The slow-burn crisis inside Ukraine's pension system

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Millions of older people in Ukraine receive pensions below the real cost of living – and this trend seems to be only getting worse

A dramatic situation with state pension provision is unfolding in Ukraine. In autumn last year, Ukrainian prime minister Denys Shmyhal stated that if "decisive measures" are not taken, then in 15 years the state will not be able to pay pensions.

With the collapse of the Soviet Union, Ukraine inherited a so-called "solidarity pension system": current pensioners are supposed to receive payments from pension contributions made by the working population. However, today the number of people employed in the Ukrainian economy is constantly falling. Accordingly, pension contributions are sorely lacking to pay even meager – by European standards – pensions.

The first attempt to reform Ukraine's pension system was made 15 years ago – through the launch of non-state pension provision. The government allowed private pension funds to accept voluntary contributions from citizens – with the expectation that they will receive pension payments in the future. But private pension funds never became popular due to their unreliability, on the one hand, and extremely low salaries in Ukraine, on the other.

The Ukrainian government's last hope is compulsory accumulative pension insurance, and a corresponding reform is being hastily carried out. But attempts to push the necessary bill through parliament have also been unsuccessful; and even a specialised parliamentary committee does not pass new initiatives.

Meanwhile, millions of older people in Ukraine receive pensions that are below the real cost of living – and this trend seems to be only getting worse.

Uncertain future

"I can't count on a normal pension," Yevhen Kolishevskyi tells me. A little over 50, Kolishevskyi has another 15 years before he can retire in Kam'yanske, a typical industrial town in central Ukraine.

For decades in cities like Kam'yanske, people chose to work in harmful industries – in order to retire earlier and receive maximum payments. Ukraine still has special lists of dangerous or especially harmful professions, under which people employed in them receive certain benefits – such as early retirement or a higher pension. This includes metal work, mining, certain engineering and mechanical jobs.

True, the number of these jobs at industrial enterprises have decreased over the years when factories close or cut jobs. Finding a job that would provide a high pension in old age is thus becoming increasingly difficult.

Kolyshevskyi originally graduated from a military school in Leningrad, but he decided against a career in the Soviet military – and working his whole life at a hazardous factory.

For many in Kam'yanske, Kolishevskyi is someone who sought to avoid the 'system' – but who has still had his successes. A well-known karate coach, he is the head of the city football federation. Many more people know him as a civic activist and the head of a local environmental organisation.

Yet coaching children at football or working in civic organisations is hardly a profitable business – or even one that could guarantee you a decent life after retirement.

On the brink

Approximately 80% of single pensioners in Ukraine live below the official poverty line, according to Ukrainian media Liga.

Today there are about 11 million pensioners in Ukraine, and 65% of them receive a pension below 3,000 hryvnia (£79) per month. Only 2.7% receive a pension above 10,000 hryvnia (£264) per month. As a rule, these are former ministers, parliamentary deputies, judges, prosecutors and other high-ranking officials of the state apparatus.

"Today, if you don't work in the public sector, you can hardly count on a normal pension," Kolishevskyi states. "Having provided themselves with pensions, state officials declare that there's not enough money to pay normal pensions to everyone else. Yet lack of money is not a reason, but a consequence of policies pursued by government officials. This policy is not aimed at developing the national economy, creating new jobs, supporting small- and medium-sized businesses. As a result, almost all entrepreneurship is forced to work 'in the shadows'."

Attempts to reform the pension system have been made by the state more than once. The biggest reform was started back in 2004. In addition to the existing solidarity system, the reform provided for the creation of two new levels of pension provision: state accumulative pension insurance (second level) and private accumulative pension funds (third level).

However, from the very beginning, the implementation of this reform looked extremely inconsistent. Instead of creating a system of accumulative pension insurance (in addition to the solidarity system), the state went directly to the third pillar, allowing the creation of private pension funds. Many were immediately used by dishonest businessmen to lure money from gullible investors. During the first financial crisis of 2008-9, many of these funds went bankrupt. For example, if in 2009 there were 95 registered non-state pension funds, then by 2013 there were 63.

According to official data, today there are 62 non-state pension funds registered in Ukraine, with less than a million people contributing to them (about 7% of the working population). Their total accumulated funds do not reach three billion hryvnya (less than 0.8% of the annual budget of Ukraine's state pension fund). Even the government is forced to admit that private pension funds, after 15 years of work, cannot provide normal pension payments.

> "Appeals to the demographic crisis and the crisis in the labour market may signal that the authorities do not see solutions, or are not ready to implement in order to overcome these crises"

Meanwhile, abandoned to the mercy of fate, the state's solidarity pension system is sinking deeper and deeper into crisis. Over the past three years, the state pension fund deficit, covered by the state budget, has risen from 155 billion hryvnya in 2018 up to 200 billion hryvnya in 2020. This year, these subsidies from the budget may grow by another 10%.

But even with such huge subsidies, pensions, on average, provide only 28% of real wages reimbursement – while Ukraine has undertaken international obligations to provide at least 40% of reimbursement.

According to government forecasts, in the coming years this figure may drop to a catastrophic 18% of real wage reimbursement, which will leave the majority of pensioners below the poverty line.

Negative demographics

There are several reasons for the rapid growth of Ukraine's budget expenditure on pension payments. Some of them are well known: a poor demographic situation and a high proportion of shadow employment.

Today, Ukraine's demographic statistics over the past 30 years looks like an endlessly declining curve. Since the first years of independence, the country's population has decreased by 11 million, to 41 million. And even this data looks doubtful. A population census has not been conducted in the country since 2000.

Last year, there was an attempt to estimate the population using digital technology. It turned out that in reality the number of Ukrainian citizens living in the country may be even lower – roughly 37 million people. These data were also heavily criticised from all sides, and have remained a failed experiment, rather than an accepted statistic.

> "The government has constantly referred to the growing threat of the collapse of the solidarity pension system, and a campaign has been launched in the media in support of the government's pension reform initiative"

However, the projections for the country's demographic future are even worse. According to the authors of a draft law on accumulative pension insurance, by 2050 the number of citizens of Ukraine may be reduced to 33 million. At the same time, the share of pensioners will increase from the current 23% to 35% of the total population of the country. The government believes that the solidarity system simply will not be able to provide for such a number of pensioners. And this is the main reason for the accelerated introduction of the second level of pension reform – compulsory accumulative pension insurance.

In fact, the government plans to introduce another type of mandatory pension contributions. However, unlike the solidarity system, funded pensions will go to special accounts with authorised banks or licensed private pension funds. According to one of the latest draft pieces of legislation, there are also plans to create a special state pension fund, in addition to the existing one – serving the solidarity system.

"Appeals to the demographic crisis and the crisis in the labour market, which underpin the introduction of the second level of the pension reform, may signal that the authorities do not see solutions, or are not ready to implement in order to overcome these crises," says Oksana Dutchak, an expert at the Center for Social and Labor Research.

"In addition, you need to understand that when you have a large share of people working in the shadow labour market, the second level system will not work for a significant number of citizens."

Unsuccessful reform of the solidarity system

Five years ago, during the presidency of Petro Poroshenko, the Ukrainian government made an attempt to legalise employment in the country's labour market and reform the solidarity pension system at the same time.

With the support of the parliamentary majority, the government almost halved the size of the so-called 'single social contribution' (pension and other social payments), which is charged to people who are officially employed. In total, these costs decreased from 41% to 22%.

At the same time, the government tightened fines for illegal employment, raising their size for employers to 60,000 hryvnia (approximately 1,800 euros). The government also almost doubled the minimum wage.

The calculation was that a decrease in the rate of social contributions against the background of increased sanctions for illegal use of employment would stimulate business to come out of the shadows. And the increase in minimum wages would provide the required amount of guaranteed receipts of money to the accounts of the state pension fund in order to pay current pension obligations.

Initially, this plan seemed to work. For example, by the end of 2019, the official level of "shadow employment" fell to its lowest level in the last decade – 21%. This data was provided by Ukraine's Ministry of Economy last year with reference to the State Employment Service of Ukraine .

At the same time, according to the former minister of economy Timofiy Milovanov, out of 28.5 million able-bodied citizens in Ukraine, only 12.8 million are legally employed. The rest are either employed in the shadow sector or have left the country altogether. The latter number roughly seven million citizens.

As a result, neither the government of former prime minister Volodymyr Groisman, nor the other two governments already appointed by President Volodymyr Zelenskyi since his election in 2019, have managed to radically change Ukraine's 'shadow employment' situation. The labour market crisis was exacerbated by the onset of the coronavirus pandemic.

All this resulted in a growing deficit of the solidarity pension system and made it impossible to significantly increase pensions – an election promise by Zelenskyi.

Storming the pension system

Yevhen Kolishevskyi hoped that the state would deal with the pension reform, which began back in 2004. Since then, he has made contributions to the solidarity pension system, and now the government says that this system is on the verge of collapse. Kolishevskyi has thus found himself in the same situation as many millions of his compatriots – his future holds not only old age, but also poverty.

Aware of this growing problem, the Ukrainian government's current efforts to launch compulsory pension insurance are more reminiscent of a decisive (or desperate – depending on your point of view) storm of parliament. The government has constantly referred to the growing threat of the collapse of the solidarity pension system, and a campaign has been launched in the media in support of the government's pension reform initiative.

The expert community has been divided. The key question was whether the funded system should be launched now, or whether the solidarity pension system should be stabilised first.

"Will the launch of the second level pension system solve the pension fund deficit? There are several threats here. The first of them is Ukraine's unstable economy in recent years and the vague prospects for its stabilisation," says Dutchak. "In conditions where we have an absence of economic growth and the continuation of economic crises, the same thing that happens to any other savings can happen to pension savings: in the period before a person retires, they will significantly depreciate. Stable investment of savings and their proper administration by operators may also be threatened by economic instability, speculation and corruption risks."

The Ukrainian parliament's main research directorate went even further in its criticism, bluntly stating that in conditions of economic instability, introducing funded pension insurance means discrediting the very idea of funded pensions.

In addition, official experts pointed out that Ukraine does not have a securities market, and there will be simply nowhere to invest funds collected in savings accounts – except to lend them to the government.

What will happen next is still unknown. After negotiations over the percentage of deducted wages that should go to the state pension system under the new law, the updated draft legislation has stalled after coming under criticism from other ministries.

The parliamentary opposition, represented by the pro-Russian Opposition Platform – For Life party, proposes an alternative bill that would link the second level system to a stable economy – but there is practically no chance that the opposition bill will be supported in Parliament.

The government, meanwhile, insists on adopting a law on compulsory accumulative pension insurance this year, so that the new system can start working from 2023. Otherwise, its introduction will be delayed for at least another year.

"Most likely, I will have to work all my life," says Yevhen Kolishevskyi.

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P.S.

Open Democracy

https://www.opendemocracy.net/en/odr/ukraine-pension-system-crisis/