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|---|---------------------------------|-------------|---------------|----------------------------------|
| <b>IFP SES</b>                                | <u>From :</u><br>Pascal ANNYCKE | <u>To :</u> | <u>Copy :</u> | <u>Date :</u><br>10th April 2005 |
| <b>SOCIAL SECURITY AND REFORMS IN UKRAINE</b> |                                 |             |               |                                  |

#### Introduction:

As the other former Soviet Socialist Republics, Ukraine inherited from the USSR social security system at its independence.

Pension and social security system had to face regular deficit. Among other things, as wage arrears have been a regular problem, it was also resulting in a lack in social security contribution based on wages.

This note will try to present the system for each social security branch.

From the independence of Ukraine until the 2003 reform, there was one global contribution rate (1 % or 2 % from employees and 37 % from employers) to finance old age, disability, survivor pensions, maternity and sickness cash benefits, work injury, and family allowances for employees. This employer contribution rate has been reduced to 32% of payroll with the 2003 law.

#### **OLD AGE PENSION:**

##### Former pension system:

Old age pension was implemented following social insurance principle, on defined benefit principle. A pension of 55% of wage base was paid to a man from age 60 with 25 years of contribution and to a women age 55 with 20 years of contribution. This pension rate was increased by 1% for each extra year of contribution.

##### Reform:

At the moment, it seems to be a **transitional period**. Two main laws will change the structure of old-age pensions. The law No. 1058-IV of July 9, 2003 concerns the reforms of the Mandatory State Pension Insurance. And the law No. 1057-IV of the same date concerns the so-called "Non-State Pension Provision. Both these laws were supposed to be implemented from January, 1<sup>st</sup>, 2004.

There are discussions about increasing the retirement age. Retirement age has been unchanged but individual deferring their retirement receive a pension increase from 3% one year later to 85.32% for 10 years and more.

Pensions were indexed on prices and from March 2005 indexation has to also integrate a 20% of real wage growth.

The Ukrainian Parliament has raised the formal minimum wage level for 2005. 4 increases of this minimum wage level have been planned in 2005, from UAH 260 on 01-01-2005, reaching UAH 332 on 01-09-2005. Minimum wage has also some impact on the pension level.

First pillar:

- A **social insurance pillar** will pay 1% of the wage base for every year of contribution. This defined benefit scheme is managed on a pay-as-you-go basis.

A minimum eligibility period of 5 years of contribution is required to receive this pension.

This pillar is based on defined benefit principle, but with a limited role.

For the elderly who are not eligible to such a pension, social assistance benefits have also been reformed by the law of 18-05-2004, implemented on 01-01-2005. Men over 63 and women over 58 are eligible to the minimum assistance benefits defined by this law. The minimum non-contributory old-age pension will also be of UAH 332 per month for 2005.

Second pillar:

- A **mandatory funded supplementary pension scheme** (called "Accumulation system within the mandatory state pension insurance system) will be based on employee contributions (7% of earnings), which will be invested in pension funds. This funded scheme does not seem implemented yet. An action plan to implement the mandatory accumulation system has been being developed and is supposed to end in 2007. This defined contribution scheme will pay out life annuities or lump sum in special cases (critical state of health, too small accumulated amount, residence out of Ukraine).

(By ILO standard, a lump sum does not fulfill the requirement of an old-age pension provision).

Third pillar:

- A **voluntary pension scheme**, based on tax incentives. Tax relief is the main source of motivation to contribute to a voluntary old age pension schemes. Ukrainian Parliament has passed 2 amendments on July 1<sup>st</sup>, 2004. One amendment concerns the law "On Corporate Profit Tax", the other one "On Individual Income Tax".

It can be based on voluntary employer contributions, voluntary employee contributions or even contributions from a close relative. This global tax relief (15% of the gross yearly wage, limited to a cap of 1.4% of the monthly minimum subsistence level: UAH 386.73 in 2004, i.e. a maximum tax relief of UAH 540).

## **HEALTH CARE:**

Health care is tax-financed. In theory, all residents have access to this universal public medical care system. Some special health care provisions have been developed for Chernobyl victims. However, there are common practices, which restrict the actual universality of health care in Ukraine.

We can note at least 2 of these practices:

- Existence of voluntary private medical insurances. Private insurance companies have developed conventions with private clinics and paid public services. Only a minority of the Ukrainian population can afford to pay such voluntary private insurance premiums.

- It is common to pay some bribes or pay additional “voluntary participation” to the public entities in order to receive treatment delivered by public hospitals. This is explained to compensate the lack of public financing for health care.

There are discussions and Parliament bills about introducing a mandatory private health insurance system. There is a will to distinguish between free basic medical treatment and other treatment to be paid.

### **MATERNITY and CASH SICKNESS BENEFITS:**

Since 1<sup>st</sup> January 2001, a new law called “On mandatory state social insurance against temporary disability and expenses caused by birth and burial” has been implemented.

While benefits were financed by the global contribution rate under old age, the new law separates the financing of maternity and cash sickness benefits.

Maternity benefits are paid to employed women for 126 days (70 days before and 56 days after confinement). The benefits are at 100% of earnings.

Cash sickness benefits at 100% of earnings with at least 8 years of contribution.

### **WORK INJURY:**

After a long delay, the 1999 law “on mandatory state social insurance against industrial accident and occupational disease resulting in inability to work” was implemented in 2001. This law separate the financing of work injury from the main global social security contribution. Benefits are fully financed by employers contributions.

Provisions have been developed for the following risks:

Temporary disability benefits (100% of earnings)

Permanent disability benefits (from 40 to 70% of earnings depending on invalidity level)

Survivor benefits (30% of the wage base)

### **UNEMPLOYMENT:**

At the independence of Ukraine when appeared the “official” unemployment rate, a law came into force in 1992 to provide with unemployment benefits. Benefits were then fully financed by employers’ contributions. Benefits were paid for one year at a decreasing rate during that year, from 100 to 50% of previous wage. Unemployment assistance benefits were paid for longer period of unemployment.

The 2001 reform mainly introduced employee contributions

### **FAMILY ALLOWANCES:**

Family benefits are means-tested. Allowances are financed by the global contributions under old-age, for children under age 16, or 18 if student. The allowance is 50% of the minimum wage per child.

## **Conclusion:**

The main reforms of the XXIst century in Ukraine are following the direction of the “classical” World Bank approach. The burden of the cost is shifted from the state and the enterprise to employees or individuals. Between 2001 and 2003, reforms in unemployment, cash sickness benefits and old age pension programs either created or increased employee contributions. This additional cost not only is borne by employees/individuals, but there is also a lower security provided by these schemes. While the former defined benefit scheme guaranteed a much higher pension level than the current 1<sup>st</sup> pillar, the pension reform is phasing in a fully funded mandatory private 2nd pillar. This future defined contribution scheme is to have 7 % of employee contributions, but this provision has not been implemented yet. There is absolutely no reason why this pillar should be fully financed by employee contributions and not by employer contributions. The ILO should suggest for at least an equal sharing of cost between employee and employer contributions (as mentioned in ILO conventions).

Are these increased employee contributions compensated by wage increases to maintain the purchasing power? If there is an increase in employee contributions, there is a risk of decrease in employee’s purchasing power. Any increase in employee contributions (not only for pension) should be compensated with a wage increase. No wage increase would mean an immediate net loss for workers and for the pensioners with the reform of benefits in the long term.

Concerning health care, the lack of public financing is at the origin of long waiting lists, lack of equipment and so on. Therefore a private health system (both private health insurance and private clinics) has developed aside. The state should make a particular effort to improve public health care as PSS and other surveys have shown that access to health is the first expectation from the public services by the population in all the countries.

For more information, check on internet:

[http://www.pension.kiev.ua/FILES/ENG/Stat\\_2004\\_E.pdf](http://www.pension.kiev.ua/FILES/ENG/Stat_2004_E.pdf)

[http://www.pension.kiev.ua/FILES/ENG/Publications\\_Ukraine-NewPensionSystem.pdf](http://www.pension.kiev.ua/FILES/ENG/Publications_Ukraine-NewPensionSystem.pdf)

## Social security contributions and benefits in Ukraine

|                          | Contributions          |  |                        |              |                                      |                                      | Benefits  |   |
|--------------------------|------------------------|--|------------------------|--------------|--------------------------------------|--------------------------------------|---|---|
|                          | Employee contributions |  | Employer contributions |              | Government financing                 |                                      | Benefits 1999   | Benefits 2004   |
|                          | 1999                   | 2004                                   | 1999                   | 2004         | 1999                                 | 2004                                 |   |   |
| <b>Old-age</b>           | 1-2%                   | 1-2%<br>+ 7%* (2 <sup>nd</sup> pillar) | 37%                    | 32%          | Subsidies                            | Subsidies                            | Defined Benefits: 55 % + 1% for extra years of service        | Defined Benefits: 1% / year<br>Defined Contributions for 2 <sup>nd</sup> pillar       |
| <b>Disability</b>        | In old age             | In old age                             | In old age             | In old age   | Subsidies                            | Subsidies                            | From 40 to 70% of earnings depending on incapacity            | From 50 to 100% of old-age pension  |
| <b>Survivor</b>          | In old age             | In old age                             | In old age             | In old age   | Subsidies                            | Subsidies                            | 30% of earnings for the widow                                 | 50% of the old age pension for the widow  |
| <b>Health care</b>       | -                      | -                                      | -                      | -            | Whole cost                           | Whole cost                           | Free public benefit in kind                                   | Free public benefit in kind   |
| <b>Sickness</b>          | In old age             | 0.5%                                   | In old age             | 2.9%         | -                                    | -                                    | From 60 to 100% of earnings depending on years of service     | From 60 to 100% of earnings depending on years of service                             |
| <b>Maternity</b>         | In old age             | In sickness                            | In old age             | In sickness  | Cost of universal maternity benefits | Cost of universal maternity benefits | 100% of earnings for 126 days                                 | 100% of earnings for 126 days   |
| <b>Work injury</b>       | In old age             | -                                      | In old age             | 1.9 %        | Subsidies                            | Subsidies                            | Same as disability or 100% of earnings for temporary benefits | From 40 to 70% of earnings if permanent benefits. 100% of earnings for temp. benefits |
| <b>Unemployment</b>      | 0%                     | 0.5%                                   | 1.5%                   | 1.9%         | Subsidies                            | Subsidies                            | From 50-100% decreasing during one year                       | From 50-100% decreasing during one year   |
| <b>Family allowances</b> | In old age             | In old age                             | In old age             | In old age   | Subsidies                            | Subsidies                            | 50% of minimum wage per child                                 | 50% of minimum wage per child   |
| <b>TOTAL</b>             | <b>2%</b>              | <b>10%</b>                             | <b>38.5%</b>           | <b>38.7%</b> |                                      |                                      |   |   |

\* provision not implemented yet