

## ALLOWING EARLY WITHDRAWALS OF KPST RETIREMENT SAVINGS IS NOT A GOOD POLICY

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Rising global energy and food prices have imposed a heavy burden on many households in Kosovo. As of March 2022, data from the Kosovo Agency of Statistics (KAS) show electricity tariffs have increased by almost 23 percent from a year ago. Transportation and food prices have also increased by about 18 and 14 percent, respectively. In response to this shock, a number of measures have been announced, including electricity subsidies, subsidies for agricultural inputs, wage bonuses, and temporary increases in pension benefits and social transfers.

But there are calls to do more. One proposal that has gained significant attention in policy debates, is to allow working age holders of accounts at the Kosovo Pension Savings Trust (KPST) to be able to withdraw up to 30 percent of their retirement savings. The rationale is to help households cope with inflation and help the economic recovery.

However, pension savings are intended to support living standards during retirement. Using these savings now will significantly erode the purchasing power of future pension incomes, increasing the probability that they might be insufficient to cover even basic consumption needs. Overall, our view is that the costs of allowing early withdrawals from KPST accounts outweigh the benefits, especially when the government has adopted other supporting measures to manage the impact of higher prices. Below we elaborate on our arguments.

### *Low KPST member account balances*

The majority of KPST members have low pension account balances that are not sufficient to ensure an adequate living standard after retirement. According to an IMF study completed in May 2021, more than 50 percent of KPST members under the age of 30 have account balances of less than €1000. Even 30 percent of those aged 60-64 (who are close to their retirement age of 65), have balances lower than €1000, and less than 50 percent of account holders in this age group hold balances of more than €5000. These relatively low balances suggest that more than 50 percent of those that will soon go into retirement will deplete their accounts within two years, while life expectancy at 65 is around 12 years.

To be clear: KPST is a very well-managed pension fund, and the low size of retirement savings can be attributed to several factors *beyond KPST's responsibility*. First, the contribution rate is only 10 percent (evenly split between employers and employees), substantially lower than the Western Balkans' average of 21 percent. Second, numerous workers have informal jobs, and thus, their contributions to pension accounts are limited and infrequent. Third, most KPST members have a short contribution history, because the system is still relatively young. Improving pension adequacy requires higher contribution rates and better contribution compliance. Allowing early withdrawals of pension savings will severely undermine the pension system.

### *A precedent with negative repercussions for the future.*

Early withdrawals also do not set a good example for the future. Most people still remember that during the pandemic, KPST account holders were *exceptionally* allowed to withdraw up to 10 percent of

their pension balances in December 2020. At the time, we [expressed concerns](https://www.imf.org/en/News/Articles/2021/03/23/mcs100820-kosovo-staff-concluding-statement-of-the-2020-article-iv-mission) <https://www.imf.org/en/News/Articles/2021/03/23/mcs100820-kosovo-staff-concluding-statement-of-the-2020-article-iv-mission> that this measure would undermine the pension system, as we thought that it could pave the way for similar measures in the future. The new proposal suggests our concern was justified. Moreover, allowing early withdrawals will only increase the size of future government spending. This is because the lack of private retirement savings will eventually put pressure on the government to increase the budget-financed basic pension or other benefits. In turn, this will result in less money for education, health, and public infrastructure.

#### *The current shock is different than the Pandemic*

In addition, the current economic difficulties are vastly different from the situation in 2020. First, the pandemic represented the most severe economic shock since Kosovo's independence, with the economy contracting more than 5 percent in 2020. Needless to say, the current increase in international food and energy prices will affect Kosovo's economy, but we believe that growth in 2022 will be positive. Moreover, the COVID shock negatively impacted both the supply and demand sides of the economy, and thus policy interventions to boost demand were more understandable. The current commodity price shock is a typical supply side shock. Higher transfers through early KPST withdrawals would have the side effect of further pushing up (already high) inflation.

#### *Why are pension savings mandatory?*

A frequently raised question is: Why does the government require mandatory contributions to build retirement savings? Or alternatively: Why cannot individuals withdraw from their KPST accounts, and transfer these funds to their bank or investment accounts? There are three reasons. First, individuals tend to underestimate how much savings they will need when they retire. A clear example of this is that even though the KPST allows the possibility of voluntary contributions of up to 15 percent and offers very good returns on investment, most contributors still choose to pay the minimum mandatory contribution rate. The second reason is that KPST savings are the largest building block of Kosovo's incipient domestic capital market. These savings are essential for government financing and as the capital market develops, they will also represent a financing pool for credit-worthy domestic private corporations. The third reason is that since Kosovo's capital market is still small, pension savings managed by KPST is currently the only available option for workers to effectively pool their longevity and investment risks and achieve a reasonable risk-adjusted return.

#### *Then, what should the government do?*

Rather than tapping pension savings, the impact of higher commodity prices on households should be managed instead through temporary and well-targeted fiscal policy measures. The size of measures announced so far is estimated at about 3 percent of GDP. These measures will alleviate much of the impact of rising living costs on households, considering that the projected impact of higher commodity prices on the value of food and energy imports is about 4.5 percent of GDP. As emphasized above, changes to pension policy, if anything, should aim at increasing the contribution rates and compliance to ensure enough that KPST account holders have sufficient savings for retirement.

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