European Commission

Kosovo*'s plan to allow contributors to withdraw 10% of their pension savings is unlikely to boost consumption amidst pandemic

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Artan Mustafa – European Social Policy Network August 2020

The Parliament of Kosovo is expected to vote a "Law on Economic Recovery" in October, which will permit unprecedented pension savings withdrawals. The purpose is to boost consumption demand in response to the recession caused by the COVID-19 pandemic. However, withdrawals are unlikely to meet this objective, as the majority of contributors have very small amounts in pension savings.

(*) This designation is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo Declaration of Independence

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Description

The Parliament of Kosovo is expected to vote a "Law on Economic Recovery" in October. The law, among other measures, would pave the way for pension contributors to withdraw around €200 million in total from the Kosovo Pension Savings Trust (KPST).

The Government had initially discussed options for replacing the withdrawals during the coming years through taxation. But it quickly backtracked on these deliberations when it was argued that such actions would primarily benefit current well-off contributors (workers) with the highest savings. The Government eventually endorsed the 10% withdrawal as a voluntary option - without pledging to replace the amounts withdrawn.

The pension savings contributors (the individual saving account owners) would have an opportunity to apply online for tax-free withdrawals from the KPST during the next four months following the entry into force of the law.

KPST manages a fund of around €2 billion, mostly invested in western financial markets (KPST, 2020). The fund has been collecting contributions since 2002, when Kosovo launched a World Bank-designed three-pillar pension system centred on the statutory funded scheme for individual pension savings (Pillar II). The other pillars included a basic pension tied to the cost of a minimum basket of food, issued to all citizens above 65 years old and financed by government revenues (Pillar I), and voluntary commercial personal pension schemes (Pillar III). Statutory savings (10% of gross wages), with the exception of cases of permanent work disability or change of citizenship, are withdrawn only when a person reaches pensionable age. It is the first time that premature (during working age) withdrawals of savings would be allowed.

Kosovo has seen the highest COVID-19 infection rate in the region during recent weeks. The growth in its Gross Domestic Product (GDP), around 4% over the past four years, has been mostly driven by consumption. Thus, the Government aims to boost consumption to respond to the present recession caused by the COVID-19 pandemic - by making savings available for current use.

Outlook and commentary

If the measure is adopted, as expected, it is unlikely to result in a substantial boost of consumption, since the persistently low formal employment rate (30.1% in 2019) has meant that the working population have insignificant savings. In July 2020, 50% of all contributors had less than €310 total savings, and 80% under €1,100 total savings; the top 5% of contributors had more than €11,200, and only the top 1% had more than €22,200 total savings (KPST, 2020). This means that savings withdrawals would not significantly add to the household budgets of the largest share of contributors – as 80% (around 550,000 individuals) could withdraw less than €110. This amount is lower than the monthly minimum wage (€170).

Social Europe

The withdrawal proposal came from the Democratic League of Kosovo (LDK), a centre-right party which currently leads the Government. It has increased fears within KPST that the precedent may be followed in the future by the less moderate parties (KPST, 2020). Indeed, during the past decade, public-financed social transfers have been prone to extensive clientelism (Mustafa, 2020 and Guardiancich, 2019).

The savings withdrawals could also be questioned from a pension adequacy perspective. Without any changes to the current system, the data indicate that only the top 5% of contributors can realistically count on maintaining a meaningful pension income relative to average market wage levels for a period of 144 months (the current average life expectancy after pensionable age) after reaching 65 years old. While a rise in contribution rates could increase savings, the model suffers from various other limitations related to the labour market (e.g. low employment rate, lack of rational incentives for those in informal employment to declare work, such as the possible absence of a minimum pension plan etc.) and investment shortcomings (Mustafa, 2020).

When the current pension system was launched in Kosovo, discontinuing the former Pay-As-You-Go (PAYG) system, it was the largest pension privatisation in the Balkans: the fully-funded individual savings are added to a minimum government financed floor, replacing the defined-benefit pensions financed from worker contributions and guaranteed by the Government. These forms of privatisation in parts of the developing world were inspired by the Chilean model of the 1980s, but their reputation declined by 2008 (Orenstein, 2008). Reacting to the consequences of COVID-19, Chile made a similar decision in July to permit the withdrawal of 10% of savings (Wall Street Journal, 2020).

In the long term, the 10% withdrawals could in fact contribute to further erosion of the existing pension system. With lower accumulated savings, and thus poorer future adequacy, contributors might have less interest in maintaining the system. Observers have rightly argued that the move could help create the momentum to reform the system and create a more solidaristic formula (e.g. Koha, 2020). Over the past two years, proposals have been made both within the Ministry of Labour and Social Welfare and in the Parliament of Kosovo to reform the system, adding a PAYG and a Notional Defined Contribution (NDC) layer (Mustafa, 2018, 2020), but repeated government coalition changes have effectively paused such reforms.

Further reading

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