

Opiate of the masses? Social standards in Ukraine and the EU

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Social utopia, election economy

Social security always was and remains today the most erogenous zone for Ukrainian voters. It is freely stimulated by the country's political leaders as they attempt to bring the electorate its latest political frisson and to gain more seats and power in return for the thrill. This all has its roots in soviet times, in the idealized enticements that elderly Ukrainians like to bring up to this day: free medicine and education, and wages and pensions that allowed for a comfortable existence.

The highly sensitive nature of social benefits is completely natural, as their impact is directly and immediately felt by most ordinary Ukrainians. Massive investment projects require decades; even a serious improvement in the business climate takes years. Only social benefits can be easily raised within a month. Because of their lightning-fast effect on voters and the short-term euphoria that results, such steps have more than once been compared to injecting a drug. Would it not be better for Ukrainians to kick their social benefit "habit" before they overdose on populism in the form of another economic crisis?

If we were to chart the intensity of policy decisions in the social sphere, it would come as no surprise to anyone that the greatest activity matches election cycles. Moreover, the political rationale for these decisions generally overrides economic considerations. Instantaneous pension hikes under Leonid Kuchma and the recent increase in social standards are only two examples among a plethora.

In terms of their expectations of social policy, Ukrainians appear to still be at the level of children's sto-

ries about the nice wizard who shows movies for free and hands out ice cream bars. If someone like that were to run for the legislature or declare himself a candidate for the Presidency, his victory would only be a matter of time. The success of the Chernovetskiy campaign in the case of a single city, Kyiv, confirms that this hypothesis would work on a national scale, too.

Ukrainians still have not learned to understand what the state can or cannot provide for us, rather than demanding that it provide "everything." We believe politicians' fairy tales about rivers of milk with banks of Jell-O at the same time as we have a subsistence minimum—set by those same politicians—that could only keep a household pet alive. Maybe the example and experience of our near and more distant European neighbors could help us separate the rational grain from the chaff of political rhetoric and to see how naked our emperors really are.

The theory and practice of social policy in Ukraine

Promises, promises: A "social" rating of top candidates

Aside from offering the opportunity to hear the latest set of tales about Ukraine's bright future and to enjoy the latest twists in negative PR, the presidential election provides a useful opportunity to analyze and compare the positions of key candidates on such a critically important issue for most voters as social policy. This will establish the relative positions of the main political players on the ideological map, to line up their social vectors and to evaluate how their declared approach matches their actual deeds.

The label "social" is attached in this analysis both to matters that are directly related to the functioning of the system of social standards, pensions and social security, and to broader measures from tangential spheres of public policy, especially healthcare and education. Still, the ambitious social programs that engorge the political platforms of most Presidential candidates look fairly strange, given that current law does not actually provide the President with enough powers to actually carry them out.

Nevertheless, we propose rating the six main candidates according to where they stand in terms of the social planks of their platforms, from the most liberal to the nearly socialist.

The American Dream in Ukraine

The least socially oriented politician in Ukraine turned out to be Serhiy Tihipko. His unusually laconic election platform actually does not touch on social issues as such. Nor does this candidate's list of priorities—which includes a competitive economy, a strong state and a well-developed democracy—mention them. What's more, Mr. Tihipko is possibly the only one of the major candidates for President who uses openly liberal slogans in his campaign. This makes it look like Serhiy Tihipko is a fan of the American model, where the social sphere accompanies economic development and the state guarantees only the absolute minimum level of social protection.

Among the few social aspects in Mr. Tihipko's platform planks, his plans for education stand out. In contrast to most other politicians, this candidate is not interested in socializing education or turning it into an instrument for supporting young people by increasing state procurements. Rather, he states that "reviving the educational system will ensure a Ukrainian breakthrough." Unfortunately, Mr. Tihipko's platform says nothing about how exactly this is to be achieved.

Serhiy Tihipko's plans in the demographic sphere are no less ambitious. Specifically, his platform mentions that "Ukrainians will have more children." At the same time, it is noted that "state demographic

policy should be subordinated to the interests of individual families." Still, the questions of how a higher birthrate will actually be generated if Mr. Tihipko is elected President and how this might relate to the interests of an "individual family" remain open.

Liberal populism

The penultimate spot for social orientation went to Arseniy Yatseniuk. His election platform also largely ignores social issues. Altogether, the content of his platform is such that only the occasional phrase and hint allows us to say anything about Mr. Yatseniuk having a definite ideological foundation. This politician also espouses liberal values and even outstrips Mr. Tihipko in this, as he admits that the state has somewhat greater social obligations. Specifically, Mr. Yatseniuk's platform states that "when it comes to the health, education and culture of the nation, profits have no place."

Mr. Yatseniuk proposes "redesigning" public healthcare and educational systems, to allow them to become "more competitive with private providers in these spheres." Recognizing the need, not just to provide social services but also to improve their competitiveness clearly puts this politician in a favorable light. However, the absence of any concrete proposals on improving status quo casts doubt on his ability to reach his declared goals.

What's more, it is unlikely that Ukraine's private medical and educational services can be deemed a shining example of quality and competitiveness. That means that an improperly chosen goal could result in a chain of errors in all subsequent steps.

In the best traditions of political rhetoric

Although Viktor Yushchenko's campaign platform is only fourth in terms of social orientation, it has a much more substantial social component than the platforms of the previous two politicians. The social planks of the Yushchenko platform are grouped in a separate section called "Ukraine must be just."

Whereas Messrs. Tihipko and Yatseniuk can be classified as liberally oriented, the next three candidates, starting with Mr. Yushchenko, belong to the

social-democratic camp, which tries to combine economic freedom with the principles of social justice. The last concept is key to the platform of Viktor Yushchenko.

Mr. Yushchenko promises to "establish a fair, transparent formula for calculating wages and pensions." More specifically, he wants to set up a "fair relationship between pay levels among all public employees" and to reduce the gap between the minimum and maximum pensions. Indeed, he says the minimum pension should be equal to a real subsistence minimum.

On the other hand, Mr. Yushchenko states that his principle is that "the rich should pay more than the poor," although he provides no specific instruments for achieving this goal, other than instituting a special tax on "luxury items." This puts into question whether Mr. Yushchenko is being consistent in terms of establishing a fairer distribution of social wealth.

Starting with Viktor Yushchenko, political platforms begin to give education, especially post-secondary education, a social function that is clearly inherited from the old soviet system and not typical of western societies. For instance, Mr. Yushchenko's platform calls for greater state procurements (placements in post-secondary institutions that are covered by state funds—and that have tended to go to the children of parents willing to pay a high bribe) "so that all talented children have an opportunity to study." Given that the number of state-funded places in post-secondary institutions is already at exceptionally high in Ukraine by European standards, there are doubts about how effective this kind of use of limited public resources is and what the future fate of such a number of specialists on the labor market will be.

One interesting instrument that Viktor Yushchenko wants to institute in socio-demographic policy is to reduce the working day by an hour while maintaining the current wages for mothers with children who are of the pre-school or primary school age. Although the likelihood that such an instrument can

be applied universally and its real impact raise considerable doubts, shifting the focus from direct payments at childbirth to indirect means of influencing the birthrate is clearly a positive signal.

Heaven on earth—as soon as the crisis ends

Yulia Tymoshenko is in third place among candidates running for President for her level of social orientation. One of the goals of her election platform is "to overcome poverty and social injustice." To achieve this, Ms. Tymoshenko also plans to institute special luxury taxes and to increase the minimum share of "wages in production costs to world levels."

A considerable part of Ms. Tymoshenko's platform is dedicated to pension reforms, especially to institute an accumulative pension system. Without any doubt, this important reform is long overdue in Ukraine, but even the most successful implementation of this reform is likely to suffice to fulfill Ms. Tymoshenko's next promise: "Pensions should be no less than 60% of the average wage that the individual earned prior to retirement."

Yulia Tymoshenko's social claim to fame is the return of deposits lost in the Soviet Union's Oschadny Bank, state savings bank. This money is supposed to be fully paid back over the course of three years. Still, it's worth noting that the means used to achieve this, so far, has led to such high inflationary pressure on the economy that it can only be compared to a direct emission. Among other social guarantees, she wants to raise student stipends to the subsistence minimum and to institute guaranteed medical insurance "paid for by the employer or the state."

As Ms. Tymoshenko understands it, the main instrument for socio-demographic policy remains to pay people to have babies. She has taken on an additional commitment to "revive long-term mortgage lending at 2-4% for 10- to 30-year terms immediately the crisis is over." The idea of "reviving" something that, even at the best of times, Ukrainians could only dream of, raises a few eyebrows, while the phrase "immediately the crisis is over" gives Ms. Tymoshenko considerable leeway, time-wise, making us

wonder if any of today's Ukrainians will live to see that grand day.

The fruitful demographer

Second in the ranks of candidates in terms of social orientation, unexpectedly, turned out to be Viktor Yanukovich. Although a strong social component was always a distinctive feature of his main opponent, Yulia Tymoshenko, this time Mr. Yanukovich has gone way further than most of his rivals in terms of social commitments made in his election platform.

What distinguishes Mr. Yanukovich's platform is its distinctly European approach to forming social standards. Among others, the platform talks about the need to "satisfy cultural needs and the opportunity to acquire big-ticket household items." It also talks about "establishing a minimum pension that can cover the basic needs of each individual: housing, food and medical treatment."

One of the priorities in Viktor Yanukovich's platform is a demographic policy aimed at increasing Ukraine's birthrate. Its main instrument is the traditional maternity benefit paid at childbirth, which he claims he will double by 2011. In addition, he plans to make greater use of payments for childcare and to extend such family allowance-type payments until the child reaches 18.

Mr. Yanukovich also plans to revive mortgage lending "with a fixed interest rate of no more than 7% p.a.," which looks slightly more realistic than Ms. Tymoshenko's "2-4%." In addition, Viktor Yanukovich proposes using an instrument that is widely applied in many European countries to handle the "housing issue," that is, public housing. Still, even in the highly unlikely case that he fulfills the entire list of promises, Mr. Yanukovich's aim to have "50 million Ukrainians in 2020" sounds utopian, as the most optimistic demographic projections suggest a number that is closer to 40 million.

Mr. Yanukovich also sees education as a social function. Specifically, his platform guarantees "increasing the proportion of state-funded placements

in public post-secondary institutions to 75%." The question is, why 75%? What purpose would this serve, given that Ukraine is already one of the top countries in the world in terms of the proportion of its workforce having a post-secondary degree?

In addition to the nigh-universal promise of candidates to provide higher pensions and social benefits, housing and an education, the Yanukovich platform contains know-how that is somewhat in contradiction to its largely social-democratic planks. The intention is to institute state "anti-crisis" consumer and medical "baskets," that is, lists of foodstuffs, medicines and medical services that will be subject to price-controls. This immediately brings to mind the kind of hand-managing of the economy that Mr. Yanukovich apparently eschewed when he accused his political opponents of doing so. As they say, remove the beam from thine own eye...

Ukraine's Hugo Chavez

Volodymyr Lytvyn has not only proved to be the most socially-oriented of the top candidates for the Presidency, but his platform also differs significantly from those of all his opponents. Our analysis of the platforms of key candidates shows that the rest range ideologically from liberal to social-democratic, while Mr. Lytvyn's is hard to call anything but socialist.

This candidate's platform is one of the most detailed and most focused on social issues. The majority of his key objectives "in the social and economic spheres" actually ignore economic considerations and are focused only on social ones. Moreover, they combine both quite justified approaches to public policy that would bring the country closer to European standards and frankly utopian soviet-style declarations that are in complete opposition to the principles of a market economy.

Among the former are such points as "dropping the system of calculating minimum wages and replacing it with a social consumption standard based on the calculation of expenditures." The latter include plans to renationalize water and sewage systems, gas and power networks, and natural gas and petro-

leum fields, and to institute state control over prices for medications, foodstuffs and primary goods.

To call Mr. Lytvyn's promises to "raise the share of labor in production costs from 8% to 30%, to raise pensions to 80% of the average national wage, and to establish a ratio of no more than 5 to 1 between maximum and minimum wages" utopian and unrealistic is to put it mildly. Moreover, he provides neither an indication of the basis for establishing such a ratio nor a mechanism for regulating the maximum salary.

Alongside the tax "on wealth" that is so popular among this year's candidates, the Lytvyn platform calls for a progressive tax system, while alongside traditional funding for public housing and the provision of construction loans, he says he intends to establish "fair rates for utilities and building maintenance services." Unfortunately, Mr. Lytvyn's platform does not indicate what he will use as a basis for establishing a "fair" rate. For instance, if market principles underlie such a concept, then it turns out that utility rates have a long way to rise yet.

One plus in the Lytvyn platform worth noting is some interesting demographic policy instruments. Firstly, he talks about "providing young families with discounted housing loans; writing off 25% of the principle of the loan after the birth of the first child, 50% after the birth of the second, and full relief when a third child is born. This kind of approach would actually be a more effective use of public money, stimulating larger families while providing more decent housing for ordinary Ukrainians.

No less worthy of notice is the approach to returning lost soviet savings proposed by Volodymyr Lytvyn, "including by participating in the privatization of closed enterprises, by being granted parcels of land, by being provided with medical and educational services at state cost, and by being relieved of utility charges." These proposals are more economically sound and represent fewer inflationary threats than direct payments of cash as was partly done by Premier Tymoshenko last year. Still, the mechanisms suggested by Mr. Lytvyn are very close to the existing system of privileges in the residential services,

healthcare and educational systems, while the privatization scheme smacks too much of the voucher system used in the 1990s. Both of these approaches have long been discredited, to say the least.

Volodymyr Lytvyn is the only leading Ukrainian politician who did not ignore the issue of gender parity in Ukraine. Among others, his platform proposes "eliminating disproportions in pensions provided to men and women."

Suspecting the usual lines

In short, the majority of Ukraine's top politicians have taken on a myriad of social commitments without burdening their platforms with concrete policy proposals that might allow them to keep these promises. And where such solutions are offered, the reality and meaningfulness of their actual implementation raises more questions than it answers. Statistical information used in most platforms look like the fruit of an over-active imagination rather than the result of objective calculations and suitable conclusions.

A practical exercise: Raising social standards

How consistent politicians are depends on how much their words match their deeds. Ukraine's leaders have never found themselves short on words, and this time they were also not short on actions. In the best traditions of the election economy, the first signal, long before the start of the official election race, was the adoption of the infamous Law "On establishing a subsistence minimum and minimum wage" dated 20 October 2009. This was preceded by the dropping of a moratorium on raising social benefits that had been adopted as one of the conditions of the IMF.

What went wrong?

The adopted Law was to bring a second wave of raises in social standards as of 1 January 2010, starting with the subsistence minimum and minimum wage. The first wave took place back in November 2009, but the Government has so far managed to successfully ignore its requirements. Moreover, the Law requires changes to be made to the State Budget, but this did not take place in 2009. If we presume that,

sooner or later, this Law will have to be enacted, it is important to understand what kind of an impact on the economy and on the country as a whole it will have.

Firstly, pressure on the State Budget will grow, as the size of the minimum wage is used to formulate the pay scales for all public employees. The subsistence minimum, in turn, is the basis for determining most kinds of social assistance. Secondly, it has already put greater pressure on businesses, as the increase in the subsistence minimum and minimum wage have pushed employer payroll contributions up as well.

As a result, if the calculations of Ukraine's Finance Ministry are to be believed, an additional UAH 8 billion were needed in 2009 to cover the new social standards—and an additional UAH 71bn in 2010. Meanwhile, total expenditures in the 2009 State Budget were only UAH 274bn.

Roughly speaking, this means that, for every month last year, about UAH 23bn in spending was planned in the Budget, while the last two months, when the new social standards came into effect, an additional UAH 4bn were needed—a rise of 17% per month in the expenditure side of the country's Budget.

We could argue long and loudly about how objective and accurate MinFin's calculations are, but the reality is that even the figures already set in the 2009 Budget were not properly fulfilled. Of course, this did not concern its socially protected and most politically sensitive components: wages, pensions and social assistance continued to be issued without major hold-ups. Any cutbacks in these expenditures would have been political suicide across the board, both for the current Government and for any other one. Still, the state has been paying out its social commitments for some time now at the expense of other, less broadly recognized public projects and commitments.

One example is the widespread practice of not refunding or selectively refunding exporters their VAT payments, underfunding of the military, education

and science, reducing funding for the support and maintenance of state institutions, and increasing indebtedness for residential services at publicly-funded organizations, and so on. What's more, even de facto reduced spending takes place at the cost of increased public debt. This means, even without any additional spending, it is hard to talk about the 2009 Budget as being properly carried out, so raising social standards will only complicate the situation.

Groundwork for the future

Until this election is over, we are unlikely to see major changes to Budget or social policy in Ukraine. Still, sooner or later the election will be over, the Budget will be adopted and the Government, whatever it might be, will have to carry it out.

Of course, we might suppose that the new Budget will be adopted based on the old social standards and the Law raising them will be cancelled. Still, given the current political situation in Ukraine, no Government is likely to allow themselves this luxury. It also makes little sense to expect that public sector salaries, pensions or social benefits will see major hold-ups or growing arrears. Theoretically, the Government will only resort to this in the most extreme case, when all other resources have dried up.

Thus, the likeliest scenario is that the norms of this law will be upheld and social standards will be raised, which will cause Budget spending to skyrocket. In this case, two main consequences are likely.

The first of these already made its appearance as the current Government systematically acted since the very start of the crisis: covering socially protected payments at the expense of other Budget articles. This means the state will fail in its commitments in other spheres that are actually no less important for the country and could result in major potential threats. This includes threats to national security, healthcare and residential services.

The second likely trend could be a continuing devaluation of the hryvnia as a result of growing inflation and downward pressure on the national currency. The current nominal rise in disposable incomes

is not economically grounded, as it reflects neither GDP growth nor a rise in productivity. The state's inability to carry out the significantly larger volume of social commitments without an emission, whether direct or indirect in the form of internal borrowing, is already nearly axiomatic—with familiar, disheartening implications.

On the one hand, such a turn of events would benefit the Government, as inflation automatically increases Budget revenues. On the other, a devalued hryvnia causes the cost of external loans to go up while inflation causes the cost of procurements of goods, works and services to rise. In the end, the final goal will not be reached, since, no matter what the nominal increase in social standards, their real size could actually decline.

It's worth noting that a further devaluation of the hryvnia could actually suit most of Ukraine's political forces, as it means that export-oriented sectors become more price-competitive, especially the steel industry, which is largely controlled by members of Party of the Regions and BYT.

Quite likely the Government will try other measures in order to ensure greater Budget revenues. Indeed, efforts to privatize the Odesa Port Plant appear to be with just this in mind. Still, the failure of this project considerably reduces the options for quickly topping up the State Budget through privatization. Another source of additional revenues could be foreign credits, which the Government has been actively courting. But the overall shortage of spare capital around the globe because of the current crisis means there are slim chances that this will accumulate enough cash for the Government's needs. Meanwhile, public debt continues to rise towards critical levels, when the cost of servicing these debts constitutes a threat to the sustainability of the state's Budget policy and its ability to carry out its social commitments.

Don't trust fortune-tellers

All in all, raising social standards at a time when there is an economic crisis is a fairly dangerous decision that will mostly bring negative consequences, such as:

- Underfunding public spending that is not directly connected to the state's social commitments;
- Growing inflation and downward pressure on the national currency, leading to its further devaluation and growing prices;
- Overloading the economy with external and internal borrowings, leading to a serious rise in the cost of servicing public debt;
- Ineffectively privatizing state assets. Who sells off when asset values have bottomed out? It makes little economic sense, as the Odesa Port Plant, as an example, was worth several times more just 18 months ago;
- Stimulating the shadow economy through the indirect rise in pressures on business as social standards rise and it becomes highly likely that pressure will increase as the Government looks for sources of tax and other revenues for the Budget;
- Reducing the tax base of individual taxpayers, leading to a reduction in revenues to the State Budget.

Still, it is worth noting that there are also some possible positive consequences from raising social standards, including:

- Growing real disposable incomes that could, however, be wiped out by both devaluation and inflation in time;
- Injecting serious cash into the country's economy, spurring demand and fostering a more rapid economic recovery from the crisis as consumption revives.

Homework: How this is done in Europe

None of the members of the EU has such a system of social standards that is as integrated as the one Ukraine has maintained to this day. For most European countries, the poverty level is the closest analogy to Ukraine's subsistence minimum, although

it is based on the size of the average salary. This is the indicator used by France, Germany, Spain and Great Britain. Meantime, countries like Poland have, in addition to the poverty level, such indicators as subsistence and social minimums, which are determined according to the amount of money needed to survive physically and the amount needed to satisfy basic social needs.

Moreover, EU countries use such indicators typically only for statistical tracking and not to determine social transfers, as is the case in Ukraine. Instead, the latter are calculated separately for each socially vulnerable group or even individual households or persons, based on their specific needs. One of the exceptions, again, is Poland, where the poverty line is used to calculate all social benefits.

Most European countries, like Ukraine, legislate minimum wages. Still, this indicator is only a limit in the EU, meaning that no one should receive less for their work, and not the basis for determining the salaries of employees in the public sector, as is done in Ukraine. Specific categories of wages are distinguished by their clear rules, which gives the state the option of having a targeted impact on wage conditions in one or another population group.

At the same time, the relationship between the minimum and average wage in Ukraine is completely within European norms. According to statistics from 2009, this indicator was 50% in France, 49% in Great Britain, 43% in Poland, 32% for Spain, and 41% for Ukraine. Nevertheless, we need to remember that the calculations mentioned earlier use official data regarding the average wage, which does not reflect shadow wages and other distortions in Ukraine's official statistics. In reality, the relationship between these two indicators is much worse in Ukraine.

The main difference between Ukraine's social standards and their European counterparts lies in the fact that these are vague, relative amounts that can rise or not based exclusively on political considerations, largely without taking any economic dynamics into account. Thus, despite the constant decla-

rations of politicians of all stripes about the need to raise the standard of living of ordinary Ukrainians, they did not review the country's social standards for years when the economy was growing steadily and the hryvnia was stable.

Nor is it any news to most people that Ukraine's subsistence minimum and minimum wage are fairly difficult to even survive physically on. Meanwhile similar indicators in the European Union generally have two components: a smaller portion that reflects the amount necessary to simply survive and a larger portion that is intended to cover all basic social needs and ensure the individual a minimum acceptable standard of living within the society.

Fixing mistakes

The impact of social standards on Ukraine's economy is not at all just a matter of social security or budgetary policy. It is much broader and the consequences of decisions to raise them will be felt by every single Ukrainian. What, then, can be done to encourage more thoughtful social policies and a system of social standards that more effectively performs the function of social security for the most vulnerable social groups?

Firstly, what is worth doing is reviewing the system of government social guarantees in its entirety and the social security system. Right now, the country's Budget carries an enormous burden due to the unimaginable number of wide-ranging privileges and other forms of social support that, too often, go not to those who are in greatest need of this support. Changing these privileges to the more contemporary, transparent and effective instruments of targeted social support will free up large volumes of public money and to direct them, among others, towards raising social standards.

The relationship between individual social standards indicators should be established at the legislative level. After all, the minimum pension cannot, a priori, be lower than the subsistence minimum or higher than the minimum wage.

A subsistence minimum should be calculated on a household basis, not an individual basis. This will make it possible to more clearly establish actual needs and to reflect the economies of scale that arise when people live together. To make such calculations more accurate, a number of different types of households should be defined and each of them designated their specific subsistence minimum. At the same time, such factors as where the family lives should also be taken into account as the costs of living in a village and in a major city differ significantly.

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In summary, we can say that raising social standards is a necessary and rational step, but it needs to be done not right now and not in the way that it was done. For social standards to stop being simply weights that are added to the scales of political horse-trading every election and to actually satisfy the basic needs of the poorest Ukrainians, they need to become more European in essence.