

Impact of the Financial and Economic Crisis on Wages, Income Distribution and the Tax System

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Foreword

The global economic crisis – the “Great Recession” – has had a profound impact on the world of work. In Ukraine, the negative effects of the crisis on enterprises and workers emerged in late 2008, but have worsened since. This study has been produced as part of the ILO’s efforts to support the country’s crisis response and its attempts to achieve a sustainable and inclusive economic recovery, in line with the Global Jobs Pact.

The Global Jobs Pact, which was adopted by the International Labour Conference in June 2009, establishes an internationally agreed approach to guide national and international policies aimed at stimulating economic recovery, generating jobs and providing protection for working people and their families. The Global Jobs Pact calls for a decent work response to the crisis in order to strengthen efforts to maintain and create jobs, stimulate the development of sustainable enterprises, develop quality public services and protect both male and female workers, while safeguarding rights and promoting voice and participation.

It provides a framework for the period ahead and a resource of practical policies for the multilateral system, involving governments, workers and employers. The Global Jobs Pact prioritizes employment and building social protection as key elements of international and national action to aid recovery and development. Its principles for global action on jobs are as follows:

- Priority given to employment and building social protection within the framework of international and national action to aid recovery and development.
- Support for vulnerable women and men, including young people at risk, the low-waged, the low-skilled, those working in the informal economy and migrant workers.
- Maintaining employment and facilitating job transitions and access to the labour market for the jobless, for example, through public employment services and skills development.
- Avoiding protectionist solutions, including wage deflation and undermining labour standards.
- Social dialogue, tripartism and collective bargaining.
- Economic, social and environmental sustainability.
- Effective and efficient regulation of market economies to enable sustainable enterprises and employment.
- Heightened policy coherence, including increased development assistance to the least developed countries, as well as to countries with restricted fiscal leeway.

This study is located within this policy framework and is the latest element in the ILO’s response to a request from the Ukrainian Ministry of Labour and Social Policy in December 2008 for the ILO to provide comprehensive policy advice on ways of mitigating the impact of the global economic crisis on Ukraine. This initiative was supported by the social partners. The ILO started practical work in December 2008, and in January 2009 a national conference on mitigating the impact of the crisis was organized in Kyiv with the technical and financial support of the ILO. In February 2009, a study of the economic and social situation of Ukraine was conducted, which was followed by a national tripartite working meeting on 26 May 2009 in Kyiv to discuss the results of this study and the way forward. The participants asked the ILO to conduct additional research and analysis on the following issues:

- Wages, income distribution and the tax system;
- Social security and pension reforms;
- Economic diversification and skills matching in the metallurgy and tourism sectors.

The draft research papers were discussed at a National Tripartite Conference on “Recovering from the Crisis: Implementing the Global Jobs Pact in Ukraine” which was held in Kyiv, 20–21 May 2010.

The report contained in this volume, entitled 'Impact of the Financial and Economic Crisis on Wages, Income Distribution and the Tax System', provides an analysis of the impact of the crisis on wages, income distribution and the tax system and suggests policy recommendations.

The preparation of this report was led by Verena Schmidt, Senior Specialist in Working Conditions/Gender Equality, ILO Decent Work Team and Country Office for Central and Eastern Europe.

Sections 1, 2 and 4 were written by Gennadii T. Kulikov, Dr. Sc. (Econ.) (Institute of Economics and Forecasting, NAS, Ukraine), and sections 3 and 5 were written by Viktoriia V. Blyzniuk, Cand. Sc. (Econ.) (Institute of Economics and Forecasting, NAS, Ukraine). The Summary and Recommendations were written by Verena Schmidt.

I would like to thank Alena Nesporova, ILO Deputy Regional Director for Europe and Central Asia and Daniel Vaughan-Whitehead, Senior Specialist for the ILO Conditions of Work and Employment Programme for valuable suggestions and comments and Mr Vasyl Kostyrytsya, ILO National Coordinator for important advice and preparation of the National Tripartite Conference.

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1. Macroeconomic aspects of the crisis with regard to wages

The global financial and economic crisis has negatively affected Ukraine's basic macroeconomic indicators. Table 1.1 shows that the key macroeconomic indicators have declined sharply, with falls of –15.1 per cent in real GDP, –9.2 per cent in real wages, –8.5 per cent in real incomes, –41.5 per cent in fixed investments, –43.4 per cent in exports and –49.9 per cent in imports. Ukraine's external debt increased substantially, from 58.6 per cent of GDP in the pre-crisis year of 2007 to 89.3 per cent in the crisis-fraught 2009.

TABLE 1.1 KEY MACROECONOMIC INDICATORS OF UKRAINE, 2004–09, FORECASTS FOR 2010 AND 2011							
Macroeconomic indicators	2005	2006	2007	2008	2009	2010 forecast	2011 forecast
Nominal GDP, UAH billion	441.5	544.1	720.7	949.9	914.7	1103.5	1252.9
Real GDP, % change	2.7	7.3	7.9	2.1	–15.1	1.0	3.5
Real wage, % change	20.3	18.3	12.5	6.3	–9.2		
Real income, % change	23.9	11.8	14.8	7.6	–8.5		
Fixed investment, % change	1.9	19.0	29.8	–2.6	–41.5	2.6	10.6
Export, % change	6.3	13.7	27.2	34.9	–43.4	1.1	2.1
Import, % change	25.8	24.8	34.5	40.3	–49.9	2.4	7.6
Consumer price index, % change, end of period	10.3	11.6	16.6	22.3	12.3	10.0	7.9

Source: References, 5, pp. 26, 28; 6. Projections by Ukrainian authorities and the World Bank (References, 7, p. 136).

Projections by Ukrainian authorities and the World Bank indicate considerable improvements in macroeconomic indicators for 2010 and 2011, in particular, increases of 1 per cent and 3.5 per cent, respectively, in real GDP, and of 2.6 per cent and 10.6 per cent, respectively, in fixed investments (References, 7, p. 136).

It is important to address the impact of changes in macroeconomic indicators on wages and incomes. The *Global Wage Report 2008/2009* and the *2009 Update of the Global Wage Report* confirm a strong relationship between economic growth and wages, drawing attention to the fact that wages were increasing at a slower pace than economic growth ten years prior to the crisis, leading to a decreasing wage share. Each additional 1 per cent in the annual growth of GDP per capita led, on average, to a 0.75 per cent increase in annual wage growth. A more recent pre-crisis period, 2005–07, demonstrated a stronger correlation between economic growth and wages (up to 0.91), perhaps providing evidence of an incipient catch-up process after a decade of wage restraint. The process ended as the crisis broke out. There were considerable changes in wage behaviour by country in 2008 and 2009: very few countries managed to maintain positive real wage growth in the face of economic decline, while the large majority cut wages.

Table 1.2 shows that Ukraine's economic conditions deteriorated considerably in 2009. In particular, the industrial output index amounted only to 78.1 per cent, year-on-year, industrial output sales were only 64.6 per cent of the previous year (UAH 591.9 billion) and commodity exports totalled 82.3 per cent, year-on-year (UAH 284.8 billion). Ukraine's economic conditions improved slightly in 2010. For example, the industrial output index in January–March 2010 amounted to 110.8 per cent, compared to the corresponding period of 2009. Up to 47 per cent of Ukraine's GDP is provided by exports. However, Ukraine's exports are almost 60 per cent raw-material-oriented, consisting of unprocessed products (in most other European countries, this indicator does not even reach 20 per cent).

TABLE 1.2 KEY DEVELOPMENT INDICATORS OF UKRAINIAN INDUSTRY, 2001–09										
Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 ¹
Industrial output index, %	113.2	114.2	107	115.8	112.5	103.1	106.2	110.2	96.9	78.1
Industrial output sales (at actual prices), UAH billion	182.7	210.8	229.6	289.1	400.8	468.6	551.7	717.1	916.6	778.2
Commodity exports, UAH billion	79.3	87.3	95.7	123.0	173.7	175.3	193.8	248.9	346.0	205.8
Fixed assets depreciation rate, %	48.8	51.9	54.5	56.4	58.3	57.9	58.6	59.0	58.0	59.1
Fixed investment index, %	123.8	113.3	106	124.6	124.9	104.1	115.3	127.0	94.7	68.5
Operating profitability of industrial enterprises, %	4.8	3.7	2.6	3.3	4.7	5.5	5.8	5.8	5.0	4.8
Share of loss-making enterprises, %	42	41	42	40	38	37	35	33	39	37.8
Share of enterprises implementing innovations, %	14.8	14.3	14.6	11.5	10.0	8.2	10.0	11.5	10.8	9.7

Note: ¹ Preliminary figures.

Source: References, 6; 7, p. 34.

The consequences of the crisis have been felt in almost every industrial sector, but to varying degrees. Least affected is the food industry, in which production fell over January–November 2009 by 6.7 per cent. The largest losses were seen in machine-building (–47.7 per cent), metal production (–29.6 per cent) and the chemical and petrochemical industry (–25.8 per cent). The decline in industrial output affected the operating results of transport enterprises, which delivered 24.1 per cent less freight from January to November 2009 than during the corresponding period of 2008. The credit shortage resulted in a decrease in construction work volume in all regions and in all basic construction activity categories; in January–November 2009, volumes amounted to 49.7 per cent of those in the corresponding period of the previous year. Such a sharp decline in output had an adverse effect on wages and incomes.

The aggregate percentage of activities related to high and medium technology is less than 13 per cent in Ukraine, with a very small proportion of sectors belonging to high technology (4.6 per cent). Ukrainian exports are dominated by medium and low technology sectors (56.1 per cent). This means that the country is geared to the manufacture of traditional industrial products, sold in competitive, saturated markets (References, 11, p. 11).

A considerable proportion of budgetary revenues was used to increase social payments, leaving too little to support domestic production and exports, secure investment projects for upgrading exhausted infrastructure and implement breakthrough innovation programmes. Domestic production provides only two-thirds of commodity resources for Ukraine's industrial products, the rest being imported.

The consumption boom was maintained by the banks. A qualitative transformation took place in the 2000s: in 2004, loans amounted to 15 times less than aggregate population income, while in 2008, personal loans exceeded aggregate population income. In other words, Ukrainian citizens borrowed more money than they earned in 2008. Overall, in the course of 3.5 years (2006–first half of 2009), consumer loans increased from UAH 18 billion to UAH 273 billion, and the balance of the economy was disturbed.

Macroeconomic policy effectiveness has declined substantially because of the prominence of the shadow economy, which adversely affects government expenditure and social protection. According to World Bank estimates, Ukraine has the largest informal sector in Europe, up to 50 per cent of official GDP (July 2007). The shadow economy rate in Ukraine, according to the Ministry of the Economy, was 31.1 per cent in 2008 and has increased by 2.3 percentage points year-on-year; it exceeded threshold limits (30 per cent of GDP) for the first time in recent years. In the first half of 2009, Ukraine's shadow economy grew at a rate of 8 percentage points year-on-year, reaching 39 per cent.

The shadow economy is most prominent in trade (80 per cent), construction (66 per cent), real estate (60 per cent), gambling (53 per cent), catering (53 per cent), mass media (53 per cent) and transport and delivery (46 per cent) (References, 11, p. 11).

Hence, the decline in macroeconomic indicators – gross domestic product, production output and sales, fixed investment, financial results of banks – has adversely affected real wage and income rates.

2. Impact of the crisis on wages and employment

2.1 Impact of the crisis on wage rates

The Global Jobs Pact, adopted by the International Labour Conference on 19 June 2009, emphasizes the importance of wages and minimum wages for exiting the crisis as soon as possible. It calls for the avoidance of protectionist solutions and warns of the dangerous consequences of deflationary wage spirals.

It is interesting to analyse wage, income and per capita gross domestic product dynamics in pre-crisis and crisis years (Table 2.1).

TABLE 2.1 WAGE, INCOME AND PER CAPITA GDP DYNAMICS, 2006–09 (% YEAR-ON-YEAR)				
	2006	2007	2008	2009
Nominal wage index	129.22	129.7	133.7	105.5
Real wage index	118.3	112.5	106.3	90.8
Household income	123.8	132.0	137.4	129.8
Per capita GDP	108.1	108.6	102.6	87.2

Source: Authors' calculations based on References, 5, p. 28, and References, 6.

It can be seen from Table 2.1 that growth rates of all the indicators in 2009, year-on-year, are lower than the growth rates of the same indicators in 2008, year-on-year, which can be explained by the negative impact of the crisis. It is also characteristic that wage and income growth rates outpaced per capita GDP growth rates considerably.

TABLE 2.2 AVERAGE MONTHLY WAGE DYNAMICS BY ECONOMIC ACTIVITY IN UKRAINE, 2000–09 AND Q1 2010 (UAH)														
Economic activity	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Q1. 2010	2009 in comparison to 2000, multiplier	2008 in comparison to 2007, %	2009 to 2008, %
Total	230	311	376	462	590	806	1041	1351	1806	1906	1993	8.3	133.6	105.5
Agriculture, hunting, forestry	114	154	183	219	311	437	581	771	1132	1,256	1194	11.0	146.8	110.9
Fishing and fish breeding	147	204	242	291	375	499	607	721	913	1,029	1017	7.0	126.6	112.7
Industry	302	406	485	591	743	967	1,212	1,554	2,017	2,117	2,312	7.0	129.8	104.9
Construction	260	362	427	546	709	894	1,140	1,486	1,832	1,511	1,428	5.8	123.3	82.5
Trade; repair of cars, domestic appliances and items of personal consumption	226	284	330	394	509	713	898	1145	1514	1,565	1737	6.9	132.2	103.4
Hotels and restaurants	178	235	286	340	429	567	735	944	1221	1,267	1327	7.1	129.3	103.4
Transport and communications activities	336	460	573	685	843	1,057	1,328	1,670	2,207	2,408	2,532	7.2	132.3	109.1
Financial activities	560	833	976	1051	1258	1,553	2,050	2,770	3,747	4,038	4,246	7.2	135.3	
Real estate operations, engineering and serv- ices to entrepreneurs	278	373	437	527	667	900	1,193	1,595	2,085	2,230	2,172	8.0	130.7	106.9
Public administration	335	396	495	577	691	1,087	1,578	1,852	2,581	2,513	2,336	7.5	139.4	97.4
Education	156	224	267	340	429	641	806	1,060	1,448	1,611	1,640	10.3	136.6	111.2
Health care and social assistance	138	183	223	279	351	517	658	871	1,177	1,307	1,413	9.5	135.1	110.0
Public utility and personal services, activities in the field of culture and sports	162	211	247	299	400	620	828	1,090	1,511	1,783	1,844	11.0	138.6	118.0

Sources: Authors' calculations based on References, 9, p. 400; 10, p. 204, 261, 262; and 6.

It is significant that wage growth rates in 2009 in comparison to 2008 (105.5 per cent) are considerably lower than wage growth rates in 2008 in comparison to 2007 (133.6 per cent) because of the financial and economic crisis. A similar pattern can be observed in every economic sector. The data presented in Table 2.2 may suggest that the wage level is determined not only by labour force quality but also by type of employment or activity.

A certain GDP share is redistributed through the wage system as can be seen in Table 2.3.

Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Wage share in GDP, %	42.3	42.3	45.7	45.7	45.6	49.1	49.4	48.8	49.0	51.0
Wage share in household income	43.4	42.7	42.7	43.9	42.7	42.1	43.5	44.0	43.3	41.9
Share of social benefits and other current transfers in household income	34.9	36.0	36.4	36.2	38.2	39.7	39.0	37.4	37.7	36.6

Sources: Compiled by the author based on References, 11, p. 100; 12, p. 93; 13, p. 89; 14, pp. 90, 91; 9, pp. 36, 98, 99, 395, 396; 6.

As the crisis got under way, the wage burden of Ukrainian companies increased. The wage share grew to 54 per cent of GDP in the first half of 2009 (January–June 2008: 51.0 per cent). Such growth in this indicator can be explained by the fact that, on the one hand, companies sought to retain staff, even at the expense of shrinking profits, while, on the other hand, the government did its best to avoid cutting jobs and wages in the public sector.

Aggregate household income is characterized by the increasing proportion of social transfers and the decreasing role of wages. As can be seen in Table 2.3, the share of social benefits and other current transfers in household income was 34.9 per cent in 2000, 37.4 per cent in 2007 and 37.7 per cent in 2008.

It is significant that real wages decreased due to the financial and economic crisis. For example, the real wage index in January–October 2009 amounted to 89.6 per cent in comparison to the corresponding period of 2008, whereas it was 119.3 per cent and 115.2 per cent in 2001 and 2006, respectively, and 112.5 per cent in 2008.

Large companies changed their compensation policy, but not significantly. The fixed portion of wages was cut by 10–20 per cent, whereas the variable portion was linked to performance targets. For example, a large foreign company's sales director might receive a \$120,000 fixed annual wage and a bonus, sometimes amounting to as much as 50–100 per cent of the wage. However, most firms either did not pay bonuses at all in 2009 or paid only small sums to their top managers. Bonuses are currently allocated for outstanding results. Managers' incomes have dropped by 30–50 per cent, on average. Wage rises for 2008 have been eaten up by the devaluation of the hryvnia. At the same time, job seekers' expectations have decreased by 15–20 per cent.

Due to the crisis, the wage funds of most enterprises and organizations (primarily in the public sector) will be regulated not so much by staff quantity as by wage rate alterations. Besides, wage systems have already experienced changes, including:

- freezes in the basic wage, first of all of official salaries and tariff rates and, if legally possible, even wage cuts;
- reductions in the supplementary portion of the wage, in particular, a general decrease in the variable wage portion (cancelling increments and fringe benefits, decreasing the share of bonuses or curtailing bonus programmes for certain staff categories, or cancelling bonus systems altogether);
- strict rules on salary adjustment/increase (for example, evaluation), higher demands made of staff ("do more with less").

There are significant problems with regard to wage regulation in the Ukrainian public sector. An imperfect system of wage regulation, low wage rates which do not reflect a high level of responsibility and work intensity, resulting in a fall in prestige and the diminution of employees' interest in improving efficiency and career development.

As a result of the insufficient funding of education and science, Article 57 of the Law on Education and the Law of Scientific and Technological Activities are not complied with as regards the establishment of wage rates for teachers at a level at least equal to the average wage of workers in industry, and for scientific and science-teaching staff at a level at least double the average wage of workers in industry. For example, the average wage in industry was UAH 2,117 in 2009, 31 per cent higher than the average wage in education and 62 per cent higher than in health care (Table 2.2).

2.2 Impact of the crisis on wage arrears

The current crisis has had a negative impact on wage arrears in most economic sectors. Although the amount of arrears varied during 2000–08, a decreasing trend could be observed. However, it started rising swiftly as early as the first year of the crisis (2008); that is, the steadily decreasing trend in wage arrears seen in 2000–07 went into reverse: arrears grew 2.5 times during 2008–09, reaching UAH 1.67 billion or 8 per cent of the wage fund accrued for October 2009. This especially concerns public administration, construction and health care. The debt amounted to 5.3 per cent of the wage fund in 2008. In some regions, however, wage arrears increased much more substantially over 2008–09: for example, by 27.7 times in Kyiv, 25.5 times in Sevastopol and 11.2 times in Volyn oblast.

The amounts of unpaid wages (as percentages of the total) were as follows in 2008: 64 per cent (UAH 760.6 million) at economically active enterprises (compared with 36 per cent in 2008), 30.8 per cent at bankrupt enterprises and 5.2 per cent at economically inactive enterprises. It should be noted that 20.1 per cent of the unpaid sum was owed by state-owned enterprises, 22.8 per cent by open joint-stock companies and only 2.4 per cent by private enterprises (References, 13, pp. 280, 291).

Hence, total arrears growth has been caused mainly by the increasing debts to workers of economically active enterprises, rising by 49.7 per cent (UAH 378.0 million) during January–October 2009 to reach UAH 1.1 billion as of 1 November 2009. Arrears growth at economically active enterprises was observed in all regions, most of all in Kyiv (by UAH 72.2 million), Kharkiv oblast (by UAH 35.4 million) and Kyiv oblast (by UAH 34.5 million).

2.3 Impact of the crisis on informal work practices and the informal economy

The informal, unregulated sector of the economy is extremely significant in Ukraine. In this sector, low-paid work is more widespread, and informal workers have no statutory social guarantees (paid leave, health insurance and so on).

Double accounting is fairly common with regard to wages, with workers officially receiving the minimum permissible statutory wage or slightly above, but in fact receiving several times more.

According to Ukrainian and World Bank experts, the total amount of hidden wages in Ukraine is about 50 per cent of legal wages. In many countries of the world, 20 per cent is defined as the threshold level of the “shadow” economy.

Large companies' wage payments are mainly above board, while the share of small and medium-sized enterprises making shadow wage payments is as much as 70–80 per cent. In other words, small business accounts for the lion's share of shadow wage payments. The largest amount of unrecorded payments is estimated to be in construction and small-scale trade. At state-owned and privatized enterprises, this practice is much less common.

According to the available estimates, the proportion of shadow wage scales correlate with the size of the shadow economy as a whole. Shadow rates in Ukraine by sector are presented in Table 2.4.

TABLE 2.4 SHADOW RATES IN UKRAINIAN PROCESSING INDUSTRY (% OF GROSS VALUE ADDED)						
Processing industry branches	2003	2004	2005	2006	2007	2008
Production of food, beverages and tobacco	42.6	40.2	36.2	34.0	32.4	40.8
Light industry	35.2	37.4	36.2	33.5	31.3	42.9
Woodworking and manufacture of wooden products, except furniture	35.8	35.5	34.9	33.0	30.1	42.1
Pulp and paper industry, publishing	35.9	35.2	35.5	33.4	32.7	36.1
Production of coke and oil processing products	42.5	38.5	37.0	33.7	36.8	45.1
Chemical and petrochemical industry	36.5	35.4	33.4	34.3	32.9	38.5
Metallurgy	38.0	34.8	35.6	34.1	32.0	39.3
Machine-building	35.3	34.1	32.9	33.0	30.0	36.2

Source: Data from the Ukrainian Ministry of the Economy.

It can be seen from Table 2.4 that the shadow rate in the processing industry is fairly high. It is characteristic that this indicator increased markedly at the beginning of the crisis.

It should be noted that, whereas the shadow economy share in the processing industry was 27.4 per cent of gross value added in 2007 and 35.3 per cent in 2008, the indicator in extractive industry was even higher in the same years, at 35.3 per cent and 42.0 per cent, respectively.

Shadow wages declined substantially in the crisis period as firms proceeded to introduce an austerity regime, resulting in unofficial pay cuts. The shadow rate in banking also fell because of problems of liquidity.

2.4 Impact of the crisis on employment

Up until 2008 employment in Ukraine has proved to be resistant to transitional shocks. In the 2009 crisis the employment rate decreased and the unemployment rate increased. Table 2.5 shows that the employed working-age population decreased by only 0.85 per cent during 2000–09 (from 18.5 million in 2000 to 18.4 million in 2009). The crisis affected employment rates. In particular, this indicator increased by 62,200 persons, or by 0.3 per cent, in 2008 year-on-year, whereas 2009 saw a contrary development, with a decrease of 886,700 persons, or 4.6 per cent, compared to 2008.

The unemployment rate (calculated according to the ILO methodology) among the working-age population declined from 12.4 per cent in 2000 to 6.9 per cent in 2008, followed by a rise to 9.6 per cent in the crisis year of 2009 (Table 2.5).

Turning to the registered unemployment rate, it has remained surprisingly low throughout the period. The unemployed population of working age registered with the public employment service amounted to 2.1 per cent relative to the working-age population in 2008 (2000: 4.2 per cent). The registered unemployment rate rose to 2.5 per cent in 2009. The registered unemployment rate relative to the working-age population is 1.8 per cent as for the 1st April 2010.

As emphasized in the Global Jobs Pact adopted by the International Labour Conference in June 2009, the global economic crisis and its aftermath mean that Ukraine, like the rest of the world, faces the prospect of a prolonged increase in unemployment, deepening poverty and inequality. It is important that, in Ukraine, the recovery merely of previous employment levels will not be enough to achieve a strong economy, including decent work for both women and men.

TABLE 2.5 KEY EMPLOYMENT AND UNEMPLOYMENT INDICATORS, 2000–09						
Years	Economically active population of working age		Employed population of working age		Unemployed population of working age (ILO methodology)	
	'000 persons, average	% of corresponding age group	'000 persons, average	% of corresponding age group	'000 persons, average	% of corresponding age group
2000	21,150.7	73.7	18,520.7	64.5	2,630.0	12.4
2001	20,893.6	72.6	18,453.3	64.1	2,440.3	11.7
2002	20,669.5	71.7	18,540.9	64.4	2,128.6	10.3
2003	20,618.1	71.4	18,624.1	64.5	1,994.0	9.7
2004	20,582.5	71.1	18,694.3	64.6	1,888.2	9.2
2005	20,481.7	70.9	18,886.5	65.4	1,595.2	7.8
2006	20,545.9	71.2	19,032.2	65.9	1,513.7	7.4
2007	20,606.2	71.7	19,189.5	66.7	1,416.7	6.9
2008	20,675.7	72.3	19,251.7	67.3	1,424.0	6.9
2009	20,321.6	71.6	18,365.0	64.7	1,956.0	9.6

Source: References, 6.

The impact of the current crisis on employment can be judged from the data presented in Table 2.6, which indicate that the crisis has adversely affected employment in the national economy and all its sectors. For example, the number of staff on administrative leave in pre-crisis Ukraine was 137,000 in 2006 and 127,000 in 2007, whereas the figure in the crisis year of 2009 was already 359,000 – or 1.2 per cent, 1.1 per cent and 3.5 per cent, respectively, of the total workforce. The number of staff working on a part-time basis was 620,000 in 2006, 506,000 in 2007 and 992,000 in 2009 – or 5.4 per cent, 4.4 per cent and 9.6 per cent, respectively, of the total workforce. A similar trend can be observed in individual economic sectors.

TABLE 2.6 CHANGES IN THE NUMBER OF WORKERS FORCED TO WORK PART-TIME, AND ITS PRE-CRISIS AND CRISIS LEVELS								
	On administrative leave				Working part-time			
	2006	2007	2008	2009	2006	2007	2008	2009
Ukraine total	137 ¹ 1.2 ²	127 1.1	180 1.6	359 3.5	620 5.4	506 4.4	1206 10.6	992 9.6
Agriculture, hunting, forestry	13 1.4	9 1.1	12 1.8	14 2.3	71 8.0	51 6.5	87 12.8	50 7.9
Industry	94 2.8	88 2.7	101 3.2	189 6.8	329 9.8	275 8.4	658 20.6	465 16.8
Construction	18 3.7	15 3.1	28 5.7	42 11.9	50 10.5	39 7.8	124 25.0	81 23.1
Trade; repair of cars, domestic appliances and items of personal consumption	2 0.3	2 0.2	11 1.2	17 2.1	25 3.2	17 1.9	100 10.5	104 12.7
Transport and communications activities	4 0.4	6 0.6	14 1.4	33 3.6	97 9.7	89 9.1	153 15.7	187 20.5

Notes: ¹ Hereinafter, numerator contains quantities in thousand persons.

² Hereinafter, denominator shows % of the average accountable number of staff members in a respective activity.

Source: Authors' calculations based on References, 13, p. 61, 103, 106, 6.

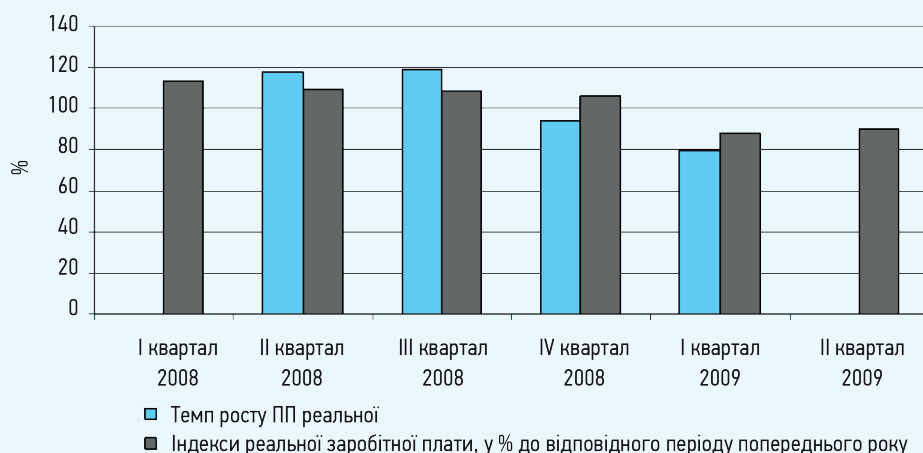
3. Relationship between wages and labour productivity

Analysing the development of key macroeconomic indicators and wages, we arrive at the conclusion that real wage changes prior to 2000 corresponded to macroeconomic trends – that is, wage growth was slower than GDP growth – whereas since 2000, real wages have risen at a faster rate than labour productivity. The average growth rate of labour productivity was 1.046 during 1997–2008, while the wage growth rate was 1.105 – in other words, wage increases outpaced labour productivity growth. This is clearly confirmed by calculations of annual real gains in labour productivity and wages (Figure 3.1).



Quarterly analysis of the situation with regard to labour productivity and wage development in 2008–09 proves the absence of a steady trend (Figure 3.2). For example, the real labour productivity growth rate during 2008 outpaced that of wages year-on-year, but the situation drastically changed as early as 2009, with real wages growing at a faster pace.

FIGURE 3.2
GAINS IN REAL WAGES AND LABOUR PRODUCTIVITY, 2008–09 (2000 PRICES)



There is a strong case for allowing wage growth rates to outpace labour productivity temporarily, for example, when there are skills shortages – especially of highly qualified specialists – in order to bolster the Ukrainian economy, as well as in light of the fact that income levels in Ukraine remain very low, both relatively and absolutely, substantially behind those not only in economically developed countries but also in some CIS partner states.

4. Social dialogue and the position of the social partners

Economic transformation processes in Ukraine have been accompanied in recent years by the development of new industrial relations. Ensuring decent work and decent pay and the protection of employees' labour rights in the contemporary context require an effective system of collective bargaining and the implementation of agreement-based regulatory principles, based on social partnership.

When the financial and economic crisis broke out in October 2008, the social partners were unable to use social dialogue to counteract the economic and social consequences of the crisis, for workers and their families, on the one hand, and for employers, on the other hand. In order to identify how social partnership might be developed, the standpoints of each of the partners must be identified.

4.1 The state

The state regulates wages both directly and indirectly. An example of direct regulation is the Law on Wages, covering minimum wages, personal income tax, wages in the public sector and so on. The role of the state with regard to wages is minimal at present.

State interference in a market economy must be definite and limited. The state should confine itself to doing everything that others cannot do, acting as an employer and a social actor.

The state's primary role is to set minimum social standards and guarantees, particularly a minimum wage. It is important to separate the state's role in minimum wage setting from its role in wage setting overall. Besides, the state should not play a direct role in the formation of a wage system. It should act less as an active participant than as a mediator between employers and trade unions.

The state's most important role consists of providing conditions for dialogue between employers and trade unions, and implementing the agreements reached. In particular, the state's role is to create a favourable investment climate, improve the tax system and so on.

Furthermore, indirect wage regulation by the state is extremely important and should be strengthened. This kind of regulation includes the financial system – primarily banking – credit, indirect taxes, innovations and investments.

4.2 Employers' organizations

There are 21 employers' organizations in Ukraine. There are hundreds of business associations which are not members of employers' organizations and thus their legitimacy is doubtful. In order to coordinate employers' activities and standpoints in the development of Ukraine's social and economic policy, three major employers' organizations (the Federation of Employers of Ukraine, the Employers' Confederation of Ukraine and the All-Ukrainian Employers' Association) founded a joint representative body on 7 July 2009. The Federation of Employers is a member of the International Organization of Employers (IOE).

In the opinion of experts from the Federation of Employers, social dialogue is necessary at the regional level. Indeed, some issues should be dealt with only at that level. The registration of an employers' federation or confederation is conditional on the existence of oblast-level organizations. At the same time, the Federation believes that regional agreements in their current form are not necessary.

From the standpoint of the Ukrvuhlerobotodavtsi Sectoral Association of Coal Industry Employers' Organizations, however, the conclusion of regional agreements makes sense because enterprises must address not only production issues but also housing and other domestic problems, which are important to members of work collectives.

Employers' opinions on the necessity of regional agreements, as well as their role and significance, differ. Some employers believe the agreements serve no purpose because they do not see what can be regulated at the regional level, whereas others think they are important because they make it possible to establish valuable relations between employers, trade unions and local authorities.

As for sectoral agreements, employers do not question their validity. At this level, it is important only to decide on representativity and the powers of the negotiating parties. According to the leadership of the Federation of Metallurgists, the issue of powers should be decided at the legislative level, involving employers' organizations rather than industrial groups. At the sectoral level, there is a major debate among the employers about the need to alter the content of sectoral agreements, in particular, the tariff system.

The Federation of Employers and the Metallurgists' Federation take the view that the existing system of job evaluation based on a tariff system is too formal, and does not provide estimates grounded on production output. Therefore, the leaders of these Federations believe, the tariff system of wages should be replaced by more progressive systems. The two largest metallurgical groups already pay their employees without a tariff system.

A different view is held by the Union of Leaseholders and Entrepreneurs, who believe that tariff scales function primarily as a starting point for wage setting. It should be pointed out that there is nothing to prevent sectors or regions – not to mention enterprises – from using a so-called contingent tariff scale.

The Metallurgists' Federation believes that provisions included in a company-level collective agreement should not be included in a sectoral agreement. They want to move away from a wage system imposed from above. In particular, this Federation is against the establishment of a ratio between the minimum wage rate and the first grade tariff rate, believing that enterprises should decide this themselves.

In the opinion of the Metallurgists' Federation, wages should not be determined according to coefficients or inter-tariff ratios. Large enterprises emphasize that they do not use tariff systems (tariff scales), so they must not be imposed on enterprises. Wage systems should be formed at enterprise level. The Federation therefore suggests that coefficients should be removed from all agreements.

4.3 Workers' organizations

There are currently more than 140 trade unions in Ukraine, including three major confederations: the Federation of Trade Unions of Ukraine (FTUU), the Free Trade Union Confederation of Ukraine (KVPU) and the All Ukrainian Union of Workers' Solidarity (VOST), which are affiliated to the International Trade Union Confederation (ITUC).

Unlike the employers, the trade unions are in favour of a tariff system and tariff scales in sectoral agreements. According to the leaders of the Federation of Trade Unions, a tariff system cannot be abandoned because it sets minimum ratios between low, medium and high skilled labour, that is, inter-tariff ratios.

In any case, a tariff system must be retained for state-owned and municipal enterprises. In other words, the trade unions believe that a tariff scale must be set at the sectoral level by means of sectoral agreements.

The Federation of Trade Unions of Ukraine also believes that various kinds of coefficients should be applied. In their opinion, the wages of skilled specialists in particular should be set on the basis of a system of coefficients. Inter-grade coefficients should be included in Annexes to the General Agreement, a practice already in use in Ukraine.

As for the minimum wage, the trade unions believe that the state must continue to be responsible for minimum wage setting for the foreseeable future.

A trade union priority is the establishment of a wage guarantee fund to protect the wage claims of their members. This is particularly important during the current crisis, as wage arrears have increased considerably.

5. Ukraine's tax system in the financial crisis

The current tax system in Ukraine took shape as far back as the start of the transformation process. It played a positive role when Ukraine was developing as an independent state, but the crisis has revealed a number of drawbacks and bottlenecks.

The need for tax reforms is illustrated by the following problems:

- too much legislation on taxation – more than 500 legal acts, the provisions of which must be grasped by both taxpayers and the staff of Ukraine's tax authorities;
- uneven and unfair distribution of the tax burden;
- the tax system suppresses economic growth and investment, encouraging tax evasion and stimulating capital outflow;
- inconsistencies and discrepancies in tax law provisions
- lack of transparent and efficient mechanisms for the protection of taxpayers' rights;
- double taxation;
- a large quantity of inefficient taxes, entailing substantial administrative costs that exceed the revenues they bring in.

The inconsistencies and high frequency of amendments and supplements to Ukraine's tax laws considerably complicate their implementation, adversely affecting enterprise functioning and reducing the attractiveness of Ukraine for foreign investors.

According to the World Bank Group and PriceWaterhouseCoopers (References, 17), the overall tax burden as a percentage of profits in Ukraine is 57.2 per cent. This far exceeds the figures for many other countries: for example, the tax burden is 44.9 per cent in Germany, 47.2 per cent in the Czech Republic, 49.1 per cent in Estonia, 31.4 per cent in Bulgaria, 42.5 per cent in Poland, 29.2 per cent in Denmark, and 31.1 per cent in Moldova.

Major revenue generating taxes include personal income tax, corporation tax, VAT and excise duties. A flat personal income tax rate has been introduced in a number of European countries, with rates of 33 per cent, 25 per cent and 26 per cent, respectively, in Lithuania, Latvia and Estonia, as well as 19 per cent in Slovakia. In 2005–06, Estonia decreased the tax rate to 23 per cent, whereas Lithuania lowered it to 27 per cent. In other new EU member states, personal income tax is progressive but rates have been reduced, for example, in the Czech Republic, Hungary and Poland.

Analysis of changes in personal income tax revenues show that nominal growth reached a peak in 2007, at 152.6 per cent (Table 5.1), while nominal household income growth amounted to 132 per cent year-on-year. As we see, till 2004 the rate increase of tax revenues to the budget from individual income tax outruns the income increase of the population.

TABLE 5.1
GROWTH RATES OF PERSONAL INCOME TAX REVENUES, 2000–08 (H1 2009)

Years	Tax revenues, million UAH	Growth rate, % yoy	Tax revenues to consolidated budget, UAH mil- lion	Growth rate, % yoy	Household income growth rate, %
2000	6,377.7	143.8	31,337.2	124.6	131.2
2001	8,774.9	137.6	36,751.2	117.3	122.7
2002	10,823.9	123.4	45,392.5	123.5	117.1
2003	13,521.3	124.9	54,321.0	119.7	116.5
2004	13,244.5	98.0	63,161.7	116.3	127.2
2005	17,325.2	115.7	98,065.2	155.3	135.1
2006	22,791.1	131.5	125,743.1	128.2	128.2
2007	34,782.1	152.6	161,264.2	128.2	132.0
2008	45,895.8	132	227,164.8	140.9	137.4
H1 2009	21,174.8	97.8	95,685.9	90.6	106.1

Source: Authors' calculations based on References, 6.

As Table 5.1 shows, growth rates in personal income tax revenues outpaced household income growth rates up until 2004. In 2004, a flat personal income tax rate was set in Ukraine, at 15 per cent (13 per cent for the period from 2004 through 2007). This decision was justified by the need to bring unregistered income “out of the shadows”, thereby increasing income tax revenues. However, the 2004 reform led to a substantial decrease in tax revenues: their level in 2004 was UAH 13.2 billion, in contrast to an estimated UAH 16.5 billion if the flat rate had not been introduced (References, 18, p. 65; 19, p. 16). Local budgets received UAH 3.3 billion less during 2004. In 2005, revenues totalled UAH 17.3 billion, as against the forecast of UAH 19.8 billion. The share of personal income tax in consolidated budget revenues fell continuously during the period of the 13 per cent flat rate: from 17.9 per cent in 2003 to 12.9 per cent in 2005. The increase to 15.8 per cent in 2007 was caused by the switch to the 15 per cent tax rate.

The first step towards fiscal efficiency with regard to personal income tax would be to transform it from a payroll tax into a tax on all forms of household income, as well as to establish the conditions for bringing income “out of the shadows”. This has already been partially realised in the Law on Personal Income Tax, as confirmed by Table 5.2.

In particular, the personal income tax proportion in the wage fund during 2000–08 varied between 15.1 per cent and 18.6 per cent. It should be noted that, following the introduction of a flat tax, the proportion of this tax in the wage fund entered a decreasing trend, from 15–16 per cent to 11.2 per cent on average, followed by growth to 18.6 per cent.

Hence, the principal goal of introducing a flat tax – to bring income out of the shadow economy and increase budget revenues – has not been achieved. In fact, it led to a fall in state revenues, with some compensation in the form of higher indirect taxes (VAT and excise duties). However, since the burden of indirect taxes falls mainly on low-income population groups, the system can scarcely be described as socially just.

TABLE 5.2
PERSONAL TAX INCOME REVENUES, 2000–08

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP, UAH billion	170.1	204.2	225.8	267.3	345.1	424.7	537.7	712.945	949.864
Personal income tax, UAH billion	6.4	8.8	10.8	13.5	13.2	17.3	22.8	34.7821	45.8958
Tax share in GDP, %	3.8	4.3	4.8	5.1	3.4	4.1	4.2	4.9	4.8
Wage fund, UAH billion	42.3	55.8	64.5	76.8	113.4	148.2	205.3	185.048	246.878
Personal income tax proportion in wage fund, %	15.1	15.8	16.7	17.6	11.6	11.7	11.1	18.8	18.6
Household income, UAH billion	128.8	158	185.1	215.7	274.2	370.6	475.2	623.3	856.6
Personal income tax proportion in household income, %	5.0	5.6	5.9	6.3	4.8	4.7	4.8	5.6	5.4

Source: Authors' calculations based on References, 20.

According to experts, introduction of a flat tax tends to leave shadow income “in the shadows”, while medium- and low-income population groups remain the main taxpayers. The principal negative implications of the uniform tax rate (13 per cent and 15 per cent) are as follows:

- the main tax burden is shifted to low-income groups;
- the rich and superrich pay very low taxes relative to their income; income inequality increases, resulting in social destabilisation and disintegration;
- the growing income of the rich and superrich is not used to develop enterprise, but is consumed by a very narrow stratum or taken abroad.

Meanwhile, developed economies apply progressive taxation, featuring much higher top tax rates than in Ukraine: 48 per cent in France, 42 per cent in Germany, 50 per cent in Austria and 59 per cent in Denmark.

Summary of research findings

1. The global financial and economic crisis has adversely affected Ukraine's basic macroeconomic indicators, as reflected in a reduction in real wages and employment rates, as well as increased wage arrears in all economic and industrial sectors and in all regions. This shows the need for the government, in consultation with the social partners, to undertake fundamental wage reforms.
2. The aggregate household income structure is characterized by the growing role of social transfers and the decreasing role of wages, which calls for a comprehensive approach to wage levels in all economic sectors.
3. The current crisis has led to the further growth of the informal economy and informal wage practices.
4. The principal goal of introducing a flat tax – to bring income out of the shadows and increase budget revenues – has not been achieved. Rather, it has resulted in a drop in state budget revenues that has been made good through higher indirect taxes (VAT and excise duties). Since indirect taxes are mainly shifted to low-income population groups, this is distributionally regressive and may not be considered socially just. Therefore, there may be a need to move from the current flat personal income tax to a more progressive one. This would require in-depth analysis of the impact of a progressive tax scale on the mechanism of personal income redistribution and the reduction of social stratification.
5. The ILO's Global Jobs Pact is an important source for policies for Ukraine to mitigate the impact of the crisis. The Global Jobs Pact warns against the threat of a wage and price deflationary spiral and points to social dialogue, collective bargaining and minimum wages as means to counter wage deflation.
6. Current data are lacking on wages and occupational groups in Ukraine.

Recommendations

(by Verena Schmidt)

Recommendations on wage policy

1. The provision of wage statistics should be improved. It is important to obtain accurate, relevant and independent data on wages in a timely fashion, thereby making it possible to develop wage policies effectively. Important indicators include wages by industry and occupational groups, including by sex.
2. The Law on Minimum Wages should be developed and adopted. This would clarify criteria and procedures for minimum wage setting, differentiation and revision, as well as a relevant regulatory framework. The minimum wage should be fixed and adjusted, as indicated by ILO Convention No. 131 on Minimum Wage Fixing (1970), which was ratified by Ukraine in 2006, according to both relevant social and economic factors – that is, the needs of workers and their families and the cost of living, as well as productivity issues and employment maintenance. At the same time, a number of constraints that currently put unnecessary pressure on the minimum wage should be removed, by consultation and negotiation with the social partners, so that the minimum wage can play its social and economic role effectively. This is particularly important to protect the most vulnerable workers in the crisis.
3. The objectives and effectiveness of labour market institutions are negatively affected by the large amount of economic activity taking place outside the legal framework. Measures should therefore be taken to reduce the informal economy.
4. Legislative provisions are needed in the wages area – for example, to avoid discriminatory wage practices and unpaid and/or undeclared wages – as well as effective implementation and enforcement. Implementation can be supported by awareness-raising among both employers and workers, training and information dissemination about existing legislation, as well as improving labour inspection. Wage policies should address the gender earnings gap.
5. Wages should be better linked to productivity. Productivity should be taken into account in wage bargaining. However, as Ukraine is currently facing skills shortages and Ukraine's wages are considerably lower compared to EU and CIS countries, there is a strong case for wages rising proportionately faster than productivity in the short term.
6. The establishment of a wage guarantee fund should be considered in order to protect workers' claims and thereby mitigate the effects of the crisis. Guidance can be found in ILO Convention No. 173.

Recommendations on developing social dialogue

7. The government, in consultation with the social partners, should develop a more conducive legal and institutional framework to strengthen collective bargaining. One important task is to finalize and adopt the Law on Social Dialogue, which should become an important tool for efficiently overcoming crisis developments in Ukraine's economy.
8. A new version of the Law on Collective Agreements should be drafted in order to improve the efficiency of the collective agreement system. Such a draft might include the following: granting collective agreements the status of legal acts; strengthening liability for evasion of collective bargaining and for failure to implement it; extending sectoral agreement provisions to all enterprises in a sector.

Recommendations on changes to the tax system with regard to wages

9. Anti-crisis measures on taxation should consist in the adoption of a double tax rate: that is, a lower tax rate for basic goods and services and a higher tax rate for other goods and services.
10. The tax base needs to be expanded and the collection of taxes needs to be improved. In order to avoid excessive income differentiation and achieve fairer income distribution, a reform of the primary income redistribution system could be carried out, in particular the restoration of a progressive tax scale for household income and the implementation of a series of taxes on wealth, real estate and inheritances. Restructuring the tax base to shift the emphasis from indirect to direct taxation would strengthen solidarity and alleviate the tax burden on the poor.

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