Continue working upon retirement	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	26	26.0	27	24.4	47	23.4	14	27.8	114	24.7
No	71	72.0	78	70.6	147	73.0	31	62.1	327	71.0
Don't know	2	1.9	6	5.0	7	3.7	5	10.1	20	4.3
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Table 47: Potential Pensioners by Age Group and whether they Think they will Continue Working upon Reaching Retirement age

will continue working upon retirement age	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Continue working	53	53.2	49	44.3	90	45.0	35	70.0	227	49.3
Stop working	35	34.9	47	42.0	85	42.5	14	28.8	181	39.3
Don't know	12	11.9	15	13.7	25	12.5	1	1.3	53	11.5
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Young persons and the retirement age

Table 51: Potential Pensioners by Age Group and Choice on when and whether to Retire

	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Retire and receive a pension	38	38.2	61	54.9	97	48.1	21	41.6	216	46.9
Do not retire, continue working and receives a pension	58	58.4	45	40.6	95	47.4	28	56.4	226	49.1
Don't know	3	3.5	5	4.5	9	4.4	1	2.0	18	4.0
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Table 59: Potential Pensioners by Age Group and whether they Think that Retirement Age should Increase to More than 65 Years

Think that retirement age should increase	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Yes	12	11.8	2	1.8	7	3.5	2	4.0	23	4.9
No	85	85.8	107	96.6	191	95.2	42	84.7	425	92.4
Don't know	2	2.5	2	1.6	3	1.3	6	11.2	13	2.7
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Proportion of persons agreeing strongly with having a private pension decreases with age.

Table 61: Potential Pensioners by Age Group and Opinion of having a Private Pension apart from the Government Pension

Opinion of having a private pension	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Strongly agree	32	32.4	30	26.8	44	21.7	14	28.8	120	26.0
Agree	43	43.2	45	40.4	101	50.4	26	53.3	215	46.7
Neither agrees or disagrees	15	15.5	17	15.6	20	9.9	1	2.0	53	11.6
Disagree	6	6.0	14	12.5	23	11.2	3	6.5	46	9.9
Strongly disagree	1	1.0	-	-	10	4.8	1	2.0	12	2.5
Don't know	2	1.9	5	4.8	4	1.9	4	7.3	15	3.2
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Issues related to System Design

Table 67: Potential Pensioners by Age Group and Opinion on who should Manage these Schemes

Opinion on who should manage these schemes	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
The Government	61	61.3	73	66.0	125	62.2	33	66.8	292	63.4
A private entity	26	26.8	32	28.9	45	22.3	8	15.9	111	24.2
Someone else	7	7.5	1	1.1	23	11.6	3	6.7	35	7.7
Don't know	4	4.4	5	4.1	8	3.9	5	10.6	22	4.8
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Table 64: Potential Pensioners by Age Group and Opinion on whether these Schemes should be Voluntary or Obligatory

Schemes should be voluntarily or obligatory	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Voluntarily	72	72.6	87	78.6	168	83.8	34	68.4	361	78.5
Obligatory for everyone	24	24.0	20	18.4	27	13.3	13	26.9	84	18.3
Don't know	3	3.4	3	3.0	6	2.9	2	4.7	15	3.2
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Awareness on the state of the PAYG

Table 57: Potential Pensioners by Age Group and Perception of the Current Financial Social Security System

Current financial social security system	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Facing a big financial crisis	6	5.8	19	16.9	19	9.7	5	10.8	49	10.7
Facing a financial crisis	28	28.7	27	24.1	61	30.4	17	33.8	133	28.9
Has some financial crisis	45	45.3	48	43.0	75	37.3	9	18.0	176	38.3
Does not have any financial problems	9	8.7	9	7.7	19	9.3	4	8.6	40	8.7
Don't know	11	11.4	9	8.3	27	13.3	14	29.0	62	13.4
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Table 74: Distribution of Potential Pensioners by Age Group and Opinion on whether the Social Security Contribution should Increase to Cover the Pensions

Opinion on the increase in the social security system	18-24		25-34		35-54		55-63		Total	
	No.	%	No.	%	No.	%	No.	%	No.	%
Strongly agree	3	3.2	3	3.1	4	2.1	3	6.1	14	3.0
Agree	26	26.1	32	28.6	46	23.1	11	22.1	115	25.0
Neither agrees or disagrees	25	25.5	22	19.9	35	17.2	5	10.1	87	18.9
Disagree	34	34.8	46	41.3	92	45.6	23	46.4	195	42.4
Strongly disagree	7	7.0	8	7.1	19	9.3	3	6.1	36	7.9
Don't know	3	3.5	-	-	5	2.7	5	9.2	13	2.9
Total	99	100.0	111	100.0	201	100.0	50	100.0	460	100.0

Evolution of Pension Adequacy over a Lifetime

27

Pension Adequacy and the Need to Save

28

- One important policy question is whether a person should be compelled to save or whether he\she should be left free to determine the amount of savings;
- The PWG recommended that pension savings should be *mandatory*;
- This reflects economic thinking that has its origins in behavioural economics.

Behavioural Economics

29

- Although traditional economics suggests that people make decisions on the basis of rational assessments, in reality the difficulty of making financial decisions often leads to individuals not acting at all, leading to *undersaving*;
- People may realise they should save for retirement but lack the willpower to change their behaviour appropriately;
- People often live for today and struggle to see what their future needs might be;
- This is reinforced by the fact that people often don't understand that inflation can erode the value of any money they have 'under the mattress'.

Stylized Example 1

30

Characteristics

- Male
- Aged 24 in 2010
- Planning to retire at age 65 years
- High Earning Individual (200% of Average Wage)
- 1 Year Post-grad break

Financial Results

Initial Replacement Rate in Terms of Average Wage	60.0%
Initial Replacement Rate in Terms of Individual's Last Wage	23.0%
Replacement Rate at Death in Terms of Average Wage	51.8%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Stylized Example 2

31

Characteristics

- Female
- Aged 24 in 2010
- Planning to retire at age 65 years
- High Earning Individual (200% of Average Wage)
- 3 year break (child rearing or Phd)

Financial Results

Initial Replacement Rate in Terms of Average Wage	60.0%
Initial Replacement Rate in Terms of Individual's Last Wage	26.9%
Replacement Rate at Death in Terms of Average Wage	50.8%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Stylized Example 3

32

Characteristics

- Male
- Aged 22 in 2010
- Planning to retire at age 65 years
- Average Earning Individual
- 1 year break (Post Grad)

Financial Results

Initial Replacement Rate in Terms of Average Wage	59.2%
Initial Replacement Rate in Terms of Individual's Last Wage	54.5%
Replacement Rate at Death in Terms of Average Wage	52.2%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Stylized Example 4

33

Characteristics

- Female
- Aged 22 in 2010
- Planning to retire at age 65 years
- Average Earning Individual
- 5 year break (Studies and Child Rearing)

Financial Results

Initial Replacement Rate in Terms of Average Wage	55.0%
Initial Replacement Rate in Terms of Individual's Last Wage	58.5%
Replacement Rate at Death in Terms of Average Wage	47.2%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Stylized Example 5

34

Characteristics

- Male
- Aged 18 in 2010
- Planning to retire at age 65 years
- Low Earning Individual (60% of average wage)
- 3 year break (studies and unemployment)

Financial Results

Initial Replacement Rate in Terms of Average Wage	48.4%
Initial Replacement Rate in Terms of Individual's Last Wage	62.6%
Replacement Rate at Death in Terms of Average Wage	42.9%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Stylized Example 6

35

Characteristics

- Female
- Aged 18 in 2010
- Planning to retire at age 65 years
- Low Earning Individual (50% of average wage)
- 4 year break (studies\unemployment\child rearing)

Financial Results

Initial Replacement Rate in Terms of Average Wage	44.1%
Initial Replacement Rate in Terms of Individual's Last Wage	62.6%
Replacement Rate at Death in Terms of Average Wage	38.3%

Note: Figures are presented for illustrative purpose only

Source: PWG, World Bank

Case for Further Savings

36

- In view of the illustration of developments in the level of adequacy outlined above it is evident that there is a strong need for further savings in order to enable retired persons to retain a decent standard of living in retirement;
- For illustrative purposes we will be presenting the accumulated savings in a funded account under different assumptions on rates of return and contribution rates.

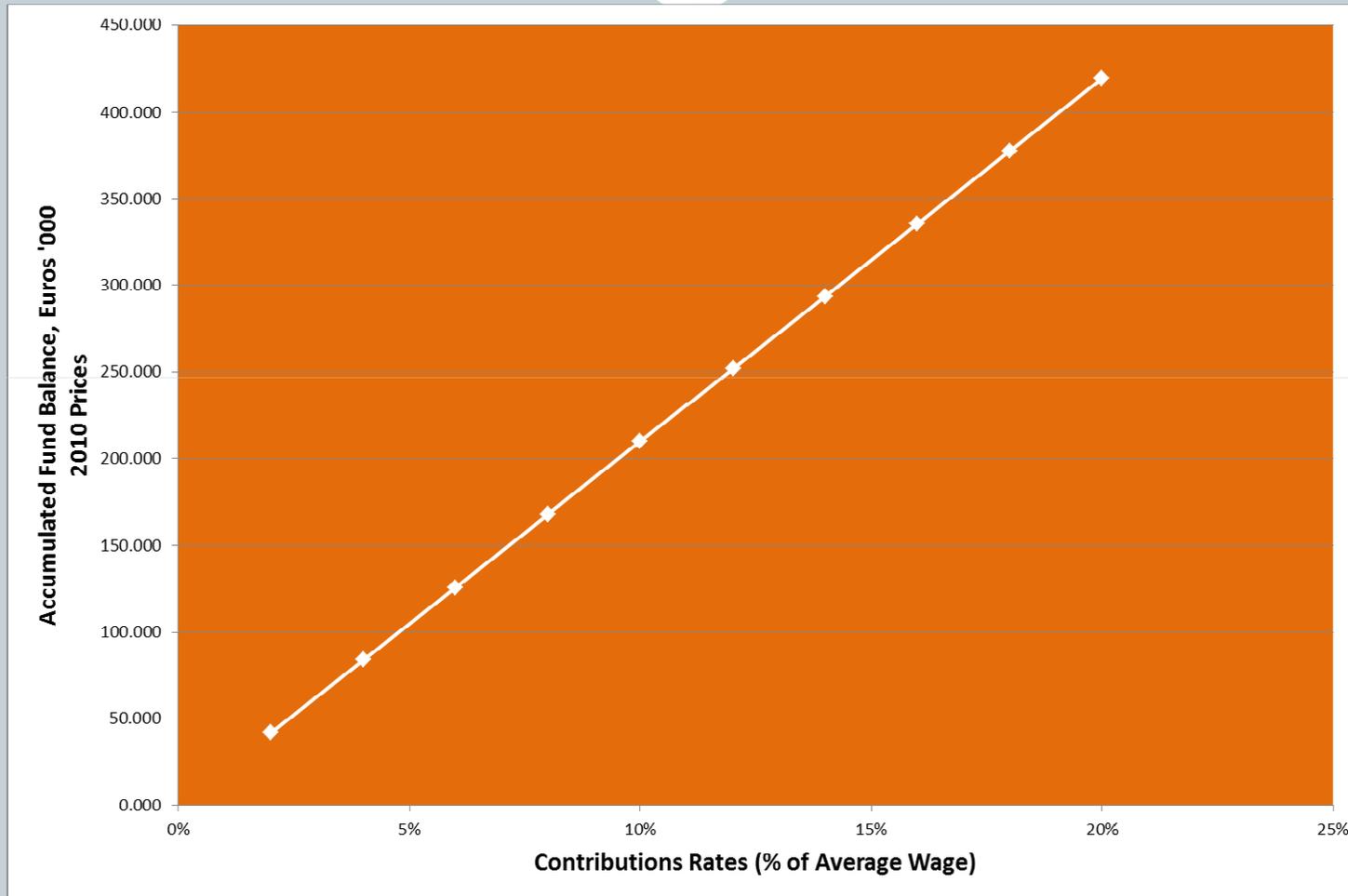
Assumptions

37

- Assume that individual earns the average wage throughout his\her working life.
- Individual starts working in 2010 at age 25 and retires in 2050 at age 65
- Figures are presented in terms of 2010 prices;
- In reality, the rates of the fund's rate of return reflect the developments in the financial markets and are therefore subject to a significant degree of uncertainty;

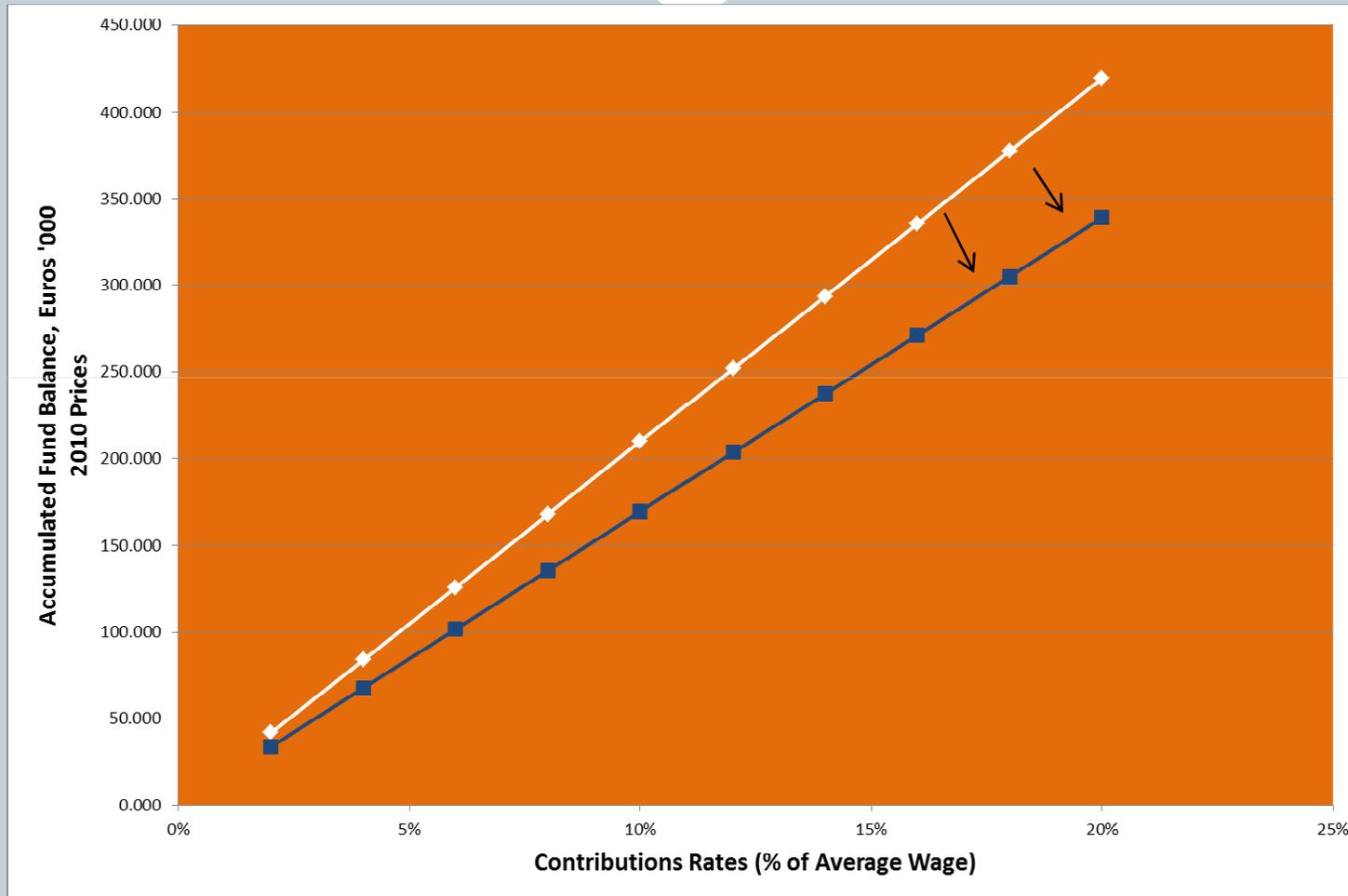
Accumulated Savings (Nominal Rate of Return: 6%)

38



Accumulated Savings (Nominal Rate of Return: 5%)

39



Case for Further Savings

40

Retirement income can be provided by:

- **An annuity** - providing a guaranteed income for the rest of your life
- **Income drawdown** – after a lump sum the remaining pension is invested and you simply take an income directly from it
- How would these accumulated sums translate into an annuity payment over period in retirement?

Illustration: Annuity Pay-outs

41

Conventional annuity rates are for a pension of £100,000 after the tax free lump sum of £33,333 has been taken.

Level annuity rates					
Male Single Life			Female Single Life		
Male 55	£5,534		Female 55	£5,269	
Male 60	£6,084		Female 60	£5,704	
Male 65	£6,745		Female 65	£6,228	
Male 70	£7,407		Female 70	£7,000	
Male 74	£8,494		Female 74	£7,887	
Level annuity rates + 10-year guarantee					
Male Single Life			Female Single Life		
Male 55	£5,496		Female 55	£5,246	
Male 60	£6,025		Female 60	£5,666	
Male 65	£6,639		Female 65	£6,144	
Male 70	£7,142		Female 70	£6,806	
Male 74	£7,970		Female 74	£7,536	
3% escalation annuity rates					
Male Single Life			Female Single Life		
Male 55	£3,642		Female 55	£3,360	
Male 60	£4,129		Female 60	£3,756	
Male 65	£4,763		Female 65	£4,307	
Male 70	£5,606		Female 70	£5,118	
Male 74	£6,598		Female 74	£5,996	

Illustration: Annuity Pay-outs (2)

42

Conventional annuity rates are for a pension of £100,000 after the tax free lump sum of £33,333 has been taken.

Level annuity rates + 50% spouse	
<i>Male + Female spouse joint rates</i>	
Male 55 and Female 55	£5,205
Male 60 and Female 60	£5,691
Male 65 and Female 65	£6,225
Male 70 and Female 70	£6,773
Male 74 and Female 74	£7,572
Level annuity rates + 100% spouse	
Male 55 and Female 55	£4,920
Male 60 and Female 60	£5,210
Male 65 and Female 65	£5,594
Male 70 and Female 70	£6,131
Male 74 and Female 74	£6,791
3% escalation annuity rates + 50% spouse	
Male 55 and Female 55	£3,309
Male 60 and Female 60	£3,718
Male 65 and Female 65	£4,241
Male 70 and Female 70	£4,966
Male 74 and Female 74	£5,778

Case for Further Savings

43

- The above examples illustrate the payouts from an annuity instrument over the retirement period;
- These sums may be adequate or otherwise depending on the aspirations of the individual;
- In any case, one notes the link between pension contributions and fund savings over the lifetime and the eventual payouts.
- Hence the higher the level of savings, the higher the standard of living afforded by the retired individual.

Concluding Points

44

- The system balance of the State PAYG is projected to worsen over the medium to long term as a result of population ageing;
- In the absence of increases in social security contributions, the attainment of an adequate and sustainable pension requires an increase in private savings;
- Such private savings could take form of mandatory funded defined contribution schemes.

Concluding Points

45

- Today's youths are likely to be strongly affected by these changes;
- Consequently the need to raise own savings is also strong, also in view of the rather modest payouts associated with annuity products.
- In addition, in view of the lengthening of working life, life-long learning and flexible working arrangements (including family-friendly measures) remain key to ensuring the sustainability of the social contract.