Covid-19 underlines the problems of savings-based pensions: The case of Kosovo and Chile

The pension model adopted by Chile in 1981 was promoted by the World Bank and other institutions as an example for emerging markets to follow. Variants of the model were subsequently adopted by more than 30 countries across the world. One of the closest copies was made in Kosovo. Yet as **Bernard H. Casey** *and* **Artan Mustafa** *explain, recent developments in both Chile and Kosovo have raised major questions about the future of such systems.*

Chile and Kosovo are not so far apart. Geographically maybe, confessionally and linguistically, too. But they share at least one thing – their funded pension systems and how the key element of them was functionalised to meet the exigencies of Covid-19.

Amongst those familiar with pension schemes and pension reform, the case of Chile is frequently mentioned. Back in the early 1980s under the Pinochet regime, the system was completely revised. For most employees, or at least those who were lucky enough to have regular employment in the formal sector, the system had paid earnings-related benefits on a pay-as-you-go (PAYG) basis. This model was thrown over. A new system, based on individual savings accounts was installed.

People – admittedly still only those who were in something like formal employment – had to contribute into a personal savings plan. Their contributions, and the returns earned upon their investments, built up into a pot that could be liquidated on retirement. The money from the pot could then be drawn down in stages each year, or it could be used to buy a lifelong annuity.

The World Bank loved the system. In a much-cited book, it propagated it widely – suggesting that such a model reduced state expenditure, generated resources for national development, and encouraged higher participation in the labour market. Whether the reform achieved this is another matter – and one that has been much discussed in the decades that followed.

Kosovo embraced the model much later. As a breakaway from Serbia, Kosovo's creation as a state was one of the final stages of the disintegration of what had once been Yugoslavia. Workers in Yugoslavia had been part of a PAYG pension system that, in many ways, was like that which had prevailed in Chile prior to its reform. After the breakup, the new states made reforms, some more radical than others. In Kosovo, this process went further than elsewhere.

International experts, drawing on the World Bank's experience and with its involvement, set up a new system of which the main component is a funded second pillar. It became operative in 2002 and is managed by Kosovo Pensions Savings Trust (KSPT). As in Chile, the pillar is based upon individual savings accounts accessible at retirement. The main difference to its Chilean counterpart was that under the KPST almost all the money was to be invested abroad – among others, a reflection of how capital markets were (and still are) very underdeveloped in Kosovo.

Similar responses to Covid-19

Come Covid-19, the parallels between the two countries persisted. The pandemic disrupted employment and jobs were lost. Social security provisions in Chile – including unemployment benefits and social assistance – are much less encompassing than in most European countries. There existed no permanent scheme for short-time working as for example in Germany (*Kurzarbeit*), although a temporary furlough scheme – somewhat like that in the UK, if much less extensive – was introduced.

In June 2020, and under pressure to provide supplementary income to households, the Chilean government legislated to allow people to take up to 10% from their savings pots. The then president, Sebastián Piñera, opposed the move. So, too, did both the pension funds, which regarded it as contrary to the retirement scheme's purpose, and the central bank, which saw it as contributing to inflationary pressure.

However, congressional approval was almost universal. What had been a one-off exercise was repeated twice more. By the conclusion of the third round in mid-2021, 39% of all account holders had made at least one withdrawal. Some 3.8 million out of about 9.7 million accounts held by the population had been reduced to zero. Total assets in pension funds were reduced by $50 billion, or by at least a quarter.

Chile's new, radical president, Gabriel Boric (himself of Yugoslavian descent), had, as a member of congress, supported the withdrawal plans. However, when in office he acted to prevent a fourth round of withdrawals. Various alternatives were proposed – including allowing access only under strict conditions for specific purposes and providing opportunities for people to make additional contributions to help repair their savings pots. So far, and as the president's popularity has been on the wane, these proposals have come to nought.

Kosovo – albeit six months later – followed Chile's suit with its own withdrawal scheme. In December 2020, around the time of the Chilean second round, the government legislated to allow savers to take up to 10% of their pots. Again, parliament's support was across the board (only one left-wing party opposed). Some two thirds of savers took advantage of the provision and 10% of the KPST's assets were withdrawn.

One difference to Chile was that the government in Kosovo agreed to reimburse the pension funds for any individual withdrawal up to €999. Whilst partly protecting pension savings, this component generates an increase in public expenditure. Kosovo had, historically, sought to maintain a fiscal deficit not exceeding 2%. Total withdrawals amounted to some €200 million, and the state ended up taking on reimbursement liabilities of just over half of this amount. Although reimbursement is not scheduled to start until 2023, the sum involved is close to 1.4% of what was the country's 2020 GDP.

Like Chile, once a withdrawal process had been initiated, people wanted more. Currently, legislation is proposed to permit a withdrawal of 30% of remaining funds. Unlike with the first round, there are no plans so far for partial reimbursements. This might be good for the public finances, but it will probably be bad for the retirees of the future. Even though the main party in the government (the left-wing Self-Determination Movement) has declared itself against the plan, most of the main opposition parties have backed it. The trade unions say 90% of their members want the proposal to be passed. The IMF, however, cautioned strongly against it.

The end of a paradigm

Withdrawals have also been discussed and implemented in other countries, but events in Chile and Kosovo are highly significant because they are prominent cases of a reform paradigm that was once prescribed for countries with unsustainable PAYG systems. Now, these withdrawals could decide the fate of this model.

Several other countries in Latin America and other post-socialist countries in Eastern Europe have backtracked from reforms introducing a funded component to pensions. That form of privatisation has often created small and unequal savings that are costly to manage and are prone to market uncertainty. Like their abrupt arrival, the individual account systems in Chile and Kosovo could be sounding their systems' own death knell – emptying people's pension pots but presenting no clear reform alternatives.

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