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# ICPS newsletter

## Businesses are interested in pension reform

*At the end of 1999, the International Centre for Policy Studies and the Canada-Ukraine Legislative Co-operation project carried out a joint project to evaluate the consequences of the implementation of new pension legislation in Ukraine, with funding from the Canadian International Development Agency. In the framework of this research, whose results will be presented in the nearest future, experts of ICPS's Business Opinion Survey project investigated the perception of managers of enterprises about pension reform. The complete analysis of the research results will be published in the next issue of ICPS's Business Opinion Review*

The current "solidarity system" needs to be radically reformed, as it is not able to provide Ukraine's citizens with proper levels and social equity of pensions. In developing a strategy for pension reform, the possible impact of changes in the pension system on the economy must be taken into account.

The main goal of the special survey of enterprise managers was to obtain their answers to the following questions:

- how do managers evaluate the impact of the current pension system on production and employment indicators and on employee incentives to work for official wages?
- do managers expect that the begun pension reform will have a positive impact on these indicators?

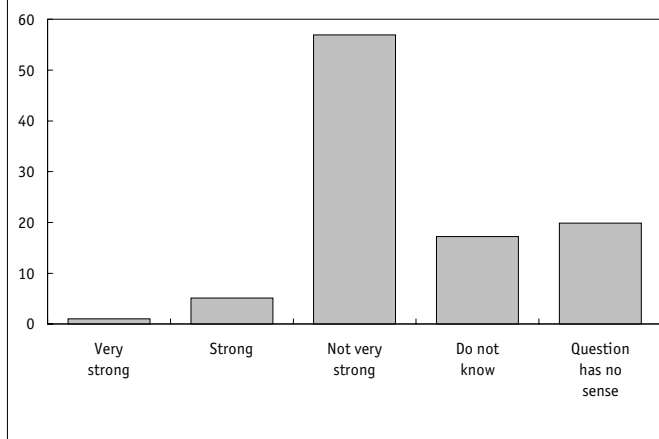
Moreover, it was planned to investigate manager opinions on the usefulness of establishing a non-government pension fund for enterprise employees.

### Current pension system slows enterprise growth

The conducted survey shows that the greater part of enterprise managers is sure that the current system of tax deductions to the Pension Fund prevents production growth, and increases in wages and job opportunities as well. For example, 56.1 percent of respondents believed that the current payroll tax (32 percent) slows production growth in enterprises strongly or very strongly. 64.5 percent of respondents contended that this tax strongly or very strongly restrains wage and employment increase. Moreover, the trend was discovered that the larger number of workers, the more frequently this opinion was recorded.

In addition, employees have weak incentives to work for official incomes due to the lack of a relationship between benefits and performance. Thus, only 1 percent of respondents believes that

*Figure 1. Current pension system as an incentive to work for only official wages, percentage of managers*



the current pension system strongly motivates workers to receive official wages (5 percent answered "very strongly"). At the same time, 56.9 percent of surveyed managers are sure that the system weakly motivates working for only legal wages (see Figure 1).

Thus, on the one hand enterprise managers think that the current rate of tax deductions to the Pension Fund is one the causes slowing enterprise growth, and seek different ways to abate its impact. On the other hand, employees are not interested in making the Pension Fund payments. Under these circumstances, the practice of paying unofficial wages (i.e., pocket payments) spreads further.

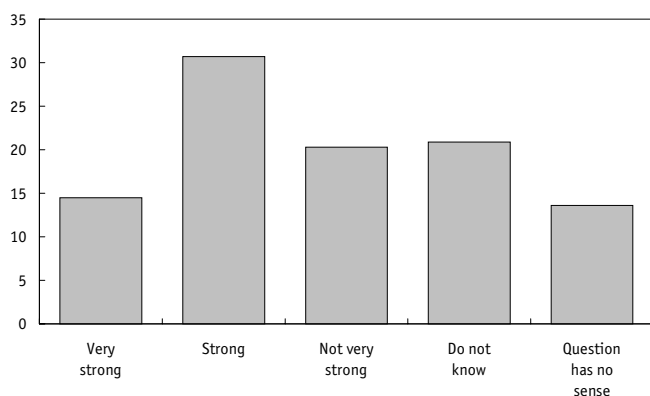
### Reforms promote income legalisation

The program of pension reform in Ukraine foresees reforming the solidarity system, as well as introducing mandatory state and voluntary non-state pension insurance, i.e., systems of mandatory contributions and of voluntary individual accounts. One of the arguments for opening savings accounts is the expected positive impact of this system on the economic environment. It is foreseen that through the introduction of savings accounts, incentives to legalise income will increase, leading to revenue growth under the solidarity system. Moreover, this system will further promote the accumulation of financial resources floating in the economy.

The results of the conducted survey testify that enterprise managers are quite well-informed about pension reform. The majority of respondents—80.7 percent—knows about the begun pension reform, and 40.7 percent of them are even acquainted with some its provisions. Based on these figures, we came to conclusions that:

- public opinion is well prepared by the mass media for comprehending pension reform;
- answers regarding the expected reform impact on the economic environment are reliable and trust worthy.

*Figure 2. Future pension insurance system as an incentive to work for official wages, percentage of managers*



### ***This Week***

**Regional budget in Ukraine.** This year's first macroeconomic seminar on "Regional Budgets in Ukraine: Turning the Pyramid Upside Down?" will be held at ICPS on January 18. Participants will discuss the following questions:

1. Regional budget execution in 1999. If the patient is so sick, why is it doing comparatively well?
2. Intergovernmental relations in Ukraine, as affected by the revised draft 2000 budget
3. January 1, 2001: Entering the new millenium with a brand new intergovernmental system?

The presentation will be given by Mr. Ihor Shpak, Budget Committee Fiscal Analysis Office/Barents Group, Intergovernmental Advisor.

*Concerning invitations for ICPS's seminar, please contact Larysa Romanenko, manager of the Communication Forums Group. E-mail: LRomanenko@icps.kiev.ua tel. (380-44) 463-5967.*

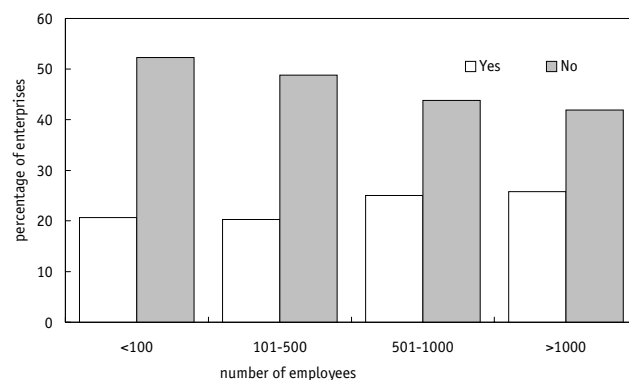
According to 14.5 percent of respondents, the future pension insurance system, where workers save their future benefits in individual accounts, will strongly stimulate working for only official wages. 30.7 percent of surveyed managers believed that the incentives will be more or less strong, but 20.3 percent of respondents considered the additional incentives to be weak. Moreover, many respondents could not answer this question: 20.9 percent did not have an opinion about this matter, and 13.5 percent noted that the question had no sense (see Figure 2). The results of the survey show that the majority of enterprise managers do not think that pension reform is capable of completely solving the problem of income legalisation. Obviously, the cause of these presumptions was their sound view on reality—in society there are various reasons for tax evasion, and pension system reform will be able to remove only some of them.

### **Managers are not ready for non-government pension fund**

According to the survey results, 21.5 percent of enterprise managers believed that it would be expedient to create a non-government pension fund for their employees. The majority of respondents (48.8 percents), though, was against this idea, and 24.4 percent hesitated to answer. Typically, managers of enterprises with larger numbers of employees rarely responded that the establishment of a non-government pension fund would be inexpedient (see Figure 3).

Notwithstanding the negative image of non-government pension funds formed through criminal activities of trusts, the indicator of readiness for creating non-state pension fund at enterprises (21.5 percent) may be evaluated as rather strong. The level of this indicator (along with the 24.9 percent of respondents hesitating with their answer) shows that in society there is great potential for establishing and developing non-government pension funds.

*Figure 3. Do you support establishing a non-state pension fund?*



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