

ICPS newsletter®

Hard times at the Pension Fund

As employment and wages started to be cut back in the last few months, contributions to the Pension Fund are also in decline. This puts the sustainable level of pension benefits under threat, writes ICPS economist Liudmyla Kotusenko in a recent issue of *Financist*, a journal

Since 2004, Ukraine's rotating Governments have been competing to do their predecessors one better to please the country's pensioners—a hardly surprising phenomenon, given that Ukraine's elderly represent more than a third of all voters. The average pension is now nearly three times higher, going from UAH 316 in 2004 to nearly UAH 900 at the end of 2008.

Of course, even this average of UAH 900 is hardly the sky for politicians or pensioners. Still, at this moment, not only the question of higher pensions, but the question of paying out existing ones in time and fully is coming under threat with the economy rapidly contracting.

2008: Great start, lousy end

For the Pension Fund, 2008 started out as not a bad year at all. Over January–October, the Fund drew 4.1% more contributions than it had planned, or UAH 3.3bn. Of course, by the end of the year, this surplus will be considerably less. And as a result of the deepening crisis, 2009 is likely to see Pension Fund contributions falling short, which means the Budget will be more and more pressed to top the Fund up.

Moreover, this year's increase was not just on the income side, but on the outgo as well. A policy of aggressive pension rises by the Government meant that already in H1'08, even as it fulfilled its contribution intake better than planned, the Fund's expenditures were higher still, even including contributions from the State Budget and Social Funds. By the end of nine months,

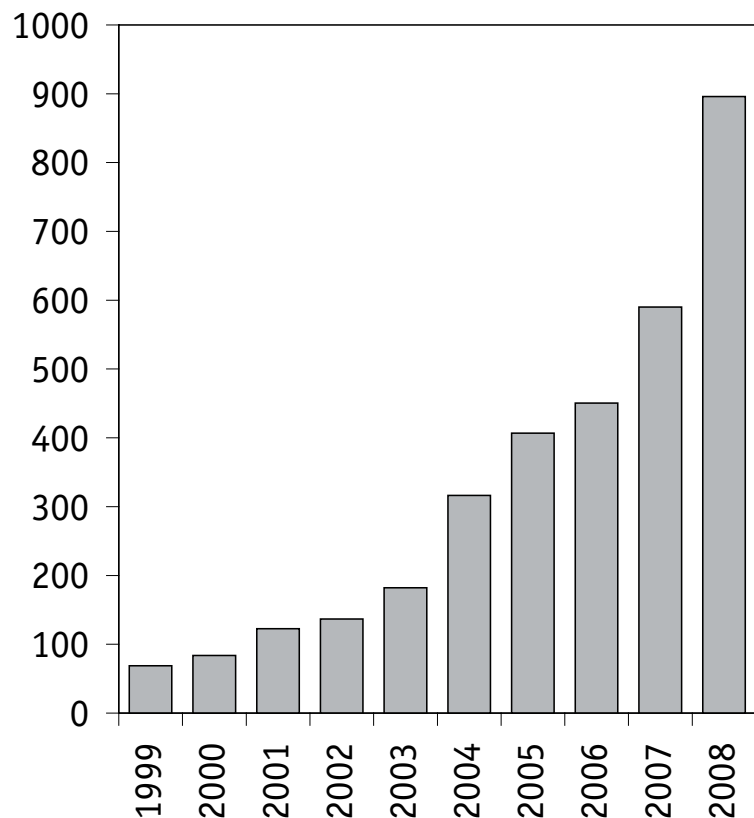
the gap was up to UAH 3.5bn. Despite the fact that the Pension Fund's budget was already in disarray, the Government went ahead with its October scheduled rise in pensions.

According to Ms. Kotusenko, the Pension Fund's expenditures for the year will be UAH 147bn, while its deficit will be around UAH 5.4bn. And this is without

counting the money needed to top up the pensions of former miners, in accordance to the September Law "On increasing the prestige of mining work."

At the end of 2008, the Verkhovna Rada increased Budget spending on pensions by UAH 6.6bn. That will be enough to cover this year's shortfall.

Average pension, UAH at end of year



Sources:
Derzhkomstat, Pension Fund, author's calculations

2009: A bad year for the Pension Fund

In 2009, the question of balancing the Pension Fund's budget will become more urgent. The Fund's own receipts will go down as the situation on the labor market worsens. Among others, workers will continue to be let go or sent on involuntary leave without pay, salaries and wages will be cut, and the shadow economy is likely to grow again.

At the same time, the Fund's expenditures will grow, if nothing else than because pensions will be indexed to inflation. The Government's intentions to index, after all, are indirectly evident from Point 5 of the Final Provisions of the anti-crisis law passed in October, which talks about raising the subsistence minimum in accordance with the pace of inflation.

As the case may be, the most that pensioners are likely to see this coming year is that part of their pension benefit will be indexed. The traditional indexing of pensions that takes place in March of every year, using the coefficient for average inflation, will probably not happen.

Still, even indexing pensions according to the inflation rate will be beyond the power of the Pension Fund, given that its own revenues are looking at a sharp reduction. That is, it will not be able to do this without help from the State Budget. How much do Budget subsidies to the Fund have to grow this coming year, then, and how realistic is this?

According to the author's calculations, with inflation projected at 16% for 2009 (ICPS forecast) and indexing applied to only that part of the pension benefit that does not reach the level of the subsistence minimum for the disabled, pension costs will go up around UAH 13–14bn, to over UAH 160bn next year. With Pension Fund contributions going down, subsidies from the Budget for pension benefits should grow from this year's UAH 40–41bn to UAH 55–6-bn in 2009.

If the economic recession proves mild, Consolidated Budget revenues will likely be marginally bigger than in 2008, about UAH 25bn according to Ms. Kotusenko. This makes such a major subsidy for the Pension Fund at the very edge of what the Budget can withstand. Still, the Government will do whatever it can to ensure that pensions are paid out without interruption, including by allowing itself to dip into the Treasury Account.

This, according to the author, is the most likely way the situation will develop in the pension sphere. Still, things could get much worse than this. Should the economy fall sharply, say to –10%, Budget revenues will go down and Pension Fund intake will be much lower than in the "bottom line" scenario. In this situation, not only indexing pensions, but even just paying them out without interruption will prove very difficult.

On the other hand, the approach of a Presidential election could stimulate the next round of pension "generosity." Of course, any decision to raise pensions that is not backed by financial realities could have a ruinous effect on the public financial system.

Pension system – no reform in sight?

With the Pension Fund deficit on the rise, reforming the pension system will become an impossible luxury over the next few years. A necessary condition for instituting the accumulation pillar of the pension insurance is a PAYGO system that is without a deficit, because contributions to the PAYGO system are automatically reduced in favor of the accumulative one. Obviously, no one will dare to institute the accumulation pillar in 2009, or even in 2010, while attempts to introduce it later on will stumble on worsening demographic trends.

Overall, pension policy will require particularly careful consideration in

By the way...

ICPS economists are preparing the latest issue of *quarterly predictions*, with its rolling three-year forecasts for all sectors of Ukraine's economy.

On 16 December, ICPS Director Olga Shumylo and ICPS Director of Policy Analysis and Security Policy Programs Viktor Chumak participated in the European Borders conference organized by the Brookings Institute, the Viktor Pinchuk Fund and the Yalta European Strategy (YES) in Kyiv.

This month's *political commentary* has been published, with expert analyses of likely developments in the political situation in Ukraine. Analyses cover both politics and policy.

Under the "Managing Migration in the Black Sea Region: Improving the implementation of national policy in Ukraine, Moldova and Rumania through regional cooperation among NGOs" project, a report called "Migration Policy in the Black Sea Region: Rumania, Moldova, Ukraine. Current trends and prospects" is being prepared for publication.

On 17 December, an expert discussion took place in Kyiv on the topic "On the Way to Europe: Spain's experience", organized by ICPS with the CIDOB Fund (Spain).

2009. After years of steep growth, this will not be easy, and will require a matching of pension appetites with available funding. Only in this way will Ukrainians be able to look forward to a stable system and uninterrupted pension benefits. ■

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