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The 10% dilemma:

The benefits and drawbacks of the early withdrawal of pension savings

July 2020

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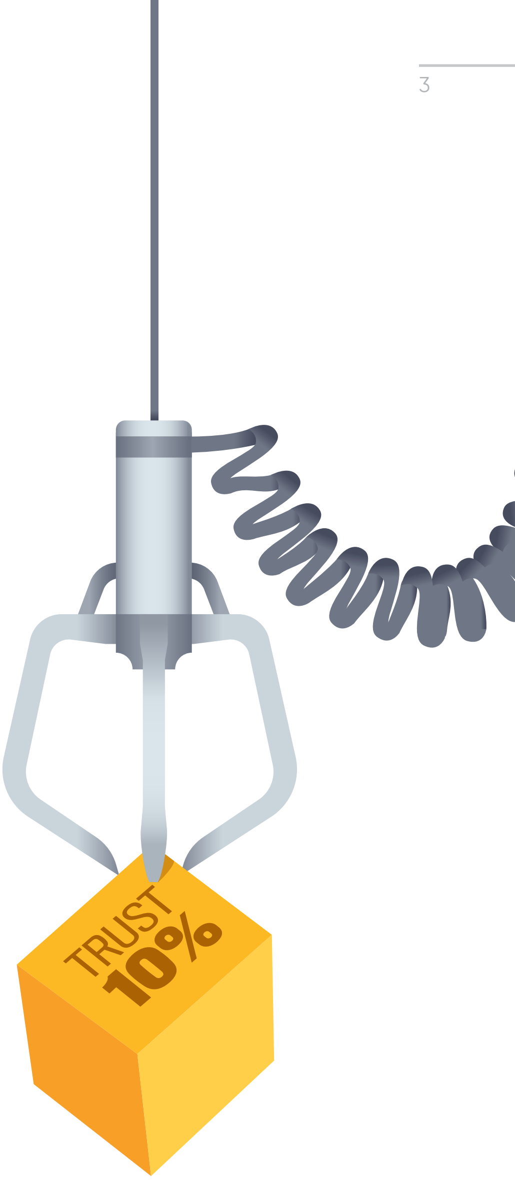
Executive Summary

To reduce the socio-economic consequences of the pandemic, the Kurti Government approved the Emergency Fiscal Package which contained 15 measures for immediate financial intervention in the wake of the pandemic.[1] In the months that followed, through a series of research, GAP Institute analyzed the impact of the Emergency Package on on the lives of Kosovo citizens,[2] focusing on unemployment[3] and fall of capital investments.[4] Shortly after that, the Hoti Government introduced the post-pandemic economic recovery program, aiming to provide support to the private sector and compensate for losses caused by the pandemic. However, the part of this program that attracted the most attention from citizens, is the one for increasing the aggregate demand, which will practically enable them to withdraw a part of their contributions from the Kosovo Pension Savings Fund (Trust).



Such a measure, albeit temporary, in addition to requiring legal amendments by the Assembly of Kosovo, requires a more in-depth analysis of immediate benefits and long-term consequences. Therefore, in this analysis, the GAP Institute will focus on the potential impact of this policy on citizens and the country's economy. More specifically, a qualitative analysis of the strengths and weaknesses of such a policy will be provided. However, as access to current data from the Trust has not been made available to the GAP Institute, there is a need for quantitative research on the potential differences of the impact of "10%" policy based on different categories of contributors to the Trust.

1 Decision of the Government of Kosovo. Source: https://bit.ly/3bCWLr4
2 GAP Institute, "Impact of COVID-19 Pandemic on the Local Government". Source: https://bit.ly/3owcJQm
3 GAP Institute, "Impact of COVID-19 Pandemic on the Labor Market". Source: https://bit.ly/3eRbmRg
4 GAP Institute, "Impact of COVID-19 Pandemic on the Kosovo Budget". Source: https://bit.ly/39iinJD

Introduction

Since the beginning of the Coronavirus pandemic, Kosovo restricted the movement of its citizens and ordered the closure of many economic activities. Considering that the restrictive measures had an impact in keeping the number of infected people relatively low at first, the Government of Kosovo ordered the state to go through three stages of mitigation, where the measures would be gradually removed. However, the closure of most economic activities other than the essential ones, albeit not for a long time, caused an immediate decline in the revenues of many businesses.[5] In fact, according to the latest World Bank report on the Western Balkans, it is predicted that the economy of Kosovo, will plummet by 4.5% during 2020 as a result of the closure of the economy with the highest decline seen in investments (-21.5%) and exports (-12.2%).[6]

To address these challenges, on June 22, 2020, Prime Minister Hoti unveiled a 1.2 Euros billion economic recovery program aimed at long-term economic development following the pandemic, development of incentive policies for the private sector and compensation for economic losses, caused as a result of the pandemic. This program contains some facilitation measures in doing business, such as measures to facilitate access to finance, measures to reduce the tax burden, and measures to support employment, agriculture and aggregate demand.[7]

One of the measures of this program, which has attracted the most attention from citizens, is the incentive for aggregate demand. This measure is expected to be implemented by enabling citizens to withdraw prematurely up to 10% of the funds saved in the Kosovo Pension Savings Fund (Trust).[8] Initially, according to the governing program, the funds withdrawn were supposed to be reimbursed by the Government of Kosovo within five years. However, on July 6, 2020, the Government announced that it had decided against the compensation of the withdrawn funds.[9] However, apart from the fact that the withdrawal process is still unclear, the implementation of this measure requires the amendment of the Law No. 04 / L-101 on Kosovo Pension Funds, through Law No. 04/L-115, Law 04 / L-168 and Law No. 05/L-116.[10]

Article 12 of the Law No. 04 / L-101 stipulates that when the contributor reaches retirement age (65 years), he or she purchases the pension savings.[11] However, the amendment of this law, within the recovery package, involves the addition of Article 12A with 6 items, specifying among others that the contributor may withdraw up to 10 percent of their pension savings in case of economic crises caused by the pandemic, and that withdrawn funds shall not be subject to personal income tax.[12] Pension contributions provide for the livelihood of citizens for a certain period of time after retirement, so an early withdrawal of a portion of those funds will undoubtedly have an impact on the long-term pension plans of citizens. Although there is the alternative of the Slovenian-Kosovo pension insurance fund, the draft law on economic recovery does not contain any article that affects it.

5 "Survey on the Impact of COVID-19 on Enterprises in Kosovo," American Chamber of Commerce in Kosovo, April, 2020. Source: https://bit.ly/2C5KWhA
6 "Western Balkans Regular Economic Report: Spring 2020," World Bank. Source: https://bit.ly/30eZLq3
7 "Prime Minister Hoti: We have a detailed program for economic recovery," Office of the Prime Minister, June 22, 2020. Source: https://bit.ly/32lnx6y
8 Governance Program 2020-2023. Source: https://bit.ly/2CBlXTb
9 "Clarification," Kosovo Ministry of Finance, July 6, 2020. Source: https://bit.ly/3jePC5s
10 "DRAFT LAW ON ECONOMIC RECOVERY - COVID-19," Office of the Prime Minister, July 15, 2020. Source: https://bit.ly/39beGWe
11 "LAW NO. 04 / L-101 ON KOSOVO PENSION FUNDS," Office of the Prime Minister, May 08, 2012. Source: https://bit.ly/30v8Mvj
12 "DRAFT LAW ON ECONOMIC RECOVERY - COVID-19," Office of the Prime Minister, July 15, 2020. Source: https://bit.ly/39beGWe

Because the early withdrawal of funds from Trust is unprecedented, both citizens and host institutions will be faced with a partially unknown situation. Would the premature withdrawal of pension savings increase domestic consumption? Will this policy help alleviate the debt burden of citizens and increase Kosovo's budget revenues? Is there a possibility that the withdrawn funds will be spent on imported products or even abroad, which would not necessarily help the Kosovo economy? And above all, is the government creating a practice of premature intervention in pension contributions that will be used by other governments in cases of difficult economic situations? These are just some of the questions that this short report of the GAP Institute aims to analyze.

Advantages of early withdrawal of pension savings from Trust

If the Kosovo Assembly approves legal amendments allowing the early withdrawal of pension savings of up to 10%, this would not have a direct impact on Kosovo's state budget or its public debt. Considering that this money will not be reimbursed from the state budget, it will not have a direct impact on the budget or public debt.[13]

People with higher income and longer work experience have more money saved, consequently these people would have the opportunity to withdraw larger amounts of money. This would enable the Government of Kosovo, through the "Recovery Package", to direct more funds towards people who have not been able to benefit from this measure, such as unemployed citizens, employees without employment contracts, and persons who have insufficient savings in Trust. However, based on the proposed package, this advantage does not seem to have been used.[14]

The withdrawal of money from Trust is intended to be done on a voluntary basis. Citizens who do not want to withdraw pension savings are not obliged to do so.[15] On the other hand, this measure allows early access to savings for citizens who are in need of such funds. During the withdrawal, the contributors are exempted from income taxes and any other penalty for early withdrawal of funds, as would be the case with private pension funds and insurance companies.[16]

In addition to the contribution which is required by law, there is a possibility for employers and employees in the future to voluntarily recover the money withdrawn from the Trust, by increasing contributions by up to 10% of their annual salary.[17] On the other hand, citizens have the possibility to invest/save in other private funds, insurance companies or financial institutions that offer individual pension schemes.[18] The average age of contributors in the Trust is relatively young, at around 41, which allows recovery of withdrawn funds before reaching the retirement age.[19]

13 Ministry of Finance. Source: https://bit.ly/2Ow8WNk
14 Recovery Package measures summarized by the GAP Institute. Source: https://bit.ly/3fNNcsf
15 Ibid.
16 Draft Law on Economic Recovery - Covid-19. Source: https://bit.ly/2OIfV6o
17 Central Bank of Kosovo. Regulation. Article 6, under c. Source: https://bit.ly/3hhJKGD
18 Law on Pension Funds of Kosovo. Article 21 Forms of individual supplementary pensions. Source: https://bit.ly/2CmuiKN
19 Trust. 2019Annual Report. Source: https://bit.ly/2ZwjUsE

The possible withdrawal of part of the Trust funds from the Central Bank of Kosovo (CBK) and commercial banks would not jeopardize the liquidity of the financial system of Kosovo. By July 13, 2020, the Trust had around 196.6 million Euros in commercial banks in Kosovo, around 32.5 million in CBK and around 1.8 billion Euros in other financial instruments.[20] The possible withdrawal of all assets of the Trust from the Central Bank and short-term deposits from commercial banks to cover the payments of citizens who decide to withdraw 10% of the savings, would not cause a liquidity crisis in commercial banks in Kosovo. Trust money in the CBK comprises less than 11 % of all cash, while out of 196.6 million Euros of bank deposits, around 75 million are short term deposits (less than one year).[21] Depending on the amount withdrawn, these two sources can cover a large portion of the withdrawn savings.

The early withdrawal of savings is not expected to jeopardize the liquidity of the Trust itself. As of June 2020, this institution had around 20.4 percent of its funds invested in highly liquid financial instruments, which could be easily and quickly converted into cash to cover payments.[22] In case of need, the Trust can even sell financial instruments such as debt or various shares to cope with the 10% withdrawal. Moreover, even after the eventual withdrawal of 10%, the Trust remains liquid and thus able to buy additional Kosovo bonds or invest in other financial instruments. However, the reallocation of funds remains under the authority of the Trust Fund management, which makes investments based on contributors' best interest, in accordance with applicable laws and regulations.

As of July 13, 2020, the Trust had over 2 billion Euros under its management. The possible withdrawal of 10% of savings from each account, amounts to a maximum of about 200 million Euros. If a large portion of this amount is withdrawn and spent, then this could increase domestic consumption, by shifting the consumption or investment curve. Moreover, the option of withdrawing savings from the Trust, for some citizens, can ease the debt burden caused by economic situation of the pandemic and increase the circulation of money in the market even for people who do not benefit from this measure.

Trust investments are expected to fluctuate steadily during the months of the pandemic, making savings relatively uncertain. In case the unit price of the Trust plummets, then withdrawing some assets at this time would be advantageous. However, predicting the unit price trend within certain periods is almost impossible.

20 Trust. Strategic Allocation. Source: https://bit.ly/2DGeouL
21 CBK statement until June. Source: https://bit.ly/3fNrzIr
Trust Report for the first quarter of 2020. Source: https://bit.ly/32AcR3N
22 Ibid.

Drawbacks of early withdrawal of pension savings from Trust

Early withdrawal of money from the Trust would reduce the savings of contributors dedicated for retirement. Taking into account the average return on investment of Trust, the withdrawal of 1 thousand Euros at the age of 40, reduces the return on interests for around 2 thousand Euros or around 3 thousand Euros less in total for the retirement period. Whereas individuals that withdraw 2 thousand Euros, loose about 4 thousand Euros of interest for the next 25 years.[23]

The option of early withdrawal of funds from Trust would not be beneficial for a high number of citizens of Kosovo. Initially, this measure does not provide a stimulus for the people who are mostly in need, such as the unemployed and employed without employment contracts whose incomes are relatively small. In particular, this group includes the agriculture, construction and gastronomy sectors, where informality is higher.[24] Likewise, the average balance of all accounts in the Trust reaches the amount of 3,284 Euros, which with a new measure provides the possibility of withdrawing around 328 Euros. This amount would be beneficial, if applied to all contributors, however there are large deviations in terms of savings on individual accounts. In 2019, about 46% of contributors were under the age of 34 and consequently unlikely to have saved large sums to make the withdrawal of their 10% profitable. Also, there are significant differences in terms of gender, with about 67% of contributors who are men and 33% women.[25] In 2019, the monthly contribution to the Trust for a working woman was 40.59 Euros and 46.47 Euros for men. Apart from the fact that women are less employed and contribute less to the Trust, according to the Kosovo population projection, they live on average about 3.6 years longer than men, putting them in risk of being left longer without a pension.[26]

The potential beneficiaries of this measure may be regular contributors aged 35 to 64 who have money saved in the Trust. Withdrawal of the Trust funds, as a single measure to incentivize the economy during the pandemic, is insufficient. A number of citizens do not have enough savings to make the withdrawal profitable, whereas some others may choose to keep those funds in the Trust for the retirement period. Therefore, the amount withdrawn and its impact in the economy can be insufficient for the economic situation expected to be caused by the pandemic.

Table 1. **Age and the average amount of contributors in 2019.**

Age group	15-24	25-34	35-44	45-54	55-64	65+
Percentage	16.7%	29.1%	22.9%	17.9%	12.4%	0.9%
The average monthly contribution of employees	€28.81	€41.00	€51.09	€51.30	€57.02	€64.32

Source: Trust [27]

23 The average return 2010-2019 is about 4,469 percent, the initial investment of 1,000 Euros for 25 years, when a 40-year-old is expected to reach retirement age, with inflation rate of around 2 percent. This calculation assumes the same return rate (4.469%) of the Trust for 25 years.
24 Trust. 2019 Annual Report. Source: https://bit.ly/2ZwjUsE
25 Ibid.
26 Kosovo Agency of Statistics. Kosovo Population Projection 2017-2061. Source: https://bit.ly/3eAmJgk
27 Trust. 2019 Annual Report. Source: https://bit.ly/2ZwjUsE

Trust has around 670 thousand open accounts of contributors since its establishment, of which around 380 thousand are active accounts.[28] Offering the possibility for early withdrawal of 10% of savings from each account, requires processing and execution of a large number of payments within a short period of time. This may present the need to increase the staff of the Trust to make timely transfers. At the last meeting of the Trust Steering Board and the Prime Minister of Kosovo, the Board emphasized the need to expand its operational capacity to implement this measure.[29]

A number of citizens are not informed about the Trust's online platform which shows the amount saved by each registered person and/or the amount they can withdraw. In addition, the assets of citizens in Trust, change in real time and as a result there may be ambiguity or discrepancy between the savings at the moment they are viewed online and at the time of withdrawal of 10%. After the proposal of this measure, the interest of the citizens for the online platform of Trust has increased and a periodic downtime of the online system was noted.

There is no legal basis for providing the possibility of early withdrawal of 10 percent of funds from the Trust, as a result legal amendments are required. According to the law on Kosovo pension funds and the regulations of the Central Bank of Kosovo, pension savings can be withdrawn by contributors a) when the retirement age is reached (65 years); b) when the person is a beneficiary of disability assistance from the Ministry of Labor and Social Welfare; and c) in the event of death before the withdrawal of pension savings, in which case their heirs withdraw the entire savings balance.[30] However, the package of laws for economic recovery envisages amendment of the law to enable the early withdrawal of 10 percent of pension savings.[31]

A large portion of the added consumption from the withdrawal of savings from the Trust can be directed toward imported products thus reducing multiplier effect or money circulation in the economy beyond expectations. Also, considering that people with higher incomes can withdraw more funds, some of that money may not be consumed at all, but saved in the bank for another period and consequently end up out of circulation again. Such a situation would not affect the growth of domestic consumption as expected.

Although Trust's possible withdrawal of its money from commercial banks does not threaten to make banks illiquid, this policy can reduce bank liquidity in general. Such a reduction could affect the growth of interest rates on deposits and/or loans, although that is less to be expected given the current level of bank liquidity even without the Trust' funds.

Offering the possibility to withdraw 10% of savings from Trust can create a practice of government's interference in Trust funds, to facilitate the economic situation of citizens. This phenomenon may be repeated in the coming months when the economic effects of the pandemic are expected to continue or in another economic crisis in the future.

28 Ibid.
29 Trust. The 10% issue: KPST (Trust) in a meeting with the Prime Minister of Kosovo. Source: https://bit.ly/32jadiL
30 Trust. 2019 Annual Report. Source: https://bit.ly/2ZwjUsE
31 Draft Law on Economic Recovery - Covid-19. Source: https://bit.ly/2OIfV6o

With the withdrawal of 10% of pension savings, people lose the opportunity to invest those funds through the Trust in global financial markets, at a time when prices per unit are relatively low and the profit opportunities in the future are greater. The unit price in the Trust is currently lower, than it may be in the future, when citizens want to recover their investments. In that case, the recovery of savings (units) will cost more than if current savings were held, because the unit price in the Trust would have increased. Withdrawal of funds from the Trust at a time when the Trust's investments are experiencing a periodic decline in the unit price, means capitalization of the investment loss, as the funds are withdrawn before the recovery has taken place.

Poor information of citizens about financial planning especially pension savings over the rate required by law, may make many citizens depend on state assistance, at the time of retirement. Currently, with the average balance of 3,284 Euros saved in Trust, citizens can receive 200 Euros per month for 16 initial months of retirement, whereas according to the population projection of Kosovo, life expectancy averages 77 years of age.[32] Consequently, withdrawal of funds in this time period, reduces the purchasing power of citizens in the future.

Conclusions

The emergency health crisis caused by the Coronavirus pandemic has directly affected the economies of almost all countries in the world. The restriction of movement has caused a drop in revenues from many business activities, in various types of industries and generally a decrease in the aggregate demand. Therefore, it is natural for the Government of Kosovo to propose measures for economic recovery aimed at increasing the aggregate demand.

The proposal to allow the withdrawal of 10 percent of pension savings is an unconventional method of achieving this goal. However, as we have argued above, this measure does not directly affect the state budget or public debt of Kosovo, and it offers the opportunity for citizens who have savings to withdraw them in order to get through this situation as easily as possible. The expenditures of these citizens can increase the circulation of money in the market, even for persons who do not directly benefit from this measure. Furthermore, the withdrawal of 10% of savings from Trust does not jeopardize the liquidity of the financial system of Kosovo or the liquidity of Trust itself.

On the other hand, this new incentive measure does not guarantee the projected growth of aggregate demand. The possibility of withdrawing pension savings benefits neither the people who need cash the most such as the unemployed, nor the ones with relatively low wages, who do not have enough money saved to make withdrawal of their savings worthwhile. Finally, the total amount that can be withdrawn under this measure is less than 200 million Euros, making the impact on aggregate demand relatively small.

32 Ibid, and Kosovo Agency of Statistics. General Statistics Source: https://bit.ly/3jpC72H

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