THE RISK OF EARLY PENSION WITHDRAWALS IN SOUTH AFRICA

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MENTENOVA

INTRODUCTION

COVID-19 has had far-reaching implications for the global economic and political landscape, putting pressure on policymakers to provide support to individuals and businesses that have been gravely affected by the pandemic. Lowering interest rates and spending more have been among the main responses by global policymakers to shore up their economies, and so far, it has been successful.

South African policymakers have pursued similar strategies, reducing the repo rate to record-low levels and redirecting expenditure towards COVID relief packages. However, context is important. Clearly, South Africa's economic and political situation before 2020 left the country with few buffers to handle the type of shock that was triggered by the pandemic.

More than a year has passed and South Africa is still reeling from the impact of COVID-19, with slow progress on the vaccination front and, on top of that, social unrest, compounding South Africa's woes. It is against this backdrop that policymakers are under increasing pressure to provide relief to the poorest of the poor.

In addition to the recent announcement about extended social grants, the government is now looking at the possibility of allowing South Africans to make withdrawals from their retirement funds to obtain further relief during these unprecedented times.

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South Africa wouldn't be the first country to allow early pension withdrawals in response to the COVID-19 pandemic, with developing market peers in Latin America adopting a similar policy response in 2020.The impact of early pension withdrawals in these countries holds important lessons for South Africa – not least of which is that the number of people being able to retire comfortably is likely to decline significantly.

EXPERIENCE IN LATIN AMERICA OFFERS IMPORTANT LESSONS

After the pandemic first hit, policymakers in parts of Latin America, including Peru and Chile, decided to allow members of retirement funds to access a portion of their retirement savings, providing a short-term reprieve to those adversely affected by the pandemic. Many people were eager to take up the opportunity to access additional sources of income in the face of a difficult economic climate. Faced with a large influx of redemption requests, fund managers were required to quickly sell assets, generating some significant financial market volatility and angst.

In Chile, for example, the central bank was forced to step in and purchase bonds in the secondary market to stem the outflows, thus creating knock-on effects for the currency and Chilean assets more broadly. Beyond the short-term effects on financial markets, the impact on financial stability and long-term retirement savings in Chile is already evident. According to the International Monetary Fund, early pension withdrawals in Chile to the end of February 2021 'amounted to 14% of GDP and resulted in about 30% of individuals who withdraw funds depleting their pension accounts'.

The Latin American experience suggests that, if not responsibly managed, early withdrawals of retirement savings have the potential to leave many workers without sufficient savings to finance their pensions. This inevitably means that more pressure will be placed on public finances down the line as the need for social safety nets increases, thus perpetuating the problem.

THE SOUTH AFRICAN SITUATION

According to National Treasury, South Africa is considering what is being called a ‘two-pot system’ as part of proposed amendments to the country’s retirement regulations. In terms of the proposal, one-third of pension savings would be accessible to members of retirement funds, while the rest would remain out of reach until retirement. Finance Minister Tito Mboweni has been a strong proponent of this proposal and has expressed his intention to expedite the decision-making process, while trade unions have also thrown their weight behind the proposal.

Although policymakers have provided assurances that any withdrawals will be limited and that mandatory preservation will ensure that retirement savings are not depleted, this decision could exacerbate the retirement crisis we already face in South Africa, with most people finding themselves with insufficient money when they retire.

CONCLUSION

Allowing early pension withdrawals could provide some much-needed economic relief to South Africans during these very difficult and uncertain times. However, there are clear trade-offs associated with such a decision. The experience in Latin America offers some pointers in this regard, with the large withdrawals seen to date leading to significant outflows from the financial markets and many individuals depleting their retirement savings. This has dealt a blow to savings rates in the countries in question and prioritised short-term consumption, a trend that is likely to exacerbate fiscal constraints down the line.

With the South African government under immense pressure to bring economic relief to many in the country, the decision to pursue avenues other than increasing its own debt has been welcomed by many. According to deputy director-general of the National Treasury, Ismail Momoniat, withdrawals will be allowed only under ‘specific circumstances’ and there will be a ‘limited window of access’, suggesting that the quantum of withdrawals will be limited and preservation will still be mandatory. While this offers some comfort, providing access to pensions before retirement appears to be a short-term solution to South Africa’s deep-seated economic and social problems – one that could add to the burden placed on the state to cast its social safety nets far and wide for the foreseeable future.

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