

Study on the Advantages and Disadvantages of Early Access to Pension Funds and Its Enlightenment to China

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Abstract: It seems that early access to pension funds provides more flexibility for contribution payers in the short term, but may jeopardize the retirement savings in the long term. In practice, there are dozens of countries allowing this policy for several years. How to balance short-term and long-term profit and loss? Why could so many countries allow early withdrawals so liberal? What are the advantages and disadvantages of early access? Is it possible for China to ease the restrictions of early access to pension funds? This article tries to answer these questions and get the enlightenment to China from international experiences by analyzing the advantages and disadvantages of early withdrawal in different types.

1. Introduction

With the outbreak of COVID-19, how to secure the old-age insurance system is one of the key issues currently in many countries, as the declining economy and a high unemployment rate. Since 2020, some counties have already implemented emergent policies to help people have the ability to smooth consumption and get through the tough times. Early access to pension funds is one of the policies used in some countries, such as Australia, Chile, etc. Early withdrawals from retirement accounts have been used widely in some countries before this pandemic. This policy provides flexibility for young old-age insurance contribution payers, especially for those who still need to contribute many years to get a pension. This flexibility is significant for people to make decisions whether they want to join the old-age insurance system if they can choose. Moreover, Munnell, Sundén, and Taylor (2000) have shown that the possibility of making emergency withdrawals is a critical consideration how much to contribute given the decision to participate [1]. One argument about the potential merits of early access to pension savings is that it could increase the overall number of individuals saving into a pension and encourage higher levels of contributions by those already saved, to the extent that the increase in overall retirement saving outweighs the effects of any funds actually withdrawn before age 55 [2]. However, early withdrawals from retirement accounts are a double-edged sword [3]. Some researches show that early access to pension savings would jeopardize the retirement system as it will result in the depletion of pension funds at last.

Therefore, although about twenty countries have already implemented this policy in different ways, there is still much debate about whether it should be used and how to use it. In practice, in China, according to the Social Insurance Law of China, advance withdrawal from an individual account that belongs to basic old-age insurance shall not be allowed. Enterprise pension could be accessed before retirement age under limited conditions which include total disability, leaving the country, and death. Compared to the implementation in the United States, the account of social security is illiquid, and the 401Ks, which is the second pillar in the five pillars developed by World Bank in 2005, is liquid partially. It seems that both governments choose the “middle-tier” to provide flexibility, while the conditions in the US are more generous. At the same time, with vigorous development of individual retirement accounts (IRAs) in the US, withdrawals from it are simpler and more liberal than the 401Ks. Why could the US and other countries allow withdrawals so liberal? What are the advantages and disadvantages of early access? Is it possible for China to ease the restrictions of early access to pension funds? This article tries to answer these questions and get the enlightenment to China from international experiences by analyzing the advantages and disadvantages of early withdrawal in different types. It should be noticed that the focus of the study is on individuals, not enterprises, because early access to pension funds is the individual behavior.

2. Classifications of Early Access to Pension Funds

There are several classification standards of early access to pension funds, including different modes, conditions, and participation forms.

2.1 Different modes of early access to pension funds

The followings are the different types of early access to pension funds classified by different modes of use.

The first is permanent withdrawal which allows individuals to take a lump sum without paying it back, but it should be assessed that the individual is under a situation of hardship, and the individual has to decide whether it is really necessary to transfer long term savings to short term benefits or not, as this would result in considerably less of one’s pension after retirement. This kind of hardship is always about financial shortages. In cases of extreme financial need, Australia, Canada, France, Korea, New Zealand, Sweden, Turkey, United States can have this policy.

The second is loan-repayment which allows individuals to borrow from their own pension fund and need to reimburse the loan with interest within a certain timeframe. This method is commonly used to purchase the home and other property. Prior research has shown that it has been taken by 13 countries, including Canada, Iceland, Mexico, Poland, South Africa, and some other counties.

The third is taking pensions as collateral. This means an individual can use pension assets as collateral to get flexible money. It is different from the loan as an individual cannot lend money from the pension fund directly, but from a third party ---the financial institution. The pension funds provide a guarantee without facing the risk of financing the loan. World Bank (2019) thought the interest rate charged on this loan should be higher than loans offered in the banking system. Moreover, if individuals cannot pay back, the bank would take over the collateral, and the individual would no longer have the possibility of using it again [4]. In practice, South Africa, Switzerland, and the United Kingdom have implemented this to help occupational pension payers to get money to pay housing loans and other expenses.

The fourth is hybrid saving accounts which include two accounts, one is a liquid savings account, another one is an illiquid one which is a pension savings account. Individual contributions could be circulated between these two accounts. When the amount in the liquid savings account reaches a limited threshold, then the amount saved above this would be put into the illiquid account, which

could have pensions tax relief. Individuals could withdraw funds from the liquid account. The balance would be influenced by such behavior. The US, New Zealand, and the UK have piloted this model, although it is limited by some countries' legislation.

2.2 Different conditions of early access to pension funds

Although there are different modes of early access to pension funds, most countries agree to use this policy in some restricted situations due to the negative effect on retirement savings. One of the reasons why some governments of countries agree with this policy is that the contribution payers indeed need much more money to cope with emergent contingencies, such as income shocks, marital shocks, and so on. However, it should be admitted that there are so many possibilities to withdraw pension funds. Then, it is vital to classify the different types of conditions accepted by some countries to use the withdrawal policy.

This article classifies into four groups by health factor, necessary expenditure factor (without health expenditure), identity factor, and other factors.

Table 1 Different early withdrawal factors sorted by conditions

Factors	Conditions
Health factor	Disability Serious illness Medical expenses
Necessary expenditure factor (without health expenditure)	Purchase/repair home Training/education expenses Wedding expenditure Financial hardship Unemployment
Identity factor	Reaching a certain age/membership duration Leaving the country
Other factors	Small balance Establish an independent business Without any motive

Note: The listed conditions are from OECD (2019), Pensions at a Glance 2019: OECD and G20 Indicators, OECD Publishing, Paris, <https://dx.doi.org/10.1787/b6d3dcfc-en>.

As shown in Table 1, for health factor, there are three conditions agreed by some counties, including disability, serious illness, and medical expenses. Prior research by World Bank (2019) shows that 27 of the countries analyzed allow individuals to withdraw pension funds by health factor, where 17 of the countries allow the condition of disability, when individuals get a serious illness, may withdraw their funds early in 13 countries, for medical expenses, only 4 countries allow it. It should be noticed that for disability and serious illness, there are 9 counties allowing together. This may interconnect with the medical insurance system in one country, this may be the reason why only 4 counties agree to use it for medical expenses. However, it need be concerned that health factor is the primary factor which determines whether individuals have the abilities to work and earn enough money to live.

For the necessary expenditure factor, it is interesting to find that even wedding expenditures could be the conditions to withdraw the pension funds early. There are only two counties, Korea and Mexico, to allow it. This indicates that letting people have the necessary money to spend is very important. Necessary needs for one individual include the needs for food, clothing, health care, housing, home equipment and services, education and entertainment, transportation and

communications, etc. Then, it could be understood that 15 of the countries allow individuals to withdraw money early to purchase or repair the home, 3 of the countries allow spending on training and education. Both of them are essential for people. For financial hardship and unemployment, it is not hard to understand because these circumstances will cause individuals cannot bear necessary expenses for themselves. Unplanned contingencies and unemployment may cause income shocks which could result in financial hardship. In 2010, evidence showed that approximately 20% of taxpayers under age 55 with proof of pension coverage or retirement accounts experienced an income shock [3]. Therefore, the necessary expenditure factor is the second primary factor to let the countries allow the early withdrawal.

For identity factor, it is not so emergent as the above two factors, but this gives contribution payers more flexibility to choose how to use their pension funds, and brings more complex effects on the pension system. The requirement age is from 40 in Austria and 62 in Germany, and the membership period is from 5 years in Mexico to 10 years in Austria, Hungary, the Slovak Republic, Spain, India and Indonesia [4]. The spread is so large that each country chooses the most appropriate measures for itself, but most of them are for voluntary personal pension plans, not mandatory ones. It indicates that these counties focus on one's own free will, more flexibility may appeal to individuals to participate in the third pillar and contribute more, as once they need money, they could have the possibility to withdraw it early, thus this will not influence their rights to use assets although they are in the pension fund.

For other factors, it is determined by the policy purposes of the country. In Switzerland, individuals can spend early withdrawal on establishing an independent business. Small balance is the condition in 8 counties. In 7 of the counties, they even have no special motives which may be determined by situations. For example, Chile has already withdrawn third times retirement savings early for consumption since the outbreak of COVID-19.

2.3 Different participation forms of pension systems

Given the different characteristics of pension participation forms, it is necessary to distinguish between mandatory and voluntary schemes considering early access to pension funds. World Bank (2019) showed that access to mandatory pension savings is rare, and the allowed condition is highly restricted and requires repayment of the withdrawn amount [4]. Compared to the mandatory scheme, early access to the voluntary scheme is more common and the withdrawn conditions are more lenient. In the United States, social security cannot be allowed to have early withdrawal, but 401Ks and IRA can.

3. Analysis of Advantages and Disadvantages

It seems that early access to pension funds provides more flexibility for contribution payers in the short term, but may jeopardize the retirement savings in the long term. In practice, there are dozens of countries allowing this policy for several years. How to balance short-term and long-term profit and loss? Why could so many countries allow early withdrawals so liberal? It is necessary to analyze the advantages and disadvantages from different angles.

3.1 Individual angle

From the individual point of view, early access to pension funds needs to balance between short-term and long-term benefits. If short-term benefits outweigh long-term loss, the results may have more benefits. It is evidenced that flexible access to pension wealth could be a cost-effective policy to improve the health of middle-aged individuals, at least in the short run by exploiting a

unique policy rule in Singapore [5]. Human health is the foundation of longevity, it is useless to discuss retirement life without health. For total disability, the government will have additional subsidies for the disabled who could compensate one part of permanent withdrawal earlier than retirement age. By analyzing different modes and conditions of early access to pension funds, as shown in table 2, the advantage of permanent withdrawal and hybrid saving accounts could improve health. Meanwhile, all the modes could meet the basic and emergent needs, smooth consumption, and provide flexible money. As to the disadvantages of early access, it is emphasized that it will reduce retirement income. The reduction resulting from a 10% withdrawal over a year could vary from 2% to 9% depending on the length of the contribution horizon [6]

Table 2 Advantages and disadvantages by different modes and conditions of early access to pension funds

Modes	Advantages	Disadvantages
1Permanent withdrawal	<u>Health factor</u> 1,4: Improve health <u>Necessary expenditure factor</u> 1,2,3,4:	Reduce retirement income
2Loan-repayment	Meet the basic and emergent needs (Purchase properties; Increase education and experience)	
3Collateral		
4Hybrid saving accounts	Smooth consumption <u>Other factors</u> 1,2,3,4: Provide flexible money	

Note: 1 represents permanent withdrawal, 2 represents Loan-repayment, 3 represents Collateral mode, 4 represents hybrid saving accounts.

3.2 Policy angle

From the government policy points of view, as different participation forms of early access to pension funds, mandatory and voluntary schemes have different goals. Firstly, the goal of an old-age insurance policy is to secure the lives of the elderly, once reduced income cannot meet the goal of adequacy for the elderly, it is contradicted to old-age insurance policy goals. Secondly, for the purpose to construct the five-pillar pension system, the mandatory pension as the first pillar focuses on poverty alleviation and seeks to replace some portion of income[7], therefore, if mandatory pension funds were withdrawn before retirement age, the pensioners may lose the last safety net, it is hazardous to do it although income withdrawals from mandatory jars may meet the basic and emergent needs. Voluntary accounts or pension could be as the second and third pillar, not only the forms are various, but also the nature is essentially flexible and discretionary [7]. Then, as shown in table 3, early withdrawals from voluntary schemes could provide flexible money to supplement the basic and emergent needs, and improve the living standard. Moreover, it may appeal to more contributions as its flexibility. More contributions may outweigh the amount of withdrawals, the positive balance will compensate for the negative effect on reduction and secure the basic goals of old-age insurance policies.

Table 3 Advantages and disadvantages by different participation forms of early access to pension funds

Participation forms	Advantages	Disadvantages
Mandatory	Meet the basic and emergent needs	Reduce retirement income Contradict to old-age insurance policy goals
Voluntary	Meet the basic and emergent needs; <u>Provide flexible money;</u> <u>Improve incentive payment level</u>	

In short, the advantages and disadvantages are not fixed, actually, it could be varied by the amount of withdrawals, costs, and contributions. For the individual and policy angles, the focuses are different, the government should take a longer-term and more in-depth view to consider the policy of early access to pension funds.

4. Its Enlightenment to China

In China, it is reported that the number of flexible employment employees has reached 200 million released by the ministry of human resources and social security in 2021. Self-employed, part-time and new forms of employment have become the main force of flexible employment. It is a large part of the labor force in China. As to social old-age insurance, because flexible employees are facing more risks of fluctuated incomes than those with stable careers, they may have more possibility to stop pension contributions if they encounter significant changes in their lives, such as having a bad illness, being in debt, no income for a period, and so on. Since the epidemic that began last year, the government of China has already put forward some emergent regulations to help pension contribution payers to go through difficult times. These regulations include flexible employment social security subsidies for persons with employment difficulties and those less than 5 years from the legal retirement age, exemption from 5-month social insurance premiums for self-employed persons. These policies have negative effects on the balance of pension funds. In 2020, for the first time, China's pension income cannot offset its expenditure. In addition, the changes in population and support rate in the next three decades will lead to an increased pension gap.

The Chinese government may take more appropriate and more flexible measures to cope with pension issues. According to the above analysis, if the multi-level and multi-pillar pension system could be built up, the restrictions of early access to pension funds might be eased up, because voluntary accounts will play a role using its flexibility to appeal more contributions.

Although the second pillar and third pillar are still very weak as the low GDP per capita, but they have developed fast, especially for enterprise annuity. By the end of 2020, the accumulated capital scale of the national enterprise annuity was RMB¥2249.683 billion, a year-on-year increase of RMB¥451.15 billion, the increment is 25.1%. A total of 105,000 enterprises in China have established enterprise annuity plans, an increase of 9000 over the same period last year, the increment is 9.4%; The number of employees participating was 27.175 million, although the total number is still less, the increment is to 17.3%, compared with the end of the 12th Five Year Plan. The annual weighted average rate of return of enterprise annuity has been 7.3%. In 2020, the weighted average rate of return was 10.31%, an increase of 2.01% over the previous year, which reached a new peak since 2008.

It is indicated that once enterprise annuity gets to a large amount, contributions payers could have more requirements to deal with their pension funds as more and more persons will take them as their assets. If the government of China wants to improve the attractive force of the second and third pillars, flexibility must be considered as it is one important route to increase liquidity. Because early access to pension funds is a helpful way to improve liquidity, the governments of China and individuals will focus on it naturally and bring about it together.

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