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FOREWORD

The present publication is part of a series of Country Employment Policy Reviews (CEPRs) which the ILO is undertaking in different parts of the world. The CEPRs are one of the follow-up activities to the World Summit on Social Development, which took place in Copenhagen in 1995. The Copenhagen Declaration committed the governments of the participating countries to promoting the goal of full employment as a basic priority in their national economic and social policies, and to enabling all men and women to have secure and sustainable livelihoods through freely chosen productive employment and work. The ILO was given the lead role in supporting this commitment and assisting the constituents in formulating and implementing national policies to generate productive, remunerative and sustainable employment that will lead to poverty reduction.

As a first step in the preparation of the present Review, a tripartite conference was held in October 1997. The conference provided an opportunity for wide-ranging discussions on employment policy in Ukraine between the representatives of ministries, trade unions, employers’ organizations and the academic community. Subsequently, a number of background papers were prepared on selected critical areas of labour market developments in Ukraine by Valery Gueyets, Anatoly Kolot, Tetyana Kyryan, Olga Novikova, Mykola Shapoval, Yulia Tretyak and Zaphary Varnaly.

The preparation of the Review was a joint effort of the ILO and the tripartite constituents of the ILO in Ukraine. Within the ILO, the work was carried out by the Employment and Labour Market Policies Branch in Geneva, and by the Central and Eastern European Team in Budapest. Alena Nesporova was responsible for the coordination of work for the preparation of this document. She was the Senior Labour Market Policy Specialist of the ILO-CEET when preparation for the Review started, and has continued the work on this project since joining the Employment and Labour Market Policies Branch in April 1998. Ms. Nesporova prepared chapters 1-5 and chapter 8 of the Review (chapter 2 with input from ILO-CEET specialists Markus Ruck and Daniel Vaughan-Whitehead; chapter 5 jointly with Daniel Vaughan-Whitehead, with input from Markus Ruck). ILO-CEET consultant Maarten Keune wrote chapters 6 and 7.

The Review was presented at a tripartite conference held in Kyiv on 22 October 1998, and was endorsed by the Ukrainian constituents of the ILO on that occasion. The purpose of this Review is to identify feasible options to solve the serious problems of unemployment and poverty faced by Ukraine. The ILO will further collaborate with the government, employers’ organizations and trade unions in Ukraine towards the implementation of the conclusions and recommendations as adopted at the conference.

Oscar de Vries Reilingh
Director
ILO-CEET

Gek-Boo Ng
Chief
Employment and Labour
Market Policies Branch
CHAPTER 1: INTRODUCTION

In 1991, Ukraine emerged as an independent state after several centuries of existence within Tsarist Russia and later within the Soviet Union. Production, investment, trade and consumption were centrally planned and fully controlled by Moscow under the Soviet economic system, and economic and trade links between all Soviet republics were very close. The economy suffered from deep structural imbalances, high (but suppressed) inflation and persistent shortages of goods and services in the market. In the enterprise sector, large state-owned production units dominated not only industry, but also agriculture and services. Private production of goods and services was restricted to the informal sector, which emerged as a response to market shortages and grew rapidly, especially in the 1980s. Full employment, derived from the universal obligation of all able-bodied persons of working age to be employed (except students and mothers of small children), was achieved at the cost of low wages, minimal wage differentials and low levels of motivation for workers. Low wages and labour costs led to excessive demand for labour in the market and extensive labour hoarding in enterprises. Structural imbalances in the allocation of labour resulted in low levels of labour productivity.

After independence, the disruption of the strong production ties of Ukrainian enterprises with their counterparts in other ex-Soviet republics in the first phase of the transition period caused enormous economic difficulties for Ukraine. When the government introduced economic reform measures in this unbalanced environment, economic turbulence became unexpectedly high and generated strong political and social pressures to soften reform policies. Subsequent frequent changes in legislation and decision making discouraging potential domestic and foreign investors, and had a negative effect on business development and new job creation. The resulting deep and prolonged transition crisis – GDP declined by 54% between 1991 and 1997 – was associated with a rather modest net fall in employment and low open unemployment until 1995. This was compensated by a sharp decline in real wages and labour costs. Later, when economic pressures intensified, redundancies accelerated. This led to increasing open unemployment (8.9% in October 1997), hidden partial unemployment (forced leaves and shorter working hours), and economic inactivity (often associated with involvement in the informal sector). The non-payment of wages also became widespread. The combined effect of unemployment, both open and hidden, and a decline in real wages by more than 80% over the period 1991–1997 has led to the pauperization of large sections of the population. Many people thus have to rely on their own production of food on small private plots, seek informal work, or migrate to obtain work abroad.

The transition process has so far brought tremendous under-utilization of human resources in Ukraine, from both the quantitative and qualitative point of view. New employment policies seek to reverse this negative tendency by enhancing the demand for labour by stimulating economic growth and job creation, and simultaneously by improving the quality of labour supply. Paradoxical as it might seem, the goal of employment policy in the long run remains the same as in the past – the achievement of full employment. However, this policy is different in substance in at least three respects, in accordance with ILO Convention No. 122, which has been ratified by Ukraine. First, full employment means employment for those who wish to work, and no longer reflects any obligation to work. Second, employment policy will endeavour to give equal opportunities to all workers, regardless of age, gender, ethnic or social origin, or political opinion. Finally, the policy should promote productive employment of high quality.

The present Review outlines some major elements of a national employment policy which would stimulate a desired increase in the volume and quality of employment and effectively fight unemployment. Work on the Review started with a national tripartite seminar on employment policy, held in Kyiv in October 1997, which highlighted the main problems on the Ukrainian labour market and discussed policies to address them. The participants emphasized the need for deeper analysis of certain key labour market problems and for improvements in national employment policy that would contribute

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1 Although agricultural cooperatives (kolkhozes, or in Ukrainian kolgosps) were in formal terms collectively owned, in reality there was very little difference between these entities and state-owned farms.
to their solution and an increase in employment. After the seminar, several studies were commissioned to well-known Ukrainian experts on the topics agreed to be analyzed in the Review. The Review also benefited from many discussions with Ukrainian specialists - government representatives, the social partners and academics.

Chapter 2 examines economic and social trends in the transition period. An analysis of macroeconomic policy and its role in overcoming the transition crisis, along with an investigation of structural changes in production and employment, illustrate the extremely difficult conditions under which Ukraine has had to adjust to new challenges brought by political, economic and systemic changes. A dramatic decline in real wages and incomes as well as their increasing differentiation has resulted in poverty for a considerable part of the population. The new wage policy has led to a fall in real wages that exceeds the decline in productivity and a delay in employment restructuring. The social security system has failed to protect the most needy from the adverse effects of the transition crisis, and requires substantial reform.

Chapter 3 analyses changes in the supply of and demand for labour, as well as changes in the size and composition of employment and unemployment, including unregistered and hidden forms. It identifies the major problems on the Ukrainian labour market: a lack of demand for labour in the formal economy; large structural mismatches in the labour market; and an increasing marginalization of vulnerable social groups.

Chapter 4 deals with labour market institutions and policies. It assesses their capacity and effectiveness in addressing crucial labour market problems, promoting employment, and assisting the unemployed to improve their competitiveness and ability to find new jobs. It also examines the role played by tripartite institutions in the formulation and implementation of employment and social policies. It presents recommendations for further strengthening national labour market institutions as well as for improving labour market policies to make them more effective and better targeted to those groups of jobseekers who are most disadvantaged.

Chapters 5–7 concentrate on selected issues considered crucial for enhancing the demand for labour and improving the tense employment and social situation in Ukraine. Chapter 5 examines the issue of income protection, emphasizing the need to strengthen income protection for workers, particularly those whose wages are paid with substantial delays and those put on administrative leave without pay or forced to work shorter hours without any compensation. It suggests measures to solve these problems. Chapter 6 analyses the small and medium-sized enterprise (SME) sector, which could potentially create many new jobs in Ukraine. It discusses major problems faced by SMEs (due to which the sector is still in its infancy), and proposes institutional changes and policies which would stimulate their growth and ability to create new jobs. Chapter 7 takes up the regional dimension of the problem. It focuses on regions which are losing their economic and social position in the transition process, and advocates comprehensive local development initiatives as a primary approach towards restoring sound economic development. The approach is discussed with special reference to the case of Chernobyl.

Finally, Chapter 8 outlines a national employment policy, understood in a broad sense as a multidimensional set of policies promoting demand for labour and employment, improving the quality of employment, stimulating sound employment restructuring, assisting jobless persons to find new jobs (in particular the disadvantaged and less competitive), and protecting them against poverty. This chapter deals with macroeconomic, industrial and enterprise policies to promote economic growth, investment and employment creation; education policies to upgrade education and skill levels in the labour supply; and policies on incomes, the protection of migrant workers, employment-friendly social development, and the labour market itself.
CHAPTER 2: GROWTH, STRUCTURAL CHANGES, WAGES AND INCOMES

2.1 Initial conditions

In 1991, Ukraine became an independent state under rather unfavourable economic conditions. The close interdependence of the national economies of the former Soviet republics became a real burden after the break-up of the USSR. For Ukraine this problem was particularly acute, since a large part of the USSR’s heavy industry was located in the republic – particularly steel production, oil processing, primary chemical industries, and coal mining. Most of these industries depended on raw materials and energy ‘imported’ from other republics.

Moreover, only 20% of Ukraine’s output consisted of finished goods and services; the rest was made up of intermediate goods mainly for enterprises in other Soviet republics and (to a lesser extent) in other COMECON countries. When the USSR was dissolved, economic links between enterprises in the newly independent states were distorted, for several reasons. Problems concerning inter-bank relations, the fixing of exchange rates and other financial issues following the introduction of new national currencies were unsolved. There were abrupt changes in foreign trade conditions, a decline in internal and external demand due to the end of the Cold War (hitting the large military sector), growing competition from imports and falling real incomes in the population. These developments had very detrimental effects on most Ukrainian enterprises, as the intensity and speed of changes made it virtually impossible for them to adjust quickly to these new conditions and find new markets for intermediate products and components.

Another barrier to adjustment to the new market conditions was the highly monopolist structure of the economy. Practically all production of goods and services was concentrated in huge industrial enterprises and in state or cooperative farms which were rather inflexible. Due to their size, good contacts with state authorities and links to intermediary institutions, these entities were able to maintain their dominant market share, leaving little room for new, small-scale and private initiatives. State authorities were well aware of the catastrophic potential social consequences that would result if these giants collapsed; they provided employment to most of the population, particularly in smaller towns. Therefore, the government was very reluctant to deny support to them, and newcomers faced discriminatory legal and institutional obstacles. Also, due to the absence of private businesses for more than 70 years and some initial negative experiences with private business, society at large became suspicious and later even hostile to private enterprise. Thus the conditions facing newly emerging small firms were in general disadvantageous.

On the positive side, Ukraine possesses extensive material and human resources which may, under favourable economic and social conditions, boost its long-term economic development. In terms of natural resources, Ukraine possesses 60% of the world’s extremely fertile black soil, and has also considerable reserves of coal, iron ore and other raw materials (e.g. manganese and uranium). In terms of human resource potential, the population is well educated. Of every 1000 persons aged 15 or higher, 794 have had secondary or higher education. Although changes in demand for skills may make some types of education and training obsolete or require skills upgrading or retraining, the good technical skills of the population provide promise for future recovery.

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1 See e.g. Analysis of Macroeconomic and Social Trends in 1990–1997, a background study prepared for this Review by a team from the Institute of Economics of the Ukrainian Academy of Sciences, led by V. Gueyets (Kyiv, 1997).
2 In the initial period of ‘unregulated capitalism’, many businessmen exploited the naiveté of the people for speculation and personal enrichment. For example, several firms obtained money from people in advance for promised supplies of goods and services, which were never delivered.
2.2 Macroeconomic trends after 1990

2.2.1 Macroeconomic development

In Ukraine, economic decline began in the last year of existence of the USSR, mainly due to the dismantling of production and trade networks. In 1990, consumer price inflation reached the unprecedented level of 44%, according to official statistics, and some estimates suggest a much higher figure. These negative tendencies further deepened in 1991, when GDP dropped by 8.7% in real terms in comparison with the previous year (see Table 2.1). In the existing monopolistic environment, increasing prices of energy and raw materials were directly incorporated into prices of output. Consumer prices increased by 390%, while producer prices rose by 260%. The domestic market fell into a deep disequilibrium characterized by widespread shortages on the supply side, leading to further falls in production.

Table 2.1 Main macroeconomic indicators, 1990–1997 (% annual growth, except as indicated)

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<tr>
<td>GDP</td>
<td>-8.7</td>
<td>-9.9</td>
<td>-14.2</td>
<td>-23.0</td>
<td>-11.8</td>
<td>-10.1</td>
<td>-3.2</td>
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<tr>
<td>Investment</td>
<td>-7.1</td>
<td>-36.8</td>
<td>-10.3</td>
<td>-23.0</td>
<td>-20.5</td>
<td>-20.0</td>
<td>-7.5</td>
</tr>
<tr>
<td>Gross industrial product</td>
<td>-4.8</td>
<td>-6.4</td>
<td>-8.0</td>
<td>-27.3</td>
<td>-11.5</td>
<td>-5.1</td>
<td>-1.8</td>
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<tr>
<td>Agricultural production</td>
<td>-3.3</td>
<td>-8.2</td>
<td>+1.5</td>
<td>-16.7</td>
<td>-4.0</td>
<td>-9.5</td>
<td>-1.9</td>
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<tr>
<td>Trade balance (bn USD)</td>
<td></td>
<td>-0.6</td>
<td>-1.8</td>
<td>-1.4</td>
<td>-1.2</td>
<td>-1.1</td>
<td>+0.7</td>
</tr>
<tr>
<td>Exports (bn USD)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>16.8</td>
<td>17.1</td>
<td>20.3</td>
<td>19.2</td>
</tr>
<tr>
<td>Imports (bn USD)</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>18.0</td>
<td>18.3</td>
<td>21.5</td>
<td>18.5</td>
</tr>
<tr>
<td>State budget deficit (% GDP)</td>
<td>n.a.</td>
<td>-12.2</td>
<td>-5.1</td>
<td>-8.9</td>
<td>-6.6</td>
<td>-4.9</td>
<td>-6.7</td>
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<td>Consumer prices</td>
<td>390</td>
<td>2,100</td>
<td>10,265</td>
<td>500</td>
<td>280</td>
<td>39.7</td>
<td>10.1</td>
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<tr>
<td>Producer prices</td>
<td>260</td>
<td>4,240</td>
<td>9,770</td>
<td>840</td>
<td>270</td>
<td>17.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Employment</td>
<td>-1.7</td>
<td>-2.0</td>
<td>-2.3</td>
<td>-3.8</td>
<td>+3.0</td>
<td>-2.1</td>
<td>-2.7</td>
</tr>
<tr>
<td>Average real wage</td>
<td>+31</td>
<td>-41</td>
<td>-57</td>
<td>-17</td>
<td>+18</td>
<td>-14</td>
<td>-13</td>
</tr>
<tr>
<td>Retail trade turnover</td>
<td>-9.7</td>
<td>-18.0</td>
<td>-35.0</td>
<td>-13.6</td>
<td>-13.9</td>
<td>-11.4</td>
<td>+5.9</td>
</tr>
</tbody>
</table>

Source: Statistical Yearbook of Ukraine, various issues

Confronted with this reality, the government decided to liberalize most prices in 1992 and to compensate for part of this price shock through the indexation of wages and incomes. Price increases, originally estimated by the government on the order of 300–400%, turned out to be much higher – consumer prices grew by 2,100% and industrial prices by up to twice as much. The prices of imported energy, vitally important for Ukraine, rose at an accelerated rate, and the powerful industrial lobby forced the government to subsidize enterprises at the expense of an inflationary monetary policy and an increasing state budget deficit, which reached 12.2% of GDP. Nevertheless, neither sales nor wages and incomes could keep pace with galloping inflation, resulting in a sharp fall in consumer demand and demand for investment goods. Total investment declined by almost 37%, while retail trade turnover fell by 18% in 1992.

At the end of 1992, the government returned to simultaneously regulating the prices of key inputs and products, regulating wage increases in the public sector, cancelling the indexation of monetary incomes, and reducing social programmes. In contrast, neither prices nor wages were controlled in the private sector, as the government assumed that private employers would behave in a strictly economic fashion (which was not necessarily the case). Despite this, inflation further aggravated in 1993 and reached the dimension of hyperinflation, at a rate of 10,265% for the year. The state budget deficit was lower but still considerable, at 5.1% of GDP. A sharp decline in real wages and incomes in the period 1992–1994 led to a steep fall in demand for consumer goods and services, resulting in a 35% decrease in retail trade. The enterprise sector suffered large losses in sales revenues, and had to adjust by reducing its demand for investment. External demand was also weak, to a large extent due to restrictions in exports (and
imports) imposed on Ukraine by its major trading partner – the Russian Federation. The Ukrainian currency, the karbovanets, rapidly depreciated.

Enterprises lacked not only resources for investments necessary for their restructuring and to achieve higher competitiveness, but also the means for financing everyday operations. They were unable to cope with the high tax burden and adjusted to excessive taxation through tax evasion and delays in payment. Similarly, they were increasingly unable to meet their obligations vis-à-vis suppliers and in turn were often not paid by their customers. As a result, inter-enterprise debts rapidly accumulated and an increasing part of internal and external trade within the CIS took the form of barter. Consequently, GDP further declined by more than 14% in 1993 and by 23% a year later.

The expenditure breakdown of GDP (see Table 2.2) reveals that the decline in wages and incomes was reflected in decreasing household consumption and in rapidly accumulating inventories of unsold production. In contrast, consumption by government and non-profit organizations has been growing steadily since 1991. Gross fixed capital formation jumped in 1992, and later recorded a continuous decline. These figures would suggest gross domestic saving equal to 32-36% of GDP between 1992 and 1995. This is surprisingly high, considering the steep decline of GDP in real terms. However, it seems that due to accounting problems, both fixed capital accumulation and inventory accumulation were largely overestimated; the IMF has made a much lower estimation of domestic saving, at around 17% of GDP in 1995.

Table 2.2  Utilization of GDP (% in current prices)

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<tbody>
<tr>
<td>GDP</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Final household</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>consumption</td>
<td>52.0</td>
<td>42.0</td>
<td>44.0</td>
<td>44.3</td>
<td>49.7</td>
<td>53.3</td>
<td></td>
</tr>
<tr>
<td>Final consumption</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>by government and</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>non-profit organizations</td>
<td>19.4</td>
<td>21.6</td>
<td>20.0</td>
<td>23.6</td>
<td>26.7</td>
<td>26.3</td>
<td></td>
</tr>
<tr>
<td>Gross fixed capital formation</td>
<td>20.0</td>
<td>27.1</td>
<td>24.3</td>
<td>23.5</td>
<td>23.3</td>
<td>20.8</td>
<td>18.4</td>
</tr>
<tr>
<td>Change in stocks</td>
<td>5.0</td>
<td>7.0</td>
<td>11.8</td>
<td>11.6</td>
<td>3.3</td>
<td>1.9</td>
<td>1.7</td>
</tr>
<tr>
<td>Exports minus imports</td>
<td>n.a.</td>
<td>2.0</td>
<td>-0.3</td>
<td>-3.2</td>
<td>-3.1</td>
<td>-2.6</td>
<td>-3.8</td>
</tr>
</tbody>
</table>

* Includes consumption by households, government and non-profit organizations.
Source: Ministry of Statistics

An urgent call for a new economic policy found a response at the end of 1994, when newly elected President Kuchma initiated the elaboration and adoption of an economic stabilization programme. The cornerstones of this programme were as follows: acceleration of privatization, unification of the exchange rate, suspension of price regulation, sharp reduction of subsidies to unprofitable enterprises, liberalization of foreign trade and implementation of strict monetary and fiscal policies.

These policies gradually brought some significant positive economic results. Performance in foreign trade improved considerably. Between 1994 and 1996, exports increased by 21% and imports by 19.4%. In 1997 exports slightly declined, but imports declined much more; consequently, the foreign trade balance reached a modest US$ 0.7 billion surplus for the first time in the transition period. This was primarily due to significant net income from services.

3 Gross domestic saving equals gross fixed investment plus changes in stocks minus net exports
Another major achievement was reached in curbing inflation. In 1994, consumer price inflation was still at 500%, and that of industrial prices 840%. By 1997, the annual rates had fallen to 10.1% and 5%, respectively. This was the result of a relatively tight monetary policy, with domestic credit and broad money expansion being reduced to 38% and 35%, respectively, in 1996. In the first half of 1997, respective figures were 15% and 19%. The state budget deficit was cut from 8.9% of GDP in 1994 to 4.9% in 1996, but in 1997 it again increased to 6.7% of GDP. A relative consolidation of the financial situation in Ukraine made it possible to introduce a new national currency - the hryvnya - in 1996, replacing the karbovanets (at a rate of 100,000 karbovanets per hryvnya).

However, financial stabilization was only partly the result of savings in government expenditure. The improved budget deficit should also be attributed partly to certain formerly extra-budgetary funds, such as the Employment Fund, that were brought into the state budget. The money from these funds was used to strengthen the budget. The deficit was also reduced in part through the sale of state bonds (i.e. an increase in the government debt) and at the cost of serious delays in the payment of wages, pensions and benefits in the state sector. Many private enterprises followed the state’s example, and the accumulated arrears reached some 3% of GDP in 1996.

A substantial reduction in the expansion of credit, accompanied by more cautious credit policies on the part of commercial banks towards enterprises, had negative effects on private investment. Public investment was also limited, due to the efforts to cut budget expenditures. Total investment in real terms therefore dropped by 23% in 1994, 35% in 1995 and by another 20% in 1996. While in 1997 investment was still on decline, the rate of decrease had fallen to 7.5%. The unstable political climate and numerous legal deficiencies, reflected in many economic decisions that were adopted but never truly implemented, have so far discouraged foreign investors from larger-scale investment in Ukraine. In 1997, cumulative foreign direct investment reached USD 2 billion – much less than in certain other CEE countries, such as Hungary (USD 15.5 billion) or the Czech Republic (USD 8.6 billion). The lack of both domestic and foreign capital for investment further delays the necessary upgrading of the technology level and productive structure of the national economy, making the adjustment of the country to new economic conditions a long and difficult process.

Progress in macroeconomic stabilization after 1994 relatively improved overall economic performance - the decline in GDP slowed down, in 1995 to 11.8% and to 10.1% in 1996. Although in 1997 GDP still shrank by 3.2%, it was already showing the first signs of an approaching economic recovery, particularly in the second half of the year. Real wages temporarily increased in 1995, and even though in the following years they returned to a decline, at least their rate of decline was moderated. Although figures on real incomes of the population are not available, total real incomes probably developed much better than wages alone, contributing to a recovery of domestic consumer demand, as reflected in a 6% growth of retail trade turnover in 1997. The development of domestic consumer demand contributed to an increase in the share of household consumption, as well as to a considerable slowdown in inventory accumulation. In contrast, the downward trend of gross fixed investment remained unchanged, suggesting gross domestic savings fell to 15% - a worrying signal regarding the sustainability of future economic growth.

While output in real terms declined very quickly, employment reacted more slowly and modestly. With the exception of 1995, employment constantly fell, but the annual rates of decline were rather slow after the period 1991–1994. A surprising increase in employment in 1995 had more to do with changes in statistical methodology than with any real movement. Labour productivity, already low under the communist regime in comparison with western countries, thus registered a further dramatic decline (see Table 2.3). To illustrate, GDP fell by 56.9% between 1990 and 1997, and employment by only 11.2%, and labour productivity by 51.5%.

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5 An analysis of the Ukrainian labour market situation will be provided in Chapter 3.
6 GDP per worker was used as a proxy for labour productivity.
2.2.2 Informal sector

Many economists argue that official Ukrainian statistics overestimate the real fall in output after 1990, since they do not take into consideration output of the informal sector. In Ukraine, the size of the informal sector increased substantially after 1990 and, due to the legacy of a command system lasting 70 years, it seems to be larger in comparison with many other Central and Eastern European countries. De Melo, Denizer and Gelb estimated the share of the informal sector in Ukraine at 46% of GDP in 1994, compared to 40% in Russia, 34% in Latvia, 29% in Lithuania, Bulgaria and Hungary, 25% in Estonia, 18% in the Czech Republic and 15% in Poland. Ukraine also experienced one of the region’s largest relative increases in the share of the informal sector in the economy between 1989 and 1994, by 34 percentage points.

Another estimation was based on a micro-survey of 150 enterprises of all forms of ownership, undertaken in March 1996. The surveyed firms disclosed that on average, 39% of their sales and 51% of their payroll were not reported, while in turn they over-reported their costs by 135%. The survey also revealed that private firms are more inclined to tax evasion than firms in state or collective ownership. For many private firms this is a matter of economic survival, due to frequent discrimination against them in access to producer and financial services and worse treatment from state authorities, including tax offices, in comparison with state-owned or collectively owned firms.

While estimates vary widely, the majority of economists put the size of the informal sector in the range of 40–60% of GDP at present, considerably higher than in other Central and Eastern European economies, excluding the CIS.

The reasons for the large size and rapid growth of the informal sector are many: very high taxes, foreign trade regulation and foreign exchange restrictions, unstable and unclear legislation, poor

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Table 2.3  Output, employment and labour productivity, 1990–1997 (% annual growth)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP</td>
<td>-8.7</td>
<td>-9.9</td>
<td>-14.2</td>
<td>-23.0</td>
<td>-11.8</td>
<td>-10.1</td>
<td>-3.2</td>
</tr>
<tr>
<td>Employment</td>
<td>-1.7</td>
<td>-2.0</td>
<td>-2.3</td>
<td>-3.8</td>
<td>+3.0</td>
<td>-2.1</td>
<td>-2.7</td>
</tr>
<tr>
<td>Labour productivity*</td>
<td>-7.1</td>
<td>-8.1</td>
<td>-12.2</td>
<td>-20.0</td>
<td>-14.4</td>
<td>-8.2</td>
<td>-4.8</td>
</tr>
</tbody>
</table>

* Labour productivity measured as a ratio of GDP and employment

Source: Statistical Yearbooks of Ukraine, various issues

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7 The term ‘informal sector’ is used more broadly here in comparison with the term’s usual meaning, which refers to unregistered, usually small-scale enterprises or independent workers operating outside the formal sector. Here, it also covers those activities of registered enterprises which are not reported to tax or social security authorities in order to avoid taxes.


9 Some estimates of the size of the informal sector are based on electricity consumption and its yearly changes as a proxy for changes in GDP (assuming that the electricity consumption/output elasticity is relatively stable). For example, Kaufmann and Kaliberda calculated that while in 1989 the share of total output produced informally was 12%, in 1996 nearly one-half of total GDP was produced informally. D. Kaufman and A. Kaliberda, ‘Integrating the Unofficial Economy into the Dynamics of Post-Socialist Economies: A Framework for Analysis and Evidence’, in B. Kaminski (ed.), Economic Transition in Russia and the New States of Eurasia (Sharpe, Armonk, New York, 1996). Analysis implies that the decline in GDP in 1996 from 1989 levels was ‘only’ 35.2%. A similar Ukrainian estimate, based on input-output tables on electricity consumption, put the size of the informal sector at 42.4% of GDP in 1995 and calculated that the overall decline in GDP between 1990 and 1995 was 31.6% rather than the officially recorded 52.1%. V. Borodyuk, O. Turchinov and T. Prikhodko, ‘Ocinka mashtabiv tnovoy ekonomiki ta ii vpliv na dinamiku makroekonomichnih pokaznikiv’ (Estimation of size of the informal economy and its impact on changes in macroeconomic indicators), The Economy of Ukraine, 11/1996.

financing of social services, and improperly regulated privatization are some examples. While certain firms benefit from inflated prices of exported and imported goods, undeclared exports and imports, falsified invoices, bank credits taken with no intention of repayment, or from personal contacts with influential state officials, the partial or full engagement of other firms in the informal sector is a matter of pure survival. Similarly, the lack of relatively well-paid jobs for persons laid off from state enterprises or practically forced to quit voluntarily, the enormously widespread non-payment of wages, as well as sharply decreasing real wages and incomes push the population to seek additional sources of income – mainly in the informal sector. In this sense practically every economic subject in the national economy of Ukraine is involved in the informal sector, participating in one or another way in raising, distributing, re-distributing and consuming informal incomes.

Taking this into consideration, although Ukraine has not yet reached economic recovery in the formal sector, total output, including the informal sector, is already growing. On the one hand, the informal sector may seem to be beneficial for the country as a buffer for survival of newly emerging firms in their initial stages, or for persons who are hardly able to obtain reasonable incomes in a period of vast changes, and to make the economy and labour market more flexible. On the other hand, its scale undermines economic stability, reduces state revenues and jeopardizes fair competition and the environment for sound entrepreneurial activity. It reduces motivation to participate in the formal sector.

2.2.3 Privatization and employment implications

At the beginning of economic transformation, the private sector was practically non-existent in Ukraine, as in most other countries of the former USSR. In the first years of independence, Ukraine did not make substantial progress in privatization, for political reasons. By the end of 1994, approximately 3,000 state-owned large and medium-sized enterprises (of an estimated 18,000) had been privatized. The so-called small privatization (of small-scale production units and service firms) had made no greater progress, as only 7,000 of an estimated 45,000 small enterprises were in private hands.

A new momentum was given to the privatization process when a mass privatization programme was approved by parliament in December 1994. The programme was intended to privatize 8,000 large and medium-sized enterprises, mainly through the distribution of privatization certificates among the population and their exchange for shares of enterprises to be privatized. At the same time, parliament approved a list of 6,000 enterprises and institutions (later reduced to 5,125) of a strategic character which should not be privatized at this stage. Procedures for small privatization were simplified in order to speed it up.

As a result of this effort, almost 7,000 large and medium-sized enterprises were privatized by mid-1997, and another 2,300 enterprises were undergoing privatization. Together, these firms employed 5.7 million workers. As shares of enterprises to be privatized are, as a rule, first offered to the collectives of managers and workers, 85% of all shares have actually been distributed in this way. The small privatization programme had practically been completed by mid-1997, and about 90% of small firms had been transferred into private hands.

In agriculture, a large number of state farms have been transformed into joint-stock companies and their shares offered to private persons, while many agricultural cooperatives have become cooperatives of land owners. In the private sector, due to many obstacles faced by people wishing to start private farms, only 35,400 private farms in total were operating in 1997 on 2% of all agricultural

11 Ibid.
12 For example, in 1993 Ukrainian exports to the EU totalled USD 624 million, according to Ukrainian statistics. EUROSTAT, meanwhile, reported over USD 1 billion. Exports to France showed a difference of 459% between Ukrainian and French figures.
13 See Chapter 6.
14 This very sensitive political and social issue is discussed in Chapter 5 of this Review.
land. In addition, small subsidiary plots and private gardens increased the total share of private farming to some 14% of total agricultural land, while collective farms maintained two-thirds and state farms possessed about 18% of agricultural land in 1997. A new law on land leasing was passed in early 1997 partly to overcome obstacles to real land privatization and to promote private farming and the better use of land.

Despite the progress in mass privatization, only limited improvements in the governance of enterprises seem to have been achieved thus far. In most enterprises privatized through management-worker buy-outs, the former members of management maintain their positions. Many of them lack the skills important for new economic and legal conditions, and are unable to find new markets and trade contacts for their enterprises. Slightly higher profitability and productivity of privatized enterprises is mostly achieved through higher prices, obtained through their monopoly position. External investors are not interested in investing in such enterprises unless they can gain majority ownership, which is usually not the case. As privatized enterprises usually do not have enough of their own resources for investment, they have difficulty in accessing bank credits. The economic environment and legal framework are not supportive. These firms are caught in a vicious circle of low profitability, low competitiveness and lack of resources for technology upgrading and product innovation. One in two privatized enterprises was unprofitable in 1997, according to estimates. It is also in the interests of new owners to reduce job losses as much as possible, resulting in the persistence of labour hoarding (unless workers are ruled out of decision-making processes by the management). In contrast, enterprises privatized through direct competition and sale (mostly small firms operating in services and food processing) are on average more effective and productive.

As yet, privatization has failed to achieve its major goal – a significant increase in the effectiveness and competitiveness of production through the pressure of owners on managers and workers to lower production costs, increase labour productivity and improve the sales performance and profitability of the enterprise. Also, it has not led to a significant reduction of labour costs through layoffs of redundant workers, and has not much affected employment for the same reasons.

### 2.3 Structural changes and developments in major economic sectors

The production and employment composition by sector has gone through substantial changes during the transition period (see Table 2.4). The shares of both agriculture and industry in production (measured as gross value added) declined after 1990 – in the case of agriculture in 1996 by almost half – while the share of services in the economy increased from 30% in 1990 to 49.6% in 1996. However, the composition of employment by sector has seen different changes since 1990, in contrast to general world-wide sectoral development tendencies. The share of agriculture (including forestry) in total employment slightly increased from 19.7% in 1990 to 21.8% in 1996, while both other sectors have recorded declines in their proportions – in the case of the secondary sector from 40.1% to 28.9%, and in the tertiary sector from 40.2% to 39.1%. This seemingly contradictory tendency reflects a specific adjustment of the labour market to a sharp decrease in the demand for labour and in real incomes, typical for all CIS countries. Also, statistical problems may distort the picture of the real contribution of each of the three sectors to total employment, as will be explained below.

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17 Although the Land Code of March 1992 stipulated that members (both current and retired) of agricultural cooperatives as well as employees of state farms are owners of the land cultivated by these farms, their actual property rights are rather restricted. This becomes clear when they decide to farm privately and wish to take out their land and their share on the property of the cooperative. The withdrawal itself is a rather complicated process due to unclear regulatory procedures and many other barriers created by farm managers who do not wish to lose land, assets and members. Individual farmers also have more difficult access to inputs and markets, etc., which discourages most members to leave the cooperative or to give up private farming after a while and return to the cooperative.


19 Ibid.

20 Ibid.
In line with other European transition countries, Ukraine has faced a rapid de-industrialization (an absolute decline of industrial production and employment, as well as a decline of the share of industry in GDP and total employment). However, in comparison with other transition economies, the extent of de-industrialization was perhaps even greater. While total employment in Ukraine fell by only 8.6% between 1990 and 1996, industry lost one-third of its workforce, and construction 44%. The secondary sector’s contribution to employment has fallen from 40% to 29%.

What is very surprising, however, is that the share of the tertiary sector in total employment has also declined, albeit slightly. It should be emphasized that this concerns formal employment – many services are provided informally, and therefore a part of employment in services is unrecorded by statistics. Another explanation for this surprising decline in the service sector could be associated with a rapid increase in non-specified activities (the last row in Table 2.4). The latter covers mostly self-employed persons others than those engaged in small private businesses defined within economic branches. Even though little is known about the character of such activities, many of them are probably service-oriented. Taking these two factors into account, the real share of services in total employment, both formal and informal, would be several percentage points higher and increasing in the period 1990–1996, rather than the recorded decline. Moreover, in the past many services were provided by enterprises and institutions, and statistically included in the sector of their main activity – some of these services have not yet been transferred outside the enterprise. This also proves that the actual share of services both in production and employment is higher than that recorded in statistics, while those of the primary and the secondary sectors are overestimated. However, the extent of these biases is not known.

Table 2.4 Production and employment structure by sector, 1990–1996 (% share)

<table>
<thead>
<tr>
<th>Sector</th>
<th>1990</th>
<th>1993</th>
<th>1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>National economy</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Agriculture and forestry</td>
<td>25.5</td>
<td>19.7</td>
<td>21.6</td>
</tr>
<tr>
<td>Mining, manufacturing, gas, electricity and water supply</td>
<td>36.0</td>
<td>30.7</td>
<td>29.9</td>
</tr>
<tr>
<td>Construction</td>
<td>8.5</td>
<td>9.4</td>
<td>7.0</td>
</tr>
<tr>
<td>Transport and communications</td>
<td>5.6</td>
<td>7.1</td>
<td>11.2</td>
</tr>
<tr>
<td>Trade and public catering</td>
<td>5.5</td>
<td>7.5</td>
<td>12.4</td>
</tr>
<tr>
<td>Housing and household services</td>
<td>3.9</td>
<td>3.5</td>
<td>3.3</td>
</tr>
<tr>
<td>Health, social care, sport</td>
<td>5.9</td>
<td></td>
<td>6.4</td>
</tr>
<tr>
<td>Education, culture, arts,</td>
<td>18.1</td>
<td>11.8</td>
<td>25.1</td>
</tr>
<tr>
<td>Banking and insurance science and research</td>
<td>0.4</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>State administration, political and social organizations</td>
<td>1.6</td>
<td>2.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Other sectors</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Non-specified activities</td>
<td>0.0</td>
<td>2.2</td>
<td>10.2</td>
</tr>
</tbody>
</table>

* Gross value added.

Source: For data on production, see Statistical Yearbook of Ukraine, various issues; for employment figures, see Pracya v Ukraini (Labour in Ukraine), Statistical Yearbook, Ministry of Statistics, various issues.
2.3.1 Agriculture

After independence, agricultural output also declined, although to a lesser extent than GDP and industrial output. This can partly be attributed to slow economic reforms in agriculture, which have not given rise to a more productive private sector, and partly to financial problems of agricultural enterprises. Low market demand for agricultural products and growing prices of agricultural inputs such as energy, seed, fertilizers, etc., are strongly limiting the capacity of agricultural enterprises to improve their future economic performance through investment in machines and equipment. Agriculture is thus gradually being de-mechanized and increasingly relying on manual labour, with obvious negative effects on production efficiency and labour productivity and gloomy prospects for the future, both in terms of competitiveness and productive job creation.

Employment in agriculture increased both in relative and absolute terms between 1990 and 1995, primarily due to the growth of subsidiary farming. Many families are producing agricultural products on small plots for their own use, for their relatives and to a limited extent also for the market. Labour productivity in agriculture has thus considerably declined during the period of transformation.

The share of the state and cooperative sectors in total employment has significantly decreased – from 27% for the state sector and 62% for the cooperative sector in 1990 to 11% and 51% respectively in 1996. The private sector contributed 38% to agricultural employment in 1996. However, the share of private farms is still very modest: in 1996 they provided employment only to 79,000 workers, including the owners and working family members (i.e. 1.5% of total employment in agriculture). The bulk of the private sector consists of people working full-time on small family plots. The share of such persons working on private small plots in total agricultural employment grew from 13.7% in 1990 to 37.2% in 1996. This relates particularly to people living in rural regions, who either lost their jobs in state enterprises or cooperatives and could not find new ones, or who were paid so little that they saw no point in being employed and opted for (or were forced to opt for) living through subsidiary farming. In many respects, these persons can be considered latently unemployed, as they constitute a buffer for unemployment. Such small-scale activities are typically labour-intensive with low productivity based on handwork using simple tools. Recovery of investment in agricultural machines and a switch to more productive technologies as well as an increase in labour demand in other sectors will inevitably lead to large outflows of labour from agriculture.

2.3.2 Industry

Industry experienced a sharp and accelerating decline in gross output until 1994, when the yearly rate of decline reached 27.3%. The decrease in output has since moderated substantially, to 5.1% in 1996 and 1.8% in 1997. In 1996 some industrial branches, particularly fuel, nuclear energy, steel production and non-ferrous metallurgy, returned to positive growth rates. Meanwhile industries with higher value added, more severely hit by economic crisis, such as machine building, food processing, light industry, and paper and wood production, are still on a path of substantial decline. The varied economic performance of industrial branches resulted in a changed branch structure of industrial production in Ukraine (see Table 2.5).
Changes in the shares of individual industries in total industrial output and employment were also disproportionate. While branches of heavy industry sharply increased their shares in industrial production, their proportions in total employment also rose, but at a much slower pace. In contrast, industries with higher value-added saw their shares in total output diminish very rapidly, while employment dropped to a lesser extent. In the case of food processing, employment even increased. Overmanning in higher value-added industries thus further intensified, and indeed these industries are reporting large numbers of redundant workers put on administrative leave or shorter working hours, as will be discussed later. Changes in relative prices have had an important impact on the composition of total industrial output. While prices of energy and steel have gradually increased to world levels, other producer prices lag well behind. Relatively high prices of energy and raw materials overestimate the share of primary industries in total production.

The relative boom of primary industries is not sustainable in the long run, as a large part of the sector is competitive only due to low expenditures on occupational safety and health, environmental protection, and low wages, often paid with substantial delays. They also have low levels of investment, despite production technologies that are mostly obsolete. For many coal pits, investment in proper technology would hardly bring returns, due to extreme mining conditions. The accumulated problems will have to be solved, inevitably leading to closures of unprofitable coal mines and steel works.

The recovery of processing industries will require massive investment to upgrade technology, increase product innovation and improve production processes. However, investment is again predominantly channelled to the production of electricity, steel and coal (and even for these industries it is insufficient by far, considering the obsolescence of present machinery, equipment and technology). While engineering received a mere 5% of total industrial investment in 1996, the food industry received 7% and light industry 1%. Proposals for future industrial development foreseen to lead Ukraine out of economic crisis thus look very gloomy if no energetic industrial policy is launched to promote investment activity and improve the enabling environment for business. Even if industry recovers and returns to growth, further cuts in employment must be expected as a result of the effort of enterprises to reduce extensive labour hoarding and increase labour productivity.

Table 2.5 Structure of industrial production* and employment, 1990-1996 (%)

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<tbody>
<tr>
<td>Total industry</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Power production</td>
<td>2.9</td>
<td>1.9</td>
<td>9.4</td>
<td>2.8</td>
<td>12.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Mining</td>
<td>7.4</td>
<td>9.2</td>
<td>8.5</td>
<td>11.4</td>
<td>12.1</td>
<td>11.9</td>
</tr>
<tr>
<td>Metallurgy</td>
<td>9.4</td>
<td>6.9</td>
<td>16.8</td>
<td>8.2</td>
<td>21.9</td>
<td>9.8</td>
</tr>
<tr>
<td>Engineering</td>
<td>28.2</td>
<td>43.1</td>
<td>19.8</td>
<td>40.4</td>
<td>14.7</td>
<td>35.6</td>
</tr>
<tr>
<td>Light industry</td>
<td>12.2</td>
<td>10.6</td>
<td>6.1</td>
<td>8.0</td>
<td>2.1</td>
<td>6.8</td>
</tr>
<tr>
<td>Food processing</td>
<td>22.9</td>
<td>9.6</td>
<td>19.7</td>
<td>10.4</td>
<td>16.1</td>
<td>13.3</td>
</tr>
<tr>
<td>Other industries</td>
<td>17.0</td>
<td>18.7</td>
<td>19.7</td>
<td>18.8</td>
<td>20.4</td>
<td>18.2</td>
</tr>
</tbody>
</table>

* Shares in industrial output measured in current prices.
Source: See under Table 2.4.

21 See, for example, the World Bank’s Staff Appraisal Report on the coal pilot project in Ukraine of April 1996.

2.3.3 Services

Within the service sector, transport and communications recorded very rapid growth after 1990, and have almost tripled their share in gross value added. Trade and public catering also experienced rapid
growth after 1990, but this tendency reversed after 1993. The share of other services in production also increased to more than one-quarter of gross value added in 1996.

In employment, as mentioned above, the service sector has experienced a small decline during the transition period. Employment losses in relative and absolute terms affected the majority of services, with the following exceptions: banking and insurance; state administration, political and social organizations; health, social care and sport; and so-called other economic activities (including commercial, geological and certain household services). Moreover, even these areas of activity have been reducing their workforce recently due to cuts in the state budget and problems in the financial sector.

The area hardest hit by staff cuts was research and development, which lost nearly 50% of its personnel, usually young and dynamic researchers who found better-paid jobs in the private sector. The decline in the trade and transportation sectors and in household and personal services should be considered with caution. Although no ‘hard’ data are available to prove it, very probably these three sectors have actually experienced net increases in employment, with a large part of the new jobs in the informal economy and in the forms of self-employment, part-time employment and non-traditional forms of economic activity. With a desired gradual formalization of informal economic activities and a recovery of real incomes in the population, the share of these services in total employment will rapidly increase.

In contrast, further anticipated cuts in state expenditure as well as in regional and municipal budgets will result in pressures to reduce the number of personnel in budget-financed institutions. Therefore, employment losses will continue in the civil service and public administration, in health and social care and in education, culture and the arts. In a recent public declaration, made on the occasion of signing a new memorandum of agreement between Ukraine and the International Monetary Fund, the First Deputy Prime Minister of Ukraine, Mr. Tihipko, revealed the government’s plan to cut employment in budget-funded institutions by 1 million persons over the next two and half years.22

2.4 Wage developments and incomes policy

2.4.1 Changes in the wage determination system

Under the former planned economy, almost all wage incomes were determined by the government, including the basic wage and additional sources of income, such as incentives and bonuses. Wage rates were applied by enterprises according to a centralized tariff system that provided wage coefficients by grade, also reflecting time worked and conditions of work. Total expenditure for labour was also centrally controlled through the so-called wage norms, directly linked by the government to the planned volume of production. This system combined low wages with small wage differentials between industries, regions and categories of workers, in order to ensure the principle of equal pay for equal work in all spheres of activity. Strict wage limitations, low wages and the effort to maintain employment regardless of productivity implied labour hoarding, a lack of incentives for labour mobility and insufficient emphasis on technological change. Since 1991, the parliament and the Government of Ukraine have adopted a series of measures to change regulations concerning wage fixing to suit the new socio-economic and political circumstances.

In April 1991, the centralized system of wage determination was abolished and a new wage bargaining system was introduced by the Law on Enterprises in Ukraine. Enterprises (92% of which are still state-owned) were given autonomy to determine wage levels and payment systems. The only obligation (according to article 19 of the Law) was to use the tariff system as a benchmark to ensure wage differentials between workers according to profession, skill, complexity and conditions of work. This general law promoted wage bargaining between trade unions and employers.

However, uncontrolled wage growth in 1992 pushed the government to change its policy and to reintroduce a centralized system of wage regulation for the public sector. Public enterprises in which the

22 See the Ukrainian newspaper Kievskiy vedomosti, 13 May 1998, p. 10.
wage fund was above the prescribed limit were forced to pay a progressive tax. The adoption in July 1993 of the Law on Collective Contracts and Agreements established the legal grounds and guarantees needed for collective bargaining and the conclusion of collective agreements. After the new Decree on Wages, a general tariff agreement was concluded in 1993, followed by industry and regional agreements and agreements at the enterprise level. The provisions of this national agreement were binding at all levels of contractual regulation of wages, as agreed between the Cabinet of Ministers and twelve trade union associations. The agreement set wage coefficients for different categories of workers and branches of industry on the basis of the minimum wage, which therefore assumed a key role in the entire wage structure of the economy. The primary aim of the tariff system was to limit wage inflation by controlling wages; a second aim was to limit wage differentials between enterprises and sectors of the economy, which were considered too large compared to other countries.

In May 1995 a new Law on Wages was adopted, strengthening the role of bargaining in setting wages and salaries.

2.4.2 The fall in real wages

Poor economic performance and a restrictive incomes policy resulted in a dramatic fall in real wages beginning in 1992, when wage indexation was abolished. In 1992 real wages fell by 39% and in 1993 by 52%. The decline in 1994 was a more modest 15%. In 1995 the real average wage temporarily recovered, but in the following two years it fell again. By 1997, the real average wage had declined to 29% of its 1991 level. It is therefore no wonder that most Ukrainians became not only sceptical about the benefits of economic and political reforms, but also nostalgic concerning the previous, centralized system.

Since official statistics on real wages refer to contracted wages, not wages actually paid, in reality the situation is even more dramatic. Since 1995, the non-payment of wages has represented one of the most worrying trends in the Ukrainian economy and a main source of social tensions. Although this phenomenon is mainly caused by the economic and financial difficulties of enterprises and institutions, this problem clearly emerged in connection with the very restrictive monetary and credit policies implemented in 1995.

Total wage arrears amounted to 252.5 trillion karbovanets (USD 1.33 billion) in June 1996 and have further increased since then. By January 1998, they had reached 5,148 million hryvnya, of which the budgetary sector accounted for nearly one-third. Similarly, arrears have emerged in the payment of social benefits, pensions, grants and scholarships. In order to prevent a social explosion, the President of Ukraine issued Decree No. 333 of 12 May 1996 on Immediate Action to be Taken to Secure Prompt Payment of Wages, Pensions, Grants and Scholarships, and other Social Service Benefits. A series of measures was aimed at reducing budgetary expenditure while monitoring wage arrears and indebtedness at all levels. Since then, several more decrees have been issued by the President, however they have had only limited and temporary effect.23

Because of the growing problem of wage arrears, a series of strikes in 1997–1998 interrupted production in several sectors (e.g. the mining sector), and several national protest actions were organized.

2.4.3 Minimum wage regulations and the downward pressure on the minimum wage

In Ukraine, no procedure for fixing minimum wages has been established by legislation. The Decree on Wages provided that the minimum wage is to be regulated by the state, taking into account economic development, labour productivity, average wages and the cost of the so-called minimum consumption basket. The Decree also stipulated that the minimum wage would be determined according to the prices of 70 basic goods needed for subsistence and should not fall below that subsistence level. Nevertheless,

23 Chapter 5 deals with the non-payment of wages in more detail.
the government suspended this legislation and also stopped all indexation mechanisms concerning the minimum wage.

Since December 1992, changes in the minimum wage level have been primarily decided by the Cabinet of Ministers, before submission to parliament. Today, there is still no regular dialogue with unions and employers on changes in the minimum wage. Although it has no relation to the subsistence minimum, no indexation mechanism, and no negotiated level, the national minimum wage has become the major instrument for controlling wage growth, since it is the base for all wages in the tariff system.

Between October 1990 and December 1993, the minimum wage was frequently revalued. After 1993, however, it remained constant at 60,000 karbovanets for more than two years. It was only in March 1996 that the minimum wage was again increased, to 1.5 million karbovanets (15 hryvnya). Nevertheless, due to high inflation, this is still merely a symbolic sum. Although wage regulations stipulate that the minimum wage should not be fixed below the poverty line, in reality it has fallen to a fraction of the subsistence minimum (Figure 1). The share of the minimum wage in the average wage also fell far beyond acceptable limits (Figure 2). The decline in the minimum wage, however, influenced not only workers at the bottom of the wage tariff system but also all other categories of workers, whose wages are determined on the basis of the minimum wage. Because social benefits are also linked to the minimum wage, its decline in real terms heavily eroded the real value of unemployment benefits and other social benefits. Therefore, increasing the minimum wage in early 1998 is a step in the right direction towards a recovery of its social and economic function.²⁴

Figure 1  The minimum wage as a percentage of the subsistence minimum, 1990–1998

²⁴ This will have two major implications for the expenditure side of the state budget. First, it will lead to a growth of wages in the budget-funded sector, to be counterbalanced by reductions in its workforce, as discussed earlier. Second, a subsequent increase in social benefits related to the minimum wage will increase social welfare expenditure. In order to avoid an increase in the budget deficit while providing reasonable social incomes to those in need, a reform of the social protection system is important, combining a social insurance system separated from the state budget with well-targeted social assistance. See, for example, ILO, The Ukrainian Challenge: Reforming Labour Market and Social Policy (ILO, Budapest, 1995).
2.4.4 Income differentiation

Income differentiation by sector followed an increasing trend until 1994, but since then the difference between the highest and the lowest sectoral wages has declined somewhat. Sectoral wage differences are shown in Table 2.6.

Table 2.6 Ratios of sectoral wages to the average wage in Ukraine, 1990-1997
(national average wage in each year = 100)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total economy</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Industry</td>
<td>112.1</td>
<td>124.9</td>
<td>120.8</td>
<td>114.3</td>
<td>110.5</td>
<td>111.6</td>
<td>110.3</td>
</tr>
<tr>
<td>Agriculture</td>
<td>104.8</td>
<td>74.9</td>
<td>68.6</td>
<td>68.4</td>
<td>57.3</td>
<td>66.1</td>
<td>56.6</td>
</tr>
<tr>
<td>Transport</td>
<td>104.0</td>
<td>105.2</td>
<td>107.5</td>
<td>107.5</td>
<td>112.1</td>
<td>101.2</td>
<td>102.8</td>
</tr>
<tr>
<td>Construction</td>
<td>124.6</td>
<td>112.7</td>
<td>133.0</td>
<td>142.2</td>
<td>128.0</td>
<td>118.3</td>
<td>98.4</td>
</tr>
<tr>
<td>Trade</td>
<td>90.7</td>
<td>82.0</td>
<td>77.5</td>
<td>80.8</td>
<td>76.7</td>
<td>68.1</td>
<td>73.2</td>
</tr>
<tr>
<td>Information and computing</td>
<td>94.0</td>
<td>66.0</td>
<td>81.1</td>
<td>93.3</td>
<td>97.9</td>
<td>110.3</td>
<td>108.7</td>
</tr>
<tr>
<td>Health care</td>
<td>66.1</td>
<td>80.1</td>
<td>66.1</td>
<td>76.4</td>
<td>96.4</td>
<td>77.5</td>
<td>81.3</td>
</tr>
<tr>
<td>Education</td>
<td>71.0</td>
<td>72.8</td>
<td>66.8</td>
<td>72.5</td>
<td>87.2</td>
<td>77.3</td>
<td>85.1</td>
</tr>
<tr>
<td>Science</td>
<td>126.6</td>
<td>83.3</td>
<td>85.2</td>
<td>102.4</td>
<td>101.7</td>
<td>110.2</td>
<td>104.9</td>
</tr>
<tr>
<td>Finance, credit and insurance</td>
<td>147.6</td>
<td>186.6</td>
<td>332.6</td>
<td>249.2</td>
<td>249.2</td>
<td>215.7</td>
<td>191.4</td>
</tr>
<tr>
<td>State administration, cooperative and non-governmental organizations</td>
<td>123.0</td>
<td>81.5</td>
<td>118.5</td>
<td>120.4</td>
<td>101.5</td>
<td>137.2</td>
<td>133.4</td>
</tr>
</tbody>
</table>

Source: Ministry of Statistics, 1997
Regarding sectoral disparities in wage levels, the situation in Ukraine is roughly similar to that in other transition economies. The leading sector in Ukraine is banking, followed at a distance by state administration. Industry, at third place, is slightly above the national average. Agriculture is at the opposite end of the sectoral wage scale, where the average wage has gradually fallen to half of the national average. A wage level below the national average is also characteristic of trade.

Centralized regulation and the artificial limitation of wages in the budgetary sector have resulted in a distortion of wage differentials, which should be based rather on qualifications, the complexity of work, level of responsibility, and differentiation between intellectual and physical work in the productive and budgetary spheres. This problem is particularly acute in education (where wages are at 85% of the national average) and health (at 81%). Both of these sectors have very highly educated labour forces, and a slight improvement in their wages was observed in 1997.

Within industry, the highest average wages are found in the production of electrical energy, followed by the natural gas and oil industries, with light industry at the bottom of the scale. Since 1991, wage differentials among industries have widened; the ratio of average wages in the best- and worst-paying industries was 5.8 to 1 in March 1997.

Differentiation of worker incomes has also emerged between enterprises with different property forms. The range of average income by property form in 1995 varied between 88% and 120%, a difference that has grown even further since then. The lowest average monthly income in 1995 was in the employee-managed collective sector. The highest average monthly income was reported at enterprises with foreign ownership, where it reached 130.1% in the general industrial sector, and 175.1% in the food industry. The second-highest incomes are to be found in enterprises in private ownership. Private enterprises are able to pay their workers higher-than-average wages, e.g. in engineering. In contrast, the remuneration of workers in state-owned enterprises on average lags behind that found in many private firms. This is why the President is in favour of abolishing the existing artificial wage fund limitations. A similar view is held by the Federation of Trade Unions.

The erosion of the average real wage and the minimum wage has also implied changes in income structure, with a trend toward non-monetary sources of income. Data for 1990–1997 indicate that for the relative share of work remuneration in gross family income has shrunk significantly. The proportion of wages in gross family income decreased from 60% to 41% between 1990 and 1996, with a particularly sharp drop in 1993 following the implementation of new wage regulations. This tendency is the result of increases in various kinds of payment and benefits, including unemployment and social benefits, as well as the development of joint-stock enterprises and an increase in the share of dividends in workers’ incomes.

2.5 Economic and employment implications of wage policy

2.5.1 Doubtful restrictive wage policy to control inflation

One of the most complicated ills afflicting Ukraine is inflation. In recent years the government has regulated wage increases in the public sector under conditions of liberalized prices, assuming that wage growth was a major source of price growth and inflation in Ukraine. Several indicators, however, suggest that wages have not constituted a basic determinant of inflation. The fact that wage growth lagged well behind inflation growth is a first sign that wages were not the main source of inflation. According to estimates made by the Institute of Economics of the National Academy of Sciences of Ukraine, wages did not contribute to price increases by more than 15–20% in 1994–1995, the remaining 80–85% coming from an increase in other production costs. This is confirmed by the fact that the share of wages in total production costs in industry represented a mere 6.4% in 1994 and 8.2% in 1995, while the share of production costs in retail prices was 40%.

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It seems likely that the gradual price liberalization of energy and raw materials was the main cause of inflation. To illustrate, while average industrial prices increased by 42 times in December 1992, prices grew by 72 times in the chemical industry and by 273 times in the fuel industry.\(^\text{26}\) In late 1993, there was a new jump in inflation following the government's decision to increase the price of coal by six times.\(^\text{27}\) Wages played no part in that. Since most industrial sectors use these inputs (fuel, coal, electricity, etc.), they passed on these input price increases in the prices of their products, thus leading to a vicious circle of growing inflation. In a context in which prices of energy and raw materials were out of control, a restrictive wage policy in itself could have little positive effect and was merely likely to lower the incomes of those groups and sectors with the weakest bargaining power. It lowered the purchasing power of workers, leading to further demotivation and lower productivity, and leading monopolistic enterprises to compensate for falling sales by raising prices.

A more restrictive law against monopolies would be more effective in limiting inflation. Apart from increasingly costly raw materials and monopolistic prices, other factors explaining inflation seem to have been high interest rates for bank credits, exchange rate policies, indirect taxes and high public expenditure.

### 2.5.2 Relationship between wages and productivity

Labour productivity fell by 52.9% between 1990 and 1996. Besides factors such as the scarcity of resources, increasing prices of energy and raw materials and obsolete technologies, the centralized wage system in the public sector has also significantly contributed to this decline in productivity due to its demotivating effect on workers. The adopted incomes policy did not guarantee a subsistence minimum for all workers, and led to a drastic fall in real wages. Moreover, the tariff system along with a tax-based incomes policy did not leave much room to link wages more closely to education and skills or to individual and collective performance.

In almost all sectors, this policy led to the total disconnection of wages from productivity; the highest nominal wage rises have coincided with considerable falls in labour productivity, and the slowest wage growth took place alongside labour productivity increases. For example, when in 1991–1993 labour productivity in engineering and in the timber, wood, pulp and paper industry increased by 29% and 15% respectively, average monthly wages increased by 505 and 585 times respectively (average monthly wages in total industry increased by 668 times). At the same time labour productivity in monopolistic sectors such as electricity generation, ferrous metallurgy and fuel fell by 26–42%, while average monthly wages grew over the same period by 772–973 times. State monopolies are practically unchecked, and wages grow at the cost of price rather than productivity increases.\(^\text{28}\) Such nominal wage and price growth unconnected with productivity in key sectors contributed to unjustified income differentiation that does not correspond with differences in output, quality of work, or qualifications.

Low wages obviously encouraged low work intensity and absenteeism, often related to the time spent in second or third jobs. Particularly in the budgetary sector, low wages have already resulted in a partial ‘brain drain’ of excellent young specialists from the vitally important occupations of education, health and culture to the business sector.

### 2.5.3 Impediments to employment restructuring

Low wage policies also seem to have a detrimental effect on the employment restructuring process currently underway in most enterprises. Their adverse effects on workers’ motivation and productivity

\(^{28}\) For example, price increases at the Kyiv bakery-confectionery factory increased profits in March 1995 by almost 1.5 times compared to December 1994, while output fell at comparative prices by 79% and labour productivity by 61.7%. At the same time, employees received bonuses in the amount of 278% of their tariff wage. See G. Kulikov, op. cit.
may have delayed economic recovery and constructive redeployment in some enterprises. It is quite significant that the maintenance of labour hoarding, or the phenomenon of unpaid or partially paid leaves typical for the Ukrainian economy, have been observed precisely in those sectors and enterprises confronted with the strictest wage controls – that is, in state enterprises. In those sectors, very low wages as well as delays in their payment have been clearly used as a substitute for a fall in employment. Due to low labour costs, enterprise managers have not been forced to enact a more radical restructuring of their enterprises, enhance production efficiency and redeploy workers. All this has impeded and delayed employment and labour market restructuring from unprofitable sectors and enterprises to more effective ones, with a negative effect on labour productivity and quality of employment.

Low wages in the formal economy have also contributed to the development of the informal economy. Due to low wages and incomes, many people are forced to seek additional income through engagement in informal activities and to buy goods and services more cheaply on the black market. This results in a growing informalization of production and higher consumption accommodated by untaxed goods and services, while production in the mainstream, taxable sector as well as budget income from taxes have declined. Increasing minimum and average wages would contribute to reducing the necessity of earning additional money and finding second jobs offered in the informal economy.

2.5.4 Adverse effects on consumer demand and production

Until recently, the fall in real wages was followed by a fall in consumer demand, with a negative feedback effect on production and employment. According to the National Bank of Ukraine, two out of three karbovanets’ worth of produced output corresponded to unsold goods and to production stocks in 1995.

Consumption deteriorated catastrophically. Between 1990 and 1995, annual meat consumption per person in Ukraine fell from 68 kg to 38.5 kg, consumption of milk and milk products from 373 kg to 245 kg, eggs from 272 to 172 pieces, fish and fish products from 17.5 kg to only 3.2 kg, sugar from 50 kg to 32 kg, fruit and berries from 47 kg to 34.5 kg per person, and so on.29 Many durable goods became inaccessible for large parts of the population.

This trend clearly contributed to the collapse of the internal market, and until 1995 it further aggravated the production crisis. In contrast, although real wages fell again in the period 1996–1997 after a temporary increase in 1995, their decline was more limited and was partly compensated by better development of other sources of income (social transfers, dividends, etc.). Thus, consumer demand has recently started to recover. This has had a positive effect on production, the decline of which has slowed down considerably. The employment effects of this slowdown, however, can hardly be felt, due to economic pressures to reduce labour hoarding and significantly increase labour productivity in the enterprise sector.

2.6 The social situation

2.6.1 Growing social stratification

The deep fall in real wages and incomes since 1991 has been accompanied by growing income differentiation. The distribution of persons by gross per capita income in 1996 is shown in Table 2.7.

29 Statistical Yearbook of Ukraine, 1996.
Average monthly gross per capita income equalled 107 hryvnya in 1996. In urban areas (with 68% of Ukraine’s population) average income was slightly higher (at 112 hryvnya) in comparison with that in rural regions (102.5 hryvnya). The money income differential between the richest 10% and the poorest 10% of the population in 1996 reached a ratio of 15:1 (in developed countries it generally does not exceed 4:1), from 6:1 in 1993. The gap is therefore widening. In fact, income differentials are even greater than the official statistics indicate, since statistics are hampered by the widespread under-reporting of income, especially among the richest categories. The middle class – the factor of political stability and economic prosperity in economically developed countries – is disappearing, replaced by an increasingly polarized society of a relatively small group of extremely rich persons and the poor majority.

The increasing poverty of Ukrainian households is reflected in changes in the structure of their expenditures. According to the household surveys conducted by the Ministry of Statistics, Ukrainian households spent 30.2–37.2% of their budget to buy food and 34.3–34.7% to buy other goods in 1990–1992. By 1996, 62.2% of the average household budget was spent on food items – i.e. the share of expenditure on food doubled within a few years. The growing proportion of services in total expenditure should be solely attributed to a rise in prices for housing, public utilities and transportation fares. As a result, Ukrainians could afford to buy less non-food products and also were able to save a mere 1.7% of their incomes.

### 2.6.2 Spreading poverty

A considerable portion of the population has been pushed into poverty. In 1996, 14.6 million people (28.5% of the population) had their total incomes below the ‘low income level’ – an official poverty indicator, equalling 68.1 hryvnya per month.

Poverty incidence is high particularly among families with many children, pensioners and persons of restricted employability. The Household Budget Survey of 1996 provided evidence that while 18% of all families with one child under 16 had per capita incomes below 60 hryvnya per month (i.e. slightly below...
the ‘low income level’), among families with two children 27.5% had such a low income per head. The share of low-income families among those with three children was 45.6%, and with four and more children as high as 63.3% in 1996. Similarly, every sixth household of pensioners lived below the poverty line of 45.7 hryvnya in 1996. However, poverty is now also widespread among households whose members are employed but subject to involuntary part-time work or administrative leave without pay, whose wages and salaries are paid with substantial delay, or who are working in low-paid sectors and professions.

High poverty incidence among families with more children, along with a prevalent uncertainty regarding the future, caused a steady decrease in fertility. While in the mid-1980s the fertility rate amounted to 15 births per 1000 persons, and 12.1 births in 1991, this level dropped to 9.6 in 1995 and further to 8.6 in 1997. Infant mortality has increased from 12.8 per 1000 live births in 1990 to 14.7 per 1000 live births in 1995. The current birth level does not ensure reproduction of Ukraine’s population, as the death rate increased from 12.9 persons per 1000 population in 1991 to 15.6 in 1997.

Widespread stress associated with growing unemployment, rapidly declining incomes, a loss of hope for a better future for older generations, as well as the worsening quality of health care and standards of nutrition have severely affected life expectancy. Life expectancy for men declined from 66 years in 1991 to just under 63.7 years in 1995, and for women from 75 years to 73.8 years.

These developments have resulted in a decreased dependency ratio, i.e. an increase in the proportion of the total population which is of working age. However, the decline in population between 1991 and 1993 caused by the higher death rate relative to the birth rate was offset by substantial net immigration from other former Soviet republics. Since 1995, the trend has been towards net emigration, especially to more economically developed countries such as the US, Canada or Israel. This has resulted in a small decline in population (94,500 in 1995; 121,200 over the first nine months of 1996). Ukrainians have also begun to migrate as guest workers to other Central and Eastern European countries, where average wages are higher than in Ukraine.
CHAPTER 3: EMPLOYMENT AND LABOUR MARKETS: EMERGING ISSUES

3.1 Introduction

The Ukrainian labour market has gone through substantial changes since 1991. This chapter will provide an overview of the changes in labour supply and demand as well as changes in the size and composition of employment and unemployment. The main problem on the current labour market in Ukraine - the lack of demand for labour - leads more to economic inactivity, unregistered unemployment and hidden unemployment in the form of involuntary leaves or shorter working hours than it does to open unemployment, registered by labour administration. The lack of demand for labour also contributes to a sharp increase in external labour migration.

3.2 Labour market developments

3.2.1 Changes in labour supply

Between 1990 and 1996, labour supply had a slightly increasing tendency (Table 3.1). This was mainly due to the growing participation of workers above working age, as the able-bodied population in working age slightly declined. However, the economic activity of the working-age population decreased more in connection with sharpening tensions in the formal labour market. Many persons could not find better-paid jobs, or any job at all, and either turned to the informal sector or gave up paid economic activity. In this respect, women were hit harder than men and opted for inactivity more often than men. Also, in the absence of suitable jobs, persons with disabilities were forced to retire. A number of older persons, having two or less years before retirement and threatened by unemployment, opted for early retirement. The participation rate of the working-age population declined by 8 percentage points in six years - from 85% recorded by the 1989 Population Census to 76.8% according to the 1995 Labour Force Survey (LFS).\(^1\) In contrast, the LFS recorded an increase in the participation rate of those aged 15-70 by 3 percentage points between 1995 and 1997 - from 67.8% to 70.8%. In total, the Ukrainian labour force shrank by almost 2 million persons in the period 1990-1996.

Table 3.1  Labour supply and demand in Ukraine, 1990-1996 (thousands)

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Total labour supply,(^*) of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>able-bodied population in working age</td>
<td>28,023</td>
<td>27,989</td>
<td>27,612</td>
<td>27,392</td>
</tr>
<tr>
<td>workers outside working age</td>
<td>1,665</td>
<td>1,535</td>
<td>2,534</td>
<td>2,558</td>
</tr>
<tr>
<td>Non-active population of working age</td>
<td>4,269</td>
<td>4,979</td>
<td>6,327</td>
<td>6,496</td>
</tr>
<tr>
<td>Labour force</td>
<td>25,419</td>
<td>24,545</td>
<td>23,819</td>
<td>23,454</td>
</tr>
<tr>
<td>Employment, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>employed in working age</td>
<td>23,754</td>
<td>22,970</td>
<td>21,192</td>
<td>20,674</td>
</tr>
<tr>
<td>Unemployment (registered)**</td>
<td>x</td>
<td>70.5</td>
<td>126.9</td>
<td>351.1</td>
</tr>
</tbody>
</table>

\(^*\) Labour supply includes the able-bodied population in working age and working persons under and above working age.

\(^*\) End-of-year data

Source: Ministry of Statistics of Ukraine, Pracya v Ukraini (Labour in Ukraine), various issues

1 In the case of men, this decrease was less than 6 points (from 86.3% in 1989 to 80.6% in 1995). The participation rate for women fell by more than 10 points, from 83.7% to 73.5%.
3.2.2 Changes in employment

In Ukraine, as in other newly independent countries formed after the break-up of the USSR, employment losses were fairly limited in comparison with the decline in production (see Table 2.3, in Chapter 2). The surprisingly slow fall in total employment in the first years of economic transition should be attributed to three factors:

1. Enterprise managers continue to take a paternalistic approach towards employees, persisting from communist times, often out of a declared sense of responsibility for their workers. Especially outside large cities, enterprise managers cannot afford massive layoffs without aggravating political and social pressures in the local society. A survey of 767 industrial enterprises conducted in March 1996 revealed that managers preferred declines in production capacity utilization to mass layoffs. Among the reasons mentioned by managers were insufficient protection for dismissed workers, a desire to maintain a core of skilled workers for future recovery, and a lack of demand for labour in the market. It should also be stressed that the relative social peace in enterprises often helped managers obtain a stake in enterprises privatized through management-employee buy-outs and later to gain full control over the enterprise.

2. Enterprises have a desire to avoid severance payments to laid-off workers. Instead, redundant workers were increasingly put on administrative leave (mostly unpaid) or short-time work. In most cases, workers accepted this solution, as it did not restrict their access to social services provided by their enterprise and in a situation of depressed demand for labour it gave them some hope for better employment conditions for future.

3. Labour turnover increased significantly after 1990. In 1992, 23.3% of all workers in the state sector left their jobs, while 19.1% were newly recruited; in 1996, the corresponding figures were 22% and 15.6%. The difference between job quitting and hiring has increased in time, providing evidence of a decreasing ability of the national economy to absorb free labour. Indeed, the number of vacancies reported to the State Employment Service fell significantly in this period, as seen later in Table 3.4.

Table 3.1 reveals that the decline in total employment was mainly at the cost of the working-age population. In particular, the decrease concentrates on the age group of 15–29, while employment rates increased in older age groups (55–69; see Table 3.2).

### Table 3.2 Specific employment, unemployment and inactivity rates* by age, 1989–1997 (%)

<table>
<thead>
<tr>
<th>Age groups</th>
<th>1989</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employment</td>
<td>Inactivity</td>
</tr>
<tr>
<td>15–69</td>
<td>71.3</td>
<td>28.7</td>
</tr>
<tr>
<td>15–19</td>
<td>26.8</td>
<td>73.2</td>
</tr>
<tr>
<td>20–24</td>
<td>79.0</td>
<td>21.0</td>
</tr>
<tr>
<td>25–29</td>
<td>94.4</td>
<td>5.6</td>
</tr>
<tr>
<td>30–34</td>
<td>95.2</td>
<td>4.8</td>
</tr>
<tr>
<td>35–39</td>
<td>96.0</td>
<td>4.0</td>
</tr>
<tr>
<td>40–49</td>
<td>94.6</td>
<td>5.4</td>
</tr>
<tr>
<td>50–54</td>
<td>86.8</td>
<td>13.2</td>
</tr>
<tr>
<td>55–59</td>
<td>50.4</td>
<td>49.6</td>
</tr>
<tr>
<td>60–69</td>
<td>17.4</td>
<td>82.6</td>
</tr>
</tbody>
</table>

* The rates are calculated as the number of employed, unemployed or inactive persons in the respective age group divided by the total number of persons in that age group. The unemployment rates given here thus differ from traditional unemployment rates, presented later in this chapter, which use the economically active population as the denominator.


3 A large number of workers leaving their jobs did so on a voluntary basis. However, in many cases they left after being on administrative leave without pay or on short-time work.
In the case of younger people, employment losses were partly translated into open unemployment, partly into inactivity. Although growing enrolment in education can offer some explanation for the increased inactivity of youth, the high unemployment rates of young people as well as large withdrawals from the labour market are rather worrying signals.

The quality of the working population over 15 as measured by level of education further improved between 1989 and 1997. According to the 1989 census, 7.2% of workers had primary or lower schooling only; 77.7% had secondary, including incomplete secondary education; and 15.1% had received some post-secondary education. Eight years later, only 1% of the working population over 15 had elementary schooling only, while 38.5% had received general secondary education, 20.9% secondary vocational schooling and 29.6% post-secondary education.\(^4\) However, due to economic transformation, demand for education and training has changed not only in terms of its level but also in terms of quality and specialization, as new professions are in demand while many others have become obsolete.

A significant change has occurred in employment by form of ownership. In 1990, 78% of all workers were employed in the state sector, 19% in the cooperative sector and 3% in the private sector (including mixed enterprises). By 1997, the share of the state sector in total employment had decreased to 40%, while employment in the cooperative sector had increased to 36% and in the private sector to 24%. As to employment status, according to the 1997 Labour Force Survey, 63.2% of the working population were employees, 20.5% members of cooperatives and other collective enterprises, 0.6% employers, 15.4% self-employed and 0.3% unpaid helping family members.

The proportion of part-time workers has also been on the increase. In December 1992, only 1.6% of workers worked part-time in the state sector. By October 1997, 12.2% of workers in total national employment worked part time. Half of these were transferred to part-time work on the initiative of enterprise management, 16% could not get a full-time job, and only 13% were working part-time because they wanted to.\(^5\) Part-time work became more frequent, especially in industry.

In contrast, 1.6% of the working population had second or multiple jobs in 1997. More than two-thirds of these second activities were concentrated in subsidiary family farming or in private businesses, mostly in trade and household services. Many more persons have secondary activities of an informal character; however, it is very difficult to estimate their numbers. Sociological surveys indicate that some 8.5–9 million persons (i.e. around one-third of the active population), receive incomes from informal economic activity.\(^6\) Around 3 million of these persons are estimated to be engaged full-time in the informal sector, while the rest conduct informal activities as a second job, in addition to formal employment.\(^7\) It is likely that the informal sector is the explanation for the discrepancy between employment data reported by different sources. An expert estimate puts the number of informally active self-employed to be as high as 4 million, four times the number of the formally self-employed.\(^8\)

### 3.3 Labour migration

Labour migration increased dramatically after the break-up of the USSR and an improvement in general conditions for travelling to and from Ukraine. Labour migration has been stimulated by the worsening labour market situation, spreading poverty and growing wage differentials between Ukraine and the receiving countries, particularly those that allow visa-free travel for Ukrainian citizens.

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\(^4\) The figures are not fully comparable due to some changes in the classification of education.

\(^5\) The share of part-time workers has been consistently increasing, particularly in large and medium-sized enterprises, and had already reached 16.1% of the workforce of such enterprises in 1997.

\(^6\) V. Kolot, op. cit.

\(^7\) The State Statistical Committee included a block of questions on informal labour in the 1997 Labour Survey, with the aim of obtaining more accurate information on this important issue. However, because of budget cuts, the Survey was conducted in a more modest way than originally expected and the data have not been processed further. Therefore, only estimates and results from small-scale sociological surveys on the size of informal labour are available at present.

The number of Ukrainian citizens working abroad is much higher than the number of foreigners economically active in Ukraine. In 1997, the State Employment Service registered only 18,741 Ukrainians working abroad, of whom 16,692 were hired employees and 2,049 were working under contracts concluded by Ukrainian firms. As to the country of destination, the highest number of migrant workers were employed in Greece (5,702), followed by the Czech Republic (3,287), Liberia (1,859), the Bahamas (1,660) and the Russian Federation (1,552). In contrast, the same source reported 1,820 foreigners working in Ukraine at the end of 1997: 235 Turks, 148 Bulgarians, 139 Chinese and 124 Vietnamese.

These figures seriously underestimate even legal migration, as seen from the numbers of work permits given by the receiving countries. For example, by the end of 1996 one of the receiving countries, the Czech Republic, registered 42,100 valid work permits for Ukrainian citizens, and many others might possess a business licence.\(^9\) Illegal migration is probably much higher - for example, in the Czech Republic estimates of the number of Ukrainian workers go up to 200,000–300,000.

Ukraine has concluded bilateral agreements with some receiving countries to regulate the size of labour migration and protect migrant workers against unlawful employer practices, occupational hazards and detrimental working conditions, and enabling their access to health care and social security. When such a bilateral agreement has not been concluded, legal migrant workers should generally be protected by national labour legislation in a manner similar to that of other workers. In practice, however, a lack of clear regulations may cause problems for them in access to legal, employment, health and social protection in comparison with other workers. The situation of illegal workers is much worse. According to some empirical surveys, they are often forced to work long hours under detrimental working conditions, have restricted or no access to medical care and social protection, and no protection against low remuneration, dismissals, occupational accidents or diseases. Illegal migrants are frequently exploited by employers, bribed by persons or firms mediating their illegal employment abroad and attacked by racketeers in their place of work or residence.\(^10\)

### 3.4 Unemployment

#### 3.4.1 Development of unemployment

Until 1991, demand for labour far exceeded labour supply, so that unemployment in an open form did not exist. Certain limited frictional unemployment could appear, but this phenomenon was not recognized officially. Since the end of 1991, an ever-increasing number of persons have been registered in employment offices as unemployed jobseekers, with a slight temporary decline in 1994 (see Table 3.3). However, when compared with employment losses, registered unemployment has so far been very limited, and has started to accelerate only in the last two years. Projections made by the State Employment Service (SES) suggest this recent trend could continue: registered unemployment is expected to reach 4.62% of the labour force at the end of 1998, 5.9% in 1999, and 6.86% in 2000.

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\(^9\) Annual Report of the Administration of Employment Services of the Czech Republic, 1996. Figures on business licences (in total 45,000 in 1996) issued to foreigners are not divided by nationality but one can assume that some of them are held by Ukrainian citizens.

\(^10\) For details, see the Report on Implementation of the Project of Socio-Demographic Study of Labour and Seasonal Migration of Population of Trans-Carpathian Oblast of Ukraine, (International Organization for Migration, Kyiv, 1997). This project was co-sponsored by the ILO. The survey was conducted on a sample of 715 persons (anonymously, and not questioning their migrant status), and revealed that in exchange for higher remuneration and an improvement in material well-being for families of migrant workers (reported by, respectively, 74% and 72% of respondents), labour migrants had to work 12 hours a day on average in CIS countries and 11.2 hours in other countries. Meanwhile, 88% of respondents assessed their work as hard or very hard, and 85% as requiring low intellectual effort even though the educational level of migrant workers was rather high, at 11.5 years of education on average. Many respondents called for an improvement in conditions of their stay abroad, and the remedy they saw was the conclusion of intergovernmental agreements which would extend possibilities of working abroad, protect migrant workers against low wages inadequate for the requested workload, and ensure normal conditions for work and stay abroad in compliance with the national legislation of the receiving country. They also wished to be protected against racketeers at the workplace and at home.
These unemployment figures only concern persons who have unemployment status. Their position is better than that of other unemployed persons without this status, since most persons with unemployment status are eligible for unemployment benefits and other forms of income support. However, the number of unemployed persons who turn to the SES for assistance in job placement is higher. The category of so-called non-employed persons, registered by the SES, also covers other groups of unemployed persons not (yet) entitled to acquire unemployment status. These include: persons waiting for unemployment registration (according to the Law of Ukraine on Employment of the Population, currently for seven days after turning to the Employment Service); those having refused two suitable job offers (their eligibility for benefits is then suspended for three months); youth under 16 (except for those who had worked and lost their job due to staff cuts, enterprise closures, etc.); new labour market entrants without profession; and persons eligible for pension. These groups are not entitled to unemployment benefits, but still have access to job placement assistance and the majority of active labour market programmes. However, the share of unemployed persons without unemployment status in total registered non-employment has been decreasing since 1992 (see Table 3.4).

### Table 3.3  Registered unemployment, 1991–1997 (end-of-year data)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of registered jobseekers</th>
<th>Unemployment rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>7,031</td>
<td>0.025</td>
</tr>
<tr>
<td>1992</td>
<td>70,535</td>
<td>0.3</td>
</tr>
<tr>
<td>1993</td>
<td>83,889</td>
<td>0.3</td>
</tr>
<tr>
<td>1994</td>
<td>82,232</td>
<td>0.3</td>
</tr>
<tr>
<td>1995</td>
<td>126,853</td>
<td>0.5</td>
</tr>
<tr>
<td>1996</td>
<td>351,103</td>
<td>1.3</td>
</tr>
<tr>
<td>1997</td>
<td>637,067</td>
<td>2.3</td>
</tr>
</tbody>
</table>

Source: State Employment Service

However, the fact that unemployment figures are still rather modest does not mean that unemployment is not an important issue. This becomes clear when comparing the number of non-employed persons

### Table 3.4  Registered non-employment and vacancies in Ukraine, 1992–1997 (at end of year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-employed,* of whom:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>unemployed**</td>
<td>141,100</td>
<td>23,400</td>
<td>113,200</td>
<td>161,300</td>
<td>392,300</td>
<td>677,900</td>
</tr>
<tr>
<td>Non-employment/unemployment ratio</td>
<td>2.0</td>
<td>1.47</td>
<td>1.38</td>
<td>1.27</td>
<td>1.12</td>
<td>1.06</td>
</tr>
<tr>
<td>Vacancies</td>
<td>129,100</td>
<td>131,600</td>
<td>136,600</td>
<td>86,400</td>
<td>35,200</td>
<td>34,800</td>
</tr>
<tr>
<td>Non-employment/vacancy ratio</td>
<td>1.09</td>
<td>0.94</td>
<td>0.83</td>
<td>1.87</td>
<td>11.14</td>
<td>19.48</td>
</tr>
</tbody>
</table>

* The number of all unemployed persons turning for job search assistance to the SES, regardless of whether or not they have unemployment status.
** The number of persons having unemployment status.

Source: State Employment Service

However, the fact that unemployment figures are still rather modest does not mean that unemployment is not an important issue. This becomes clear when comparing the number of non-employed persons

---

11 Persons who do not have an income from work, are registered at the State Employment Service, are actively looking for a job and are ready to start work. A more precise definition is given in Chapter 4.
12 This term is used in all reports of the SES, and therefore it is also used in this Review.
with the number of vacancies reported to the SES (see Table 3.4). While vacancies reported to employment offices even outnumbered registered jobseekers in 1993 and 1994, since 1995 the non-employment/vacancy ratio has rapidly increased. In 1997, there were already 19.5 registered non-employed persons per vacancy in Ukraine on average.

The first Labour Force Survey (LFS), conducted in October 1995, revealed a much higher level of open unemployment than suggested by data from the unemployment register. The total number of persons unemployed according to the ILO definition was 1.44 million, i.e. 13 times higher than the number of registered jobseekers. The rate of unemployment equalled 5.6% of the labour force. The second LFS, in October 1996, recorded a further increase in open unemployment, to almost 2 million persons, corresponding to an unemployment rate of 7.6%. Corresponding figures from the third LFS in October 1997 were 2.3 million persons, or 8.9% of the economically active population. An additional 511,000 persons were discouraged jobseekers, i.e. they had no job and were ready to work, but did not actively search for a job as they did not believe they would get one. The reasons why not all unemployed jobseekers register at the SES are numerous: non-eligibility for or expiry of unemployment benefits, low levels of benefits, a certain social stigma from being registered as unemployed, a lack of vacancies reported to the SES, limited access to employment promotion programmes, and other reasons.\footnote{13 Non-registration will be discussed further in Chapter 4, devoted to labour market institutions and policies.}

However, even these much higher figures underestimate the actual level of total unemployment. As already mentioned at the beginning of this chapter, a considerable number of workers are put on administrative leave, mostly without pay, as their enterprises face economic problems. This form of redundancy had already become widespread in 1992. In 1996, the number of workers put on administrative leave equalled 3.4 million, or 23.8% of all workers. In 1997, this number slightly decreased to 2.9 million persons, equal to 21.9% of total employment, of whom almost one-third were on leave for more than one month. Other workers are forced to work part time, either temporarily at the initiative of enterprise management or permanently when they are unable to find a full-time job. In 1997, altogether 2.1 million persons (16.1% of the workforce) worked part time. This means that in total, 38% of all workers were in fact partially redundant or unemployed in a hidden fashion in 1997. In 1996, the total number of man-days (full days without intra-shift losses) lost due to administrative leave or part-time work amounted to 232 million, or 25 days per worker. One year later, as many as 2.3 billion man-hours were lost, corresponding to roughly 287 million man-days. The sector hardest hit by hidden unemployment was industry, with 32 lost days per worker in 1996 and 39 lost days (309 lost hours) per worker in 1997.

Administrative leave and shorter working hours are used by many employers as they offer the possibility of moderating social pressures associated with direct layoffs during a period of economic difficulties and of avoiding severance pay, while keeping those workers who are important for the enterprise. More competitive workers usually quit the enterprise when employment problems occur, while those less competitive remain in order to at least preserve their access to social services provided by the enterprise.\footnote{14 To a certain extent the non-payment of wages, widespread at present, could also be taken as another form of hidden unemployment. Chapter 5 focuses on this problem.}

When considering open and hidden unemployment together, an indicator of ‘non-voluntary underutilization of the labour force’ could reach up to 7.3 million persons in 1997, i.e. some 30% of the labour force. However, this estimate is probably too high, because in most cases administrative leaves and shorter working hours are used only for a limited period. Moreover, many formally unemployed persons are actually active in the informal sector. Nevertheless, the high level of redundant labour cannot be maintained over a long period, and a part of it will inevitably turn into open unemployment.

### 3.4.2 Unemployment turnover

Table 3.5 provides yearly flows into and out of unemployment for the period 1994–1997. The number of newly registered non-employed persons more than doubled within four years. Surprisingly, although
unemployment grew as a result of economic pressures on enterprises to lay off redundant workers, the share of persons having lost their jobs for economic reasons constituted less than one-third of all newly registered jobseekers. In contrast, persons who quit their jobs voluntarily made up the largest group. This seeming contradiction is to be explained by the many workers who have not been paid for a longer period due to administrative leave without pay or forced short-time work, and who therefore prefer to quit their jobs even at the cost of losing their entitlement to severance pay.

<table>
<thead>
<tr>
<th>Table 3.5</th>
<th>Unemployment flows* and reasons for entry and exit,** 1994–1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Newly registered non-employed persons, of whom:</td>
<td>445.8</td>
</tr>
<tr>
<td>laid-off due to staff cuts</td>
<td>121.6</td>
</tr>
<tr>
<td>quitting jobs voluntarily</td>
<td>188.4</td>
</tr>
<tr>
<td>school leavers</td>
<td>53.3</td>
</tr>
<tr>
<td>De-registered jobseekers, of whom:</td>
<td>456.0</td>
</tr>
<tr>
<td>found a job, of whom:</td>
<td>n.a.</td>
</tr>
<tr>
<td>with the assistance of the SES</td>
<td>202.3</td>
</tr>
<tr>
<td>non-cooperation with the SES</td>
<td>n.a.</td>
</tr>
<tr>
<td>other reasons</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

*All registered jobseekers, with and without unemployment status.
**Persons registered in the respective category during the given year.
Source: State Employment Service

While in 1994 the number of de-registered jobseekers exceeded that of newly registered persons, since 1995 de-registrations have increasingly lagged behind new registrations, and the unemployment stock has grown. Among the reasons for de-registration, exits to jobs have been slowly declining while de-registration due to non-cooperation with the Employment Service has sharply increased since 1995. In 1997, this was already the main reason for the de-registration of registered jobseekers.¹⁵

Most registered jobseekers were placed in jobs in the state or collective sectors, while job placements in the private sector remained negligible over the last four years. In 1994, 79.7% of all exits to jobs were in the state sector, 14.8% in the cooperative sector and only 4.5% in the private sector. By 1997, the only change emerged between the state and cooperative sectors, with 55.8% and 37.8% respectively, while private firms recruited only 6.2%. This shows that private firms are more selective and demanding in recruitment and seem uninterested in cooperating with the SES, preferring other recruitment channels.

### 3.4.3 Characteristics of unemployment

We will attempt to shed more light on the composition of unemployment by region, level of education, age, gender, and other factors. Although the Labour Force Survey provides more reliable data on unemployment, administrative data are important for an assessment of labour market policies. Therefore, we will use information from both sources wherever available, and point out to the differences in findings between the two data sources.

#### A. Regional disparities

Regional disparities in unemployment have significantly increased since 1992. Differences in regional rates of unemployment are much smaller for registered unemployment in comparison with the LFS unemployment data (see Table 3.6).

¹⁵ The reasons for non-cooperation with the Employment Service are multiple, and will be explained in more detail in Chapter 4.
<table>
<thead>
<tr>
<th>Regions and oblasts</th>
<th>Registered unemployment*</th>
<th>LFS unemployment**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ukraine (national)</td>
<td>0.3</td>
<td>0.5</td>
</tr>
<tr>
<td>North &amp; Centre</td>
<td>0.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Cherkaska</td>
<td>0.1</td>
<td>0.4</td>
</tr>
<tr>
<td>Chernihivska</td>
<td>0.3</td>
<td>0.8</td>
</tr>
<tr>
<td>Kyivska</td>
<td>0.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Kirovogradskaja</td>
<td>0.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Khmelnytska</td>
<td>0.4</td>
<td>0.6</td>
</tr>
<tr>
<td>Poltavskaja</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Sumskaja</td>
<td>0.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Vinnytska</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Zhytomyrska</td>
<td>0.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Kyiv</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>West</td>
<td>0.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Chernivetska</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>Ivano-Frankivska</td>
<td>0.8</td>
<td>1.5</td>
</tr>
<tr>
<td>L'vivska</td>
<td>0.5</td>
<td>1.0</td>
</tr>
<tr>
<td>Rivnenska</td>
<td>0.4</td>
<td>0.9</td>
</tr>
<tr>
<td>Ternopilska</td>
<td>0.7</td>
<td>0.8</td>
</tr>
<tr>
<td>Volynska</td>
<td>0.4</td>
<td>1.0</td>
</tr>
<tr>
<td>Zakarpatska</td>
<td>0.4</td>
<td>0.9</td>
</tr>
<tr>
<td>East</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Dnipropetrovskaya</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>Donetsk</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Kharkivska</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Luhanska</td>
<td>0.1</td>
<td>0.5</td>
</tr>
<tr>
<td>Zaporizhzhskaya</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>South</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Republic of Crimea</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Khersonska</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Mykolayivska</td>
<td>0.2</td>
<td>0.3</td>
</tr>
<tr>
<td>Odessa</td>
<td>0.2</td>
<td>0.1</td>
</tr>
</tbody>
</table>

* End-of-year data  
** October of the respective year  
*** including the town Sevastopol  
**** minus Sevastopol  

The region hardest hit by unemployment according to both LFS and registry data is the western part of Ukraine, which is of a more rural character and has only a few industrial centres concentrating mainly in textile and clothing production and in mechanical and electrical engineering. Southern and eastern Ukraine seem to be better off with regard to registered unemployment. Nevertheless, the picture for these regions changes in light of the LFS data, which show they are close to the national average. The regions that are best off seem to be in the northern and central parts of the country.

Disparities in regional unemployment rates sharply increase in the case of individual oblasts, ranging from 0.5% registered unemployment in the city of Kyiv and Odesska oblast at the end of 1997 – i.e. in the capital and a major Black Sea port - to 4.8% in Ivano-Frankivsk, a rural region in western Ukraine. When measuring unemployment according to the ILO definition, regional differences in the rates of unemployment for October 1997 were much larger, from 5.4% in Vinnytska to 12.7% in Lviv, 12.2% in Zakarpatie and over 11% in Kirovograd, Ivano-Frankivsk, Rivno, Zaporizhye and the city of Kyiv. Although disparities in registered unemployment correlate in general with differences in LFS unemployment for most regions, there are some important cases of dichotomy. The most striking example is the capital, Kyiv, where LFS unemployment exceeds registered unemployment 22 times, while e.g. in Chernihiv this proportion equals just 1.6.

According to an SES forecast, regional disparities in registered unemployment will sharply increase in the near future. In 2000, the highest rates are expected for the Vinnytska oblast at 16.9%, Ivano-Frankivsk at 16.2%, Chernihiv at 12.6% and the Kyivska oblast at 12.1%. The lowest rates should be maintained in Kyiv at 1.5% and in Odessa at 1.6%.

B. Higher unemployment of better-skilled persons

In contrast to many other economies in transition, workers with higher education are over-represented in registered unemployment. In December 1997, the share of post-secondary (university and college) educated jobseekers was 36.4%, that of persons with full secondary vocational education 30.5%, and that of secondary general education 27.6%. Meanwhile, persons having lower secondary general schooling contributed only 5.1% and those with primary education 0.4%. This rather surprising composition of unemployment by education reveals a combination of low demand for labour and large skill mismatches on the labour market in Ukraine. Due to inflexibility and the resulting inability of many schools and training centres to respond properly to new demands for skills, many school leavers or university graduates cannot find a job in their field of specialization and register with labour offices for retraining. Adult training is very limited, as many enterprise-owned training centres have been closed down and neither enterprises nor the SES have enough money to fund retraining or skills upgrading for workers threatened by unemployment or already made redundant. A particularly vulnerable group are older, highly educated women who lost their jobs but can find new ones only with extreme difficulty, as employers consider them overqualified, incapable of acquiring new skills and inflexible.

The Labour Force Survey in general confirms that higher-educated workers have more severe unemployment problems. In 1997, persons with post-secondary education were equally represented in unemployment (29.4%) and employment (29.6%). Workers having secondary vocational schooling were over-represented in unemployment (31.8%) while their share in employment was 20.9%. In contrast, jobseekers with secondary general education had relatively less problems in job placement - their share in unemployment was 28.5% and in employment 39%. Persons with lower secondary or primary schooling were again equally represented in unemployment (10.3%) and employment (10.5%). The figures reveal that the Ukrainian labour market is less capable of absorbing workers with higher education than other economies in transition.\textsuperscript{16} These findings are very important for a further orientation of labour market policies.

\textsuperscript{16} For example, the LFS conducted in the Czech Republic in spring 1997 reported a more favourable labour market situation for university-educated persons, who contributed 11% to employment but only 3% to unemployment. Similarly, the share of persons with higher secondary education was 32% in employment and only 20% in unemployment. In contrast, the proportion of persons with primary education equalled 10% in employment but 35% in unemployment. In Hungary, the situation was similar: the shares of persons with post-secondary education in employment and unemployment were 15% and 4.5% respectively, those of persons with full secondary education 32% and 22%, while persons with primary education contributed 21.5% and 32%, respectively.
C. High youth unemployment

Young jobseekers are recorded separately in the unemployment register as a potential risk group. In
the case of youth under 28, disproportionately high unemployment is indeed reality – in December
1997 this group constituted 30.1% of total registered unemployment. Of these, 0.9% were persons
aged 15–18, 10.2% were aged 18–21, 10.8% aged 21–24, and 9% aged 25–28. While the share of
school leavers in registered unemployment was only 6.4%, most other young persons had some work
experience and were either laid-off for economic reasons or quit voluntarily. Young people with little
experience, and particularly those without children, are usually the first targets for dismissals –
among other reasons because in their case severance pay is minimal due to their short length of
service.

In contrast, older persons of pre-retirement age (men over 58 and women over 53) seem not to have
any special employment problems, as their share in total unemployment equalled a mere 1.2% in
December 1997. Actually, many employers indeed endeavour to avoid layoffs of older persons for
social reasons, and also because they still prefer the work routine and reliability typical for older
workers to the greater flexibility and mobility of younger persons. Moreover, jobseekers of pre-
retirement age unable to be placed in a job are usually offered early retirement. In 1996, the number
of early retirements was 46,588; in 1997, there were 46,123.

A similar picture was provided by the LFS. In 1997, youth aged 15–24 accounted for almost one-third
of total unemployment. Unemployment incidence decreased constantly with rising age, with the 55–59
age group contributing only 3.2% to aggregate unemployment and persons 60 and older for just 2%.

D. Unemployment of women

Women are over-represented in registered unemployment, accounting for 65.4% in December 1997.
Indeed, women face discrimination both in layoffs (64% of dismissals in 1997) and in recruitment
(43.7% of placements assisted by the SES in the same year). Women with small children and women
over 45 years of age have the most serious problems in finding a new job.

However, again the LFS data provide a different picture. Not only do women account for less than half
of total unemployment (47.8% in 1997), but also their rate of unemployment (8.4%) is lower than that
of men (9.5%). This surprising contradiction could be explained by several factors. First, women
generally turn more often for assistance to the SES, while men prefer other channels for finding a new
job. Reasons for this include the following: (a) there is a certain stigma of incapability in employment
connected with registration at the employment office, which is borne more painfully by men; (b)
vacancies offered by employment offices are less attractive and poorly paid, while better jobs are
usually filled through other channels; (c) women with smaller children are often not actually looking for
a job, and even the modest income support through unemployment benefits and assistance is
appreciated. Second, women are more prepared to take precarious jobs in the informal sector, and
therefore they appear in labour statistics as economically inactive. This is also one explanation for the
steeper decline observed in their participation rate in comparison with men. Third, certain structural
changes in employment – both formal and informal – in terms of sectoral composition, employment
status, type of labour contract, and so on are actually more favourable for the employment of women,
although at the expense of job security, working conditions, remuneration, etc. New jobs are often
created in services that are less secure both in terms of occupational safety and health and
employment security, and that may require flexibility, mobility and sometimes quite long working hours
while offering rather poor earnings. Many men are not prepared to take jobs under such conditions. In
contrast, male-dominated industries such as mining and machine-building (particularly in the defence
industry) are increasingly faced with economic problems that result in layoffs, and these better-paid
workers usually choose not to take poorly paid jobs in services.

17 The apparent disparity between specific unemployment rates for older workers given by the LFS and administrative data could
probably be explained by early retirements.
E. Other risk groups

Other harder-to-place groups of workers include persons released from prison, and members of certain ethnic groups in some regions, such as the Crimean Tartars and others. The SES registers such persons in a special category, together with 15-year-old youngsters; women with children below 6 and single mothers of children under the age of 14; workers within two years of pensionable retirement; those jobless for more than one year; school leavers from secondary schools and vocational education facilities; and other young people below 21. In December 1997, the share of these groups in total registered unemployment was 23%. They receive special attention of the Employment Service in job placement (all enterprises with more than 20 employees have to reserve 5% of all jobs for this group of workers) and access to employment promotion programmes; however, only 29% of persons belonging to this category and de-registering in the course of 1997 were placed in jobs.

F. Duration of unemployment

The average duration of unemployment is rapidly increasing. In 1996, of all jobless persons, 13.1% were registered for less than one month, 22.9% between one and three months, 21.6% between three and six months, 28.2% from six months to a year, and 14.1% for more than one year. Just one year later, only 7.9% were registered for less than one month and 17.2% between one and three months, 21.2% for three to six months, 31% for six months to a year, and a full 22.8% had been registered for more than one year.

The LFS data, however, show a much more dramatic picture. According to the 1997 LFS only 14.1% of unemployed persons were jobless for less than three months and another 12.6% for three to six months. Persons without a job for more than six months constituted three-quarters of total unemployment (of whom 21% were jobless for six to twelve months), and long-term unemployment of over one year accounted for 52.3%. In just two years, between 1995 and 1997, the average duration of unemployment sharply increased: while the proportion of unemployed persons looking for a job for less than six months declined by 5 points in total unemployment, long-term unemployment (for twelve months and more) increased by 10 points. This reveals the existence of a large and growing group of persons who have lost contact with the labour market. Without intensive and well-targeted assistance, they will be practically unable to return to regular employment.
CHAPTER 4: STRENGTHENING LABOUR MARKET INSTITUTIONS AND POLICIES

4.1 Introduction

Increasing tensions in the Ukrainian labour market require better intervention on the part of labour market institutions and promotion of labour market policies to stimulate the job creation process. This is particularly true in crisis regions, in jobs for disadvantaged groups of persons, and in assisting jobless persons and persons threatened by redundancies to become re-employed. This chapter will assess the capacity of national labour market institutions in Ukraine to cope with this task, evaluate the national employment programme and the efficiency of applied policy instruments, and suggest some recommendations for their improvement.

4.2 Legislative and institutional framework

4.2.1 The Law of Ukraine on Employment of the Population

The Law of Ukraine on Employment of the Population (the Employment Law), was enacted in July 1991 and has been amended several times since then. The Law guarantees to all able-bodied persons of working age: (i) the right to perform any legal economic activity on a voluntary basis, while putting all types of activity, including entrepreneurship and self-employment, on the same legal basis; (ii) protection against unjustified recruitment practices and layoffs; (iii) free assistance in job search and placement in a job corresponding to the person’s interests, capabilities, education and skills, taking into consideration the needs of the society; (iv) compensation of financial costs connected with labour migration to another region; (v) severance pay in case of losing a permanent job; (vi) free training and retraining of unemployed persons; (vii) income support for unemployed persons who have unemployment status; and (viii) jobs in the acquired profession to school leavers from state vocational schools previously assigned to jobs by an enterprise or organization.

The Law defines unemployed persons as those who: do not have an income from work due to unavailability of a suitable job for reasons not depending on them; are registered at the SES; actively look for a job; and are able to start work. In addition, the SES registers the category of non-employed persons, who are looking for a job with the assistance of the SES. The number of non-employed persons is larger, and includes unemployed persons as well as the following categories: persons not (yet) eligible for unemployment status, such as persons below 16 years of age (except those who have already worked and were dismissed for economic reasons); first-time jobseekers without profession who have refused vocational training or a paid job; persons who have refused two suitable job offers (in this case, unemployment status is postponed for three months); and persons eligible to receive a pension.

Special protection is given to persons who have lost their jobs due to staff cuts, closure, re-organization or change in the production profile of their enterprise or institution, if they register within seven days at the Employment Service. They are eligible for unemployment benefits regardless of their previous length of service, and for higher replacement rates in comparison with other groups of eligible jobseekers. Moreover, if retraining is needed for their new job, they are entitled to income compensation equal to their last average wage in the previous job for the period of training. Older persons have the right to early retirement one and a half years before their retirement age if they have reached the required number of

1 Comments on the original version of the Employment Law were given in The Ukrainian Challenge: Reforming Labour Market and Social Policy (ILO-CEET, Budapest, 1994). Many of the criticisms made there have been the subject of later amendments, particularly the latest amendments of November 1997. Most of these amendments have already taken effect, but some remain to be implemented (particularly concerning the financing of the State Employment Service and labour market policies). This chapter analyses the changes in labour legislation as well as in labour market institutions.

2 The replacement rate is the percentage of the previous wage provided as income support.
years of employment necessary for receiving an old-age pension (30 years for men and 25 years for women).

The Law also defines vulnerable groups of persons who receive more intensive assistance in job placement: women with children below 6, single mothers of children below 14, 15-year-old labour market entrants (working age starts at 16), older workers with less than two years before retirement, long-term jobless persons, school leavers, other youth below 21 and persons released from prison. For their job placement, regional authorities oblige enterprises or institutions with more than 20 employees to reserve up to 5% of jobs. Enterprises generating jobs for such people above the quota are given tax concessions to partially cover their job creation costs. In contrast, if an enterprise refuses to hire such a person sent by the employment centre for the reserved job it must pay a levy equal to 50 times the minimum wage. Forms of assistance provided to persons with disabilities are regulated by a special law on social protection of disabled persons.

4.2.2 Institutions dealing with employment and unemployment problems

The Employment Law specifies the role of the Ministry of Labour (known since its merger in 1997 with the Ministry of Welfare as the Ministry of Labour and Social Policy), the State Employment Service, other ministries and the social partners in regulating the labour market, stimulating employment and combating unemployment.

According to the Law, the government has primary responsibility for promoting employment goals through economic policy. The Ministry of Labour is responsible for creating and updating labour legislation and for dealing with employment-related issues. In particular, it has an overall responsibility for formulating the national employment programme on the basis of regional employment programmes. It also designs special national programmes aimed at promoting the employment of certain groups (e.g. youth, the long-term unemployed, etc.). The State Employment Service deals with unemployment and the implementation of labour market policies.

The involvement of oblast and district governments in employment issues is twofold: they coordinate the formulation of annual as well as longer-term regional employment programmes, and they supervise the activity and effectiveness of regional and local employment centres in moderating employment problems and promoting employment in their respective regions.

4.2.3 Tripartite bodies dealing with employment issues

The main tripartite institution responsible for economic and social issues is the National Council for Social Partnership, established in February 1993. It meets on a regular basis to advise the government on the preparation of legislation and policies regulating employment, social developments and similar issues. In many instances, the Council has been instrumental in reaching consensus among the social partners on solving important employment and social policy problems.

There are analogous tripartite bodies for social partnership at the regional level, which are forums for discussing local employment and social problems and proposing solutions acceptable for all parties. At the same time, they make sure that national policy is implemented at the regional and local levels.

Another national tripartite body, oriented solely towards employment issues, is the Coordinating Committee for Employment Promotion, established in 1992. Meetings of this Committee, held once every

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3 After consultations with trade unions and employers, the regional authority may change the quota for the region according to the economic and labour market situation. In the case of a mass layoff due to economic problems in an enterprise, the enterprise may be partly or fully relieved of this obligation.

4 In reality, this levy system does not work, as employment centres do not have the enforcement instruments necessary to exact the levy from enterprises, and rather rely on personal contacts and negotiations.
three months, are devoted to the discussion of proposed amendments to labour legislation; suggestions on changes in employment policy to respond urgent problems on the labour market; coordination of the actions of governments, trade unions and employers aimed at the effective utilization of manpower, and similar issues.

The Committee also coordinates the work of the Regional Employment Coordination Committees, the task of which is to discuss regional employment problems and their possible solutions, and collaborate on the design of regional employment policies. Although these tripartite bodies face a difficult task in a situation of ever-decreasing labour demand, some regional committees are working very hard to change the negative trends in employment and unemployment.\(^5\)

The involvement of the social partners in decision making concerning employment regulation and promotion is very positive. However, their role still seems to be more a promise for the future than current reality, as they do not have much impact on the distribution of financial resources dedicated to employment promotion and protection against unemployment. They are also associated with the level of development of industrial relations, which should be further strengthened, and a reasonable balance of power to be created among the parties in social dialogue.

### 4.2.4 The State Employment Service

The State Employment Service (SES) was established in 1991 as an autonomous body within the Ministry of Labour and Social Policy. It consists of a national centre controlling a two-level network of regional and local employment centres: one republican centre for Crimea, 24 oblast centres plus two city centres in Kyiv and Sevastopol, and 655 local centres subordinated to the former as of 1997. In that year, the staff of the SES included 11,996 persons, of whom 9,843 were managers and specialists, 541 administrative staff and 1,612 blue-collar workers. The National Employment Centre itself employed 161 persons, and the republican and oblast centres 1,767 persons. The bulk of the SES staff work in local centres providing first-hand assistance to the unemployed, other jobseekers and enterprises.\(^5\)

The division of tasks between the centre and the regional and local offices is very similar to that in most other countries. The National Employment Centre is responsible for the methodological guidance of the regional employment centres, and plays a leading role in the implementation of the national employment programme. It collects and processes administrative data on unemployment and vacancies and, on the basis of this information, elaborates analyses and forecasts of developments in the labour market and effects of labour market policies. Regional employment centres play rather similar coordinating and analytical roles at the regional level, while local offices deal directly with jobseekers and employers, registering unemployed persons, providing them with job placement assistance, income support and employment promotion programmes, collecting information on job vacancies, and other activities.

Regional and local centres have dual supervision – by higher-level employment centres and by regional or local governments. In the past, there were many attempts to include the centres directly in the structures of regional or local authorities, which would have substantially weakened the influence of the Ministry of Labour and the national centre. However, especially in the early stages, central bodies attempted to keep too much decision-making power in their hands. The actual balance of power between the two supervisory bodies usually depends on specific regional and local circumstances. As a rule, local employment centres are still greatly constrained by ‘higher’ decisions regarding the selection and extent of assistance and programmes offered to jobseekers, which significantly decreases the efficiency of their services.

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\(^5\) A good example of a very active approach is a package of resolutions on employment promotion adopted by the Committee of the Lvivska oblast in July 1997. The package covers a wide range of employment-related issues, promoting privatization, public works, job creation, measures in favour of vulnerable groups, legal employment abroad (in Poland), etc. See V. Yatsenko, ‘The Regional Dimension of Employment Policy in Ukraine’ in M. Keune (ed), Regional Development and Employment Policy: Lessons from Central and Eastern Europe (ILO-CEET, Budapest, 1998).

\(^6\) Figures on the staffing of the SES are taken from the Report on Job Placement and Employment of the Population Turning to the Employment Service of Ukraine in 1997 (SES, Kyiv, 1998). Since publication, these figures have changed (mostly declined).
Besides the three-level network of employment centres, the SES includes four training centres that provide labour market training to the unemployed, which are staffed by 39 persons. In December 1993, there still were 48 regional centres for vocational guidance, training and retraining, employing 1,048 persons. Later these centres were gradually closed down or externalized, and now only four remain. The SES also has its own staff training institute located in Kyiv with a subsidiary in Lugansk, employing 45 persons altogether.

The SES faces many problems. First, its staffing is rather low – when calculating the proportion of non-employed persons in need of assistance in relation to the number of specialists, the total number of jobseekers per one SES official was 148 in 1997. Moreover, according to the Employment Law, unemployed persons have to show up at the labour office at least twice a month, or they may lose their entitlement to unemployment benefits and other forms of income support, which further increases the workload of the SES staff. As the number of new registrations has accelerated since the beginning of 1998, first-hand assistance to non-employed persons will further deteriorate unless the staffing of local employment centres is significantly strengthened.

In response to growing unemployment, the centres must redistribute their scarce personnel in favour of interviewers or job mediators; therefore, only insufficient attention can be paid to contacts with the personnel departments of enterprises and small entrepreneurs. The needs of these clients are not always fully regarded (e.g. with regard to proper screening of job applicants sent to fill in vacant jobs in enterprises, or an effective search for required specialists). This may in turn undermine the confidence of enterprises in the usefulness of reporting vacancies or recruiting workers through the SES. Similarly, the shortage of financial inspectors and accountants in the SES does not allow for systematic checking of how enterprises pay their contributions to the Employment Fund, resulting in poor collection of the payroll tax and a lower income for the Fund.

Another obstacle to greater effectiveness in the work of the SES is the low level of computerization in the labour offices. In many centres, the registration of non-employed and unemployed persons, updating of records, and administration of labour market policies are performed manually or semi-manually. This is slow and does not allow for rapid surveys of registered jobseekers even within one labour office, which in turn makes the job matching process rather difficult and ineffective. In the near future, with a sharply increasing number of registrations, it may soon become unmanageable. Moreover, such manual processes hinder the broader sharing of data on jobseekers and vacancies between regions, having a negative effect on labour mobility and structural unemployment.

Many employment offices are located in unsatisfactory premises, and are small and modestly equipped. Therefore many jobseekers often report to job mediators simultaneously in one room, which does not provide sufficient privacy for the interviews. This may further increase the stigmatization of unemployed persons in local society, and discourage many of them from turning to the SES for assistance in job placement. Some may terminate their cooperation with the SES prematurely.

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7 The total number of jobseekers includes those registered as non-employed persons in January 1997 plus those registered in the course of the year 1997. In that year, every official dealing directly with jobseekers served 55 persons a day on average – i.e. officials had no more than ten minutes on average for each jobseeker.
8 This condition may create problems for many unemployed persons in the countryside, as rapidly increasing transportation costs make it unfeasible for them to appear at the offices so often. Instead, unemployed people rather prefer to discontinue cooperation with the labour office, especially when the office does not have vacancies or attractive programmes on offer. Indeed, this was one explanation for very low unemployment rates in the past. Now many offices have become more flexible, and when they do not have suitable jobs, certain jobseekers may call only once a month or choose another way of communication with them.
9 Another problem is the widespread underreporting of revenues, profits and wage funds of enterprises, which also decreases the tax base and the amount of contributions to the Employment Fund.
10 At present, only 27% of the staff in local employment centres are equipped with computers and 16% of local centres have no computer at all. In addition, a large number of computers are already obsolete and need replacement. For example, in the period 1995–1997 around 1,500 computers were in need of replacement but only 75 were actually replaced for financial reasons, according to one report of the SES.
11 The estimations of the costs of creating a full data base on the Ukrainian labour market go up to 30 million USD, and this is unfortunately beyond the financial possibilities of the SES unless external resources are found.
Although in most cases the staff of employment centres are committed to providing quality assistance to their clients, their initiative is to a certain extent blocked by very low salaries for such intensive, demanding work.\(^\text{12}\) In addition, working conditions in many employment centres, due to their cramped and poorly equipped premises, are truly poor. No wonder, given these conditions, that the assistance of job mediators may sometimes be very formal, limited to registration and an offering of available jobs (if such exist), without paying more attention either to individual needs of the jobseekers or their proper screening for the needs of future employers. For similar reasons, the staff may not be motivated to be more innovative in job offers to unemployed persons, in seeking closer contacts with local employers and offices in other regions, in implementation of employment promotion programmes or in enhancing local job creation initiatives.

### 4.3 Labour market policies

Labour market measures listed in the Employment Act include active measures such as professional orientation, vocational training of laid-off workers and the non-employed, labour migration assistance, interest-free business start-up loans to unemployed persons, the organization of so-called additional jobs and public works, as well as passive measures such as early retirement, unemployment benefits and other benefits related to unemployment. In this section, we will analyse all these labour market policies individually. In the following section, we will consider national employment programmes that set up a framework for the application of a policy mix according to the identified labour market needs and within given financial and administrative constraints.

#### Active policies

##### 4.3.1 Professional orientation

Professional orientation is provided to several groups of the population: students in the final grades of general secondary schools (and to a lesser extent of other schools); unemployed persons without profession or unable to find a job in their profession and in need of skills upgrading and retraining; and people threatened by unemployment who have obsolete skills not demanded by the market. Besides training specialists in local employment centres, this service was formerly also provided by regional centres for professional orientation located in each oblast of Ukraine until 1996. Specialists of these centres regularly visited schools to advise students in their final year on future employment prospects for different professions, and were also available for other groups of persons. Unfortunately, all these centres were closed down in 1996.

The possibilities of assistance to employed persons under threat of redundancy are minimal, and thus the interest of such people in obtaining professional guidance is rather low (even if it has gradually increased). This situation should improve after the latest amendments to the Employment Act are fully implemented. These amendments provide for access to training facilities for this category of workers, and for sharing their training costs between the enterprise and the Employment Fund.

The extent of provision of professional orientation has recently seen a significant increase. While the number of students and the employed population benefiting from professional orientation has remained largely stable, many more unemployed jobseekers now seek these services. In 1994, a total of 440,315 persons were given professional orientation, of whom 41,352 were employed persons, 245,152 students, and 152,811 non-employed persons (including 57,871 with unemployment status). In 1997, there were 850,991 persons who received professional orientation, of whom 90,541 were employed, 239,130 students and 521,320 non-employed jobseekers (of whom 275,286 had unemployment status). However, the increase in the provision of professional orientation has been achieved through a partial

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\(^{12}\) The average salary in the SES was 136 hryvnya, i.e. approximately USD 68 in 1997, 1.5 times less than the average salary in the state administration. Moreover, in 1996 and 1997 the payment of salaries was delayed for several months in connection with the inclusion of the Employment Fund into the state budget and the widespread non-payment of wages in the budgetary sector - see Chapter 5.
shift from individual to group counselling, made necessary by sharp cuts in the number of training specialists within the SES. This has decreased the quality of professional orientation services.

The extent and quality of professional orientation should be further strengthened, considering the importance of professional orientation in preventing or moderating skill mismatches and structural unemployment, which are sharply increasing in the Ukrainian labour market.

4.3.2 Labour market training

Up until now, labour market training has been provided only to persons registered as non-employed at employment centres, regardless of whether they have unemployment status. For those without profession, seeking a job for the first time, unable to find a job in their profession or with low skill levels for available jobs, training is very important but not always available due to scarce resources. Priority is therefore given to young people having no profession. Labour market training is delivered either by the previously described SES vocational training centres, or by training centres owned by the state, enterprises or other institutions. In the latter case, a contract between the training centre and the SES must be concluded concerning the contents and methods of training, financial terms, the period of training, etc.

Until 1996 the provision of labour market training expanded, in terms of both the number of persons participating in training courses and those successfully completing the courses (see Table 4.1). A substantial reduction of funds available for labour market policies in 1996 and subsequent years negatively affected the extent of labour market training as well. At present, demand for training significantly exceeds supply, as indicated by the increasing gap between the number of persons who received professional orientation and expressed their wish to be trained and the number of persons who actually began a training course. (In 1997, there were more than three times more applicants than available training positions.) Initial vocational training is provided to about 30% of all trainees, and has a slightly decreasing tendency. Another 5% receive training to upgrade their skills, while the majority (65%) are persons with obsolete skills who are retrained to acquire a new profession.

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<tbody>
<tr>
<td>Total participation, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>with unemployment status</td>
<td>52,266</td>
<td>67,190</td>
<td>67,969</td>
<td>53,378</td>
</tr>
<tr>
<td>women</td>
<td>20,092</td>
<td>23,942</td>
<td>29,844</td>
<td>33,611</td>
</tr>
<tr>
<td>youth under 28</td>
<td>33,360</td>
<td>40,561</td>
<td>40,296</td>
<td>30,619</td>
</tr>
<tr>
<td>school leavers</td>
<td>38,006</td>
<td>50,096</td>
<td>48,863</td>
<td>36,825</td>
</tr>
<tr>
<td>completed training</td>
<td>15,486</td>
<td>17,512</td>
<td>15,684</td>
<td>11,008</td>
</tr>
</tbody>
</table>

Labour market training is mainly oriented to young people, who account for two-thirds or more of all trainees. School leavers constitute only one-third of young trainees; the majority are young people who have already gained some work experience but whose skills are not in demand or who are without skills. Women take part in training more often than men, and there is in general no discrimination against them in access to labour market training. Labour market training is mainly offered for blue-collar professions, but less frequent training is also provided for better-educated persons, oriented to acquiring computer skills, knowledge of accounting, foreign languages and small business management.

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13 As mentioned above, there were previously 28 vocational training centres of the SES, until 1996. Now only four remain: one republican centre (in Crimea), two oblast centres (in Rivne and Sumy), and one city centre.
The placement rate of trained and retrained persons was 60% in 1995, declining to 55% in 1996 and again increasing to 71% in 1997 (this increase was rather due to a significant reduction of training than to an improvement in job placement). One reason for the generally low placement rate of retrained persons seems to be the obsolete form of training used, which is not appropriate for adults and is narrowly specialized. A modular type of training, allowing flexible adjustment to requirements of concrete job vacancies in the labour market and facilitating future skills upgrading, is needed to improve the quality of professional training and to increase the interest of all parties involved. An ILO project on modular vocational training, recently launched in Ukraine, gives assistance in elaborating such a system suitable for Ukrainian conditions.

### 4.3.3 Public works

In Ukraine, public (social) works are organized by local authorities in cooperation with employment centres. They are usually conducted by enterprises or institutions in collective (usually municipal) ownership, or on a contractual basis by other enterprises or institutions. Persons registered as non-employed, and especially those with unemployment status, have priority rights to participate in public works, particularly when their entitlement to unemployment benefits has expired. Remuneration for public works cannot fall below the minimum wage, and unemployed persons eligible for benefits continue to receive them along with their earnings from public works, in order to stimulate their participation.

According to the Employment Law, the costs of public works are jointly covered by local authorities and the enterprises organizing them, with a contribution from the Employment Fund, provided mainly for jobseekers with unemployment status. In reality, however, the bulk of the money (over 80%) comes from enterprises and 10-17% from the Employment Fund, while local budgets contribute no more than 3%. Meagre local resources significantly limit the offering of public works, which are mainly organized in agriculture (up to 60% of all participants are working in this sector, mostly seasonally) and in the municipal economy (cleaning of public areas, etc.). Larger cost-sharing on the part of the Employment Fund would significantly improve the situation.

Although the number of participants in public works increased by 50% between 1994 and 1997 (see Table 4.2), this is not enough considering sharply increasing unemployment and long-term joblessness. This is partially the consequence of insufficient interest on the side of jobseekers themselves, because the scheme offers low skilled and poorly paid jobs of short-term duration. Therefore, the actual occupation of jobs generated by the public works scheme is well below 100%, even though it has recently increased from 57% in 1994 to 76% in 1997.

#### Table 4.2 Participation in public works, 1994–1997

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>Jobs created</td>
<td>87,298</td>
<td>106,148</td>
<td>105,542</td>
<td>127,117</td>
</tr>
<tr>
<td>Total participation, of which:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>employed persons, of whom:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>underemployed</td>
<td>11,564</td>
<td>14,584</td>
<td>11,970</td>
<td>11,296</td>
</tr>
<tr>
<td>students and apprentices</td>
<td>9,441</td>
<td>12,300</td>
<td>10,363</td>
<td>9,738</td>
</tr>
<tr>
<td>pensioners</td>
<td>18,415</td>
<td>34,890</td>
<td>25,380</td>
<td>29,858</td>
</tr>
<tr>
<td>non-employed persons</td>
<td>2,198</td>
<td>2,299</td>
<td>1,769</td>
<td>1,766</td>
</tr>
<tr>
<td>persons with unemployment status, of whom:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>youth up to 28</td>
<td>7,698</td>
<td>11,226</td>
<td>19,676</td>
<td>40,463</td>
</tr>
<tr>
<td></td>
<td>2,615</td>
<td>3,705</td>
<td>6,002</td>
<td>11,563</td>
</tr>
</tbody>
</table>

Source: State Employment Service
The share of non-employed persons among the participants is increasing, but is still rather low - slightly over 50% in 1997. This may be explained both by the non-availability of such jobs in many regions due to a lack of resources in enterprises and the Employment Fund, and by a preference to be engaged in the informal sector where they may earn more. Participation in the informal sector and the fact that the SES cannot subsidize their wages could also explain the surprisingly low participation in public works of persons on unpaid leave or shortened working hours. Students and apprentices fill 30% or more of the jobs created under the public works scheme.

There are three main problems concerning public works: (i) their unattractiveness for skilled jobseekers, as the scheme usually offers jobs that require no particular skills, are poorly remunerated and regarded as socially inferior; (ii) serious financial constraints on their organization; (iii) their temporary character, with little possibility to be turned into permanent employment. Moreover, as the experience of many countries shows, they may even decrease the chances of participants to obtain regular jobs afterwards, either due to further de-skilling of the participants, gaining poor working habits, etc.

These disadvantages could have been at least partially overcome by the National Programme of Social Works launched in the biennium 1994–1995. Besides traditional activities, such as the cleaning of public areas, this programme intended to carry out large and important infrastructure projects for the Ukrainian economy, such as the construction of main railways, reconstruction of both Kyiv airports, ecological projects, etc. The very idea was also to properly train people for a wide range of demanded professions. All this would have provided good prospects for further permanent employment to the participants. Although this part of the national programme was not implemented for financial reasons, the idea is very useful and should be put into reality in the future. The funds for such extended public works schemes should come from the state or oblast budgets. Or, the state could provide tax or similar concessions to private investors, with some greater contribution from the Employment Fund for subsidizing training, the transformation of temporary to permanent labour contracts, etc.

4.3.4 Subsidized employment and business start-up assistance

Apart from the 5% job quota for vulnerable groups of workers, the Law on Employment mentions a subsidized employment scheme involving so-called additional jobs created at the cost of the Employment Fund, to promote the employment of harder-to-place persons or jobseekers in regions characterized by high unemployment. The Ministry of Labour planned to use additional jobs on a larger scale, mainly in territories of preferential development (e.g. the Employment Programme for 1994 was intended to generate 40,000 additional jobs, of which 27,000 would have been in territories of preferential development). However, this policy was cancelled for financial reasons in 1995, and since then additional jobs have been used very rarely. In 1994, the number of jobs created at the cost of the Employment Fund was 10,612. By 1995 it had decreased to 6,206; in 1996 to 1,510; and in 1997 to a mere 91.

One obvious argument against additional jobs, actually used to explain their practical abolition in 1995, is their usually high cost. Similar programmes also suffer from a dead-weight effect in many countries, i.e. the jobs would have been created anyway and the money could have been more effectively spent for other purposes. However, as the jobs generated at the cost of the Employment Fund are directly occupied by the SES, usually placing disadvantaged jobseekers there who would hardly find a job in an open labour market, this policy instrument is very important and the dead-weight effect not high. This is even more true for regions with high unemployment. Therefore, it would be desirable to expand this

14 The substitution effects (i.e. replacement of persons recruited on the regular market by persons from the unemployment register) or displacement effects (ruling out of firms normally performing such activities by firms assigned to carry out public works schemes) of these programmes may be potentially high, with a negative impact on cost-effectiveness. However, the overall economic and societal effects would be of greater weight when taking into consideration the multiplier effect in terms of job creation, income generation, business promotion and economic development, plus the effect of re-integration of disadvantaged, marginalized groups of persons that have experienced long-term joblessness.

15 The definition of a ‘territory of preferential development’ as well as concrete information on their characteristics, location, etc. are provided later in this chapter.
scheme again, and clearly specify the rules for its application in order to ensure its targeting of disadvantaged persons and crisis regions.

The newest amendments to the Employment Act also allow for interest-free business start-up loans to jobseekers with unemployment status from the Employment Fund. The rules for their provision should be more precisely specified by government decree. Thus far, this policy has been used only rarely.

**Passive policies**

**4.3.5 Early retirement**

Persons with unemployment status who have eighteen months or less before their retirement age and the requisite length of service for eligibility for an old-age pension (30 years for men and 25 years for women), have the right to early retirement. This policy has been increasingly used. In 1993, 33,746 persons were placed in early retirement; 39,247 in 1995; 46,558 in 1996; and 46,161 in 1997. Employment centres prefer this policy for solving the unemployment problems of older workers while reserving scarce vacancies and employment promotion policies for other groups of jobseekers.

While in the past early retirements were paid from the Pension Fund, in April 1998 the Employment Fund started to reimburse the Pension Fund for early retirement pensions, until the person reaches his or her retirement age. This amendment may push employment centres to become more active in placing older persons in jobs, rather than providing them with such a costly benefit that fails to use their accumulated experience and skills. As in other European countries, the population of Ukraine is growing older on average, and the worsening ratio of the active population to pensioners is pressing the government and parliament towards raising the retirement age, a policy which is in contradiction to early retirement.

**4.3.6 Unemployment benefits and other forms of income support in unemployment**

Unemployment benefits may be paid only to persons with unemployment status. Among this group of jobless persons, those who lost their jobs for economic or organizational reasons have important privileges, regardless of their length of previous employment. According to the latest amendments to the Employment Law, their benefits are paid for up to 360 days - up to 720 days after those having less than two years before their retirement (i.e. for men aged at least 58 and women aged at least 53). For this category of jobseekers, the level of benefits equals 100% of their previous average wage for the first 60 days (after one month of enterprise-funded severance pay), 75% for the following 90 days and 50% for the rest of the period. The upper cap is the average wage in the region, the lower limit the national minimum wage.

Other persons with unemployment status, if they have worked for at least 26 weeks during the past 12 months, are eligible for unemployment benefits at the level of 50% of their previous average wage (but not more than the average wage in the region in the last month, and not less than the national minimum wage) for up to 360 days within two years. All other persons with unemployment status, including those seeking a job for the first time or without a job for more than six months, are entitled to benefits not lower than the minimum wage for up to 180 days.

After the expiration of the entitlement to unemployment benefits, the person can obtain means-tested unemployment assistance for 180 days at a level of 75% of the minimum wage, under the condition that

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16 The funding of the first three months of unemployment compensation has become the subject of extensive discussion. Until now, it has been a form of severance pay to be covered by the enterprise, with unemployment benefits paid after these three months from the Employment Fund. However, due to economic problems, enterprises prefer not to lay off redundant workers, but rather put them on administrative leave without pay. This allows them to save the severance pay and to have the possibility to recall these workers when production recovers. Income losses of such workers are not compensated for, and this practice has significant negative macro- as well as microeconomic consequences. Thus the amended Employment Law has assigned the SES to cover the second and third months of unemployment compensation.
the average monthly family income per person does not exceed the minimum pension. In addition, the unemployed person and his or her dependants are eligible for a single payment benefit at the level of 50% of the minimum wage at the end of the unemployment benefit or assistance payment.

The level of unemployment benefits has been very low in Ukraine ever since its independence in 1991, moving between 12.6% (December 1993) and 25.4% (March 1995) of the average wage. Therefore, one can hardly speak of a destimulating effect of the benefits on an active job search. Rather, it discourages jobseekers others than those dismissed due to economic reasons from registration at the SES, particularly if they have the possibility of finding a job in the informal sector. While an increase in income support to a more decent level is advisable, preference should be given to a more active approach on the part of both the jobless persons and employment offices to intensify the job search or to improve the employability of such persons through suitable employment promotion programmes. If jobseekers are offered intensive assistance, eventually leading to permanent or at least temporary employment, their interest in cooperation with the SES will increase greatly.

Participants in labour market training who were made redundant and have unemployment status are paid a stipend at the level of 75% of their last average wage for the entire period of training, but the level of stipend cannot be more than the national average wage in the last month or less than the minimum wage. Other categories of trainees with unemployment status are eligible for unemployment benefits in accordance with their regular entitlements.

***

An overview of the participation rate of non-employed jobseekers (with and without unemployment status) in passive and active labour market policies is given in Table 4.3.

Table 4.3  Participation in labour market policies, 1993–1997
(% of registered non-employment, unless otherwise stated*)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Job placement by the SES</td>
<td>35.8</td>
<td>35.5</td>
<td>35.9</td>
<td>24.6</td>
<td>20.9</td>
</tr>
<tr>
<td>Job placement under the 5% quota</td>
<td>7.9</td>
<td>7.8</td>
<td>7.8</td>
<td>4.9</td>
<td>3.8</td>
</tr>
<tr>
<td>Placement in additional jobs</td>
<td>1.0</td>
<td>1.9</td>
<td>1.0</td>
<td>0.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Training and retraining</td>
<td>5.8</td>
<td>9.2</td>
<td>10.5</td>
<td>6.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Public works**</td>
<td>2.2</td>
<td>2.8</td>
<td>3.5</td>
<td>3.0</td>
<td>3.6</td>
</tr>
<tr>
<td>Early retirement</td>
<td>6.1</td>
<td>8.5</td>
<td>6.1</td>
<td>4.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Benefit recipients***</td>
<td>35.0</td>
<td>37.0</td>
<td>44.1</td>
<td>50.4</td>
<td>54.0</td>
</tr>
</tbody>
</table>

*The number of all persons registered during the respective year as non-employed jobseekers, both with and without unemployment status.
** Only non-employed persons participating in public works.
*** The average monthly share of benefit recipients in total non-employment.
Source: National Employment Service

Table 4.3 clearly shows a relative shift from active to passive labour market policies when unemployment started to increase. During the period shown, the SES was becoming relatively less successful in placing unemployed persons in jobs, due to diminishing vacancies. The share of jobs opened under the 5% quota and actually occupied also decreased constantly, as local enterprises tried to avoid recruitment of disadvantaged persons by referring to their own economic problems and enforced staff cuts.

The proportion of non-employed persons participating in employment promotion programmes such as labour market training, public works and subsidized employment (additional jobs) increased until 1995, when it reached 15%. Since then, it has rapidly fallen - in 1997, it equalled a mere 7.3% of total unemployment. The only exception among the applied active labour market policies was the public works
scheme, where the participation rate of non-employed persons has slightly increased due to growing tensions in the labour market and increasing long-term unemployment. Regarding passive labour market policies, growing unemployment as well as the declining non-employment/unemployment ratio have been reflected in a rising number of persons becoming eligible for unemployment benefits, while early retirement has been used relatively less frequently due to financial constraints.

4.4 Financing of labour market policies

Labour market policies as well as the operational and other costs of the SES are covered by the Employment Fund, which was established in 1991 as a separate fund, independent of the state budget. A major part of the Fund’s income originates from mandatory contributions of enterprises and institutions. The state budget contributed 31% in 1991 and almost 3% in 1992, and then stopped subsidizing the Fund. Some resources were also raised by the SES (8.2% in 1993 and 6.8% in 1994; after 1994, this source practically dried out) or remained on the account from the previous year. All other sources of income are essentially negligible.

The payroll tax imposed on enterprises and institutions has been changed several times, as a reaction to the anticipated and actual development of unemployment. In 1991, the tax equalled 0.6% of the wage fund. In the period 1992–1994, this increased to 3%, and then lowered to 1% from December 1994 to May 1995. In June 1995 it was raised to 2%. In 1997, the collection of contributions was even stopped for three months (from April until the end of June), in connection with considerations of dissolving the SES as a useless institution and terminating most labour market policies, but this decision was later corrected. Since July 1997, contributions have been shared between employers (1.5%) and employees (0.5%).

Another very significant change was the merger of the Employment Fund into the state budget in February 1996. However, as a consequence, not only was expenditure on active labour market policies sharply reduced; payments of benefits, salaries of the SES staff and other costs of the Service were also substantially delayed.

The suspended portion of the latest amendments to the Employment Law will again separate the Employment Fund from the state budget. Its funding is envisaged to be placed on an insurance principle, after the adoption of a law on unemployment insurance. The Fund finances all labour market policies (but contributes to the costs of public works only as explained above), as well as the administrative and other costs of the SES. This has recently been questioned by trade unions, which would prefer the Fund to cover only unemployment benefits and other forms of income support, with all other costs borne by the state budget.

There are indeed a number of countries which have two separate funds for this purpose – among transition economies, e.g. Hungary. Until the end of 1995, Hungary had two funds: a Solidarity Fund based on the insurance principle to finance unemployment benefits and assistance, and an Employment Fund supported from the state budget, which was used for active employment promotion policies and early retirement. Practice revealed weaknesses in the separate funding of passive and active labour

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17 This is the result of increasing new registrations, as well as withdrawals from the register after the expiry of unemployment benefits, as described previously.
18 The following enterprises and institutions are exempted from mandatory contributions: agricultural enterprises, enterprises of disabled persons and non-profit organizations.
19 In Ukrainian terminology, this is called the consumption fund and includes other personnel costs besides wages.
20 For example, the World Bank makes several arguments in favour of the public employment service. (i) It plays an important role in facilitating the adjustment of the labour supply to the demand for labour, particularly during economic cycles and structural changes. (ii) Employment services provided to jobseekers shorten periods of their unemployment and reduce economic and social losses associated with high persisting unemployment. (iii) It is indispensable for promoting employment and social integration of disadvantaged groups of workers, such as youth, the elderly, low-skilled persons, members of some ethnic minorities, etc. See D. Fretwell and S. Goldberg, Developing Effective Employment Service, World Bank Discussion Paper No. 208 (Washington, 1993).
market policies, as the possibility of their mutual enhancement and active assistance to jobseekers leading to their re-employment could not be fully exploited. The merger of both funds in early 1996 facilitated an activation of employment policy measures, particularly those oriented to young people and some groups of long-term unemployed persons, and contributed to a certain fall in their unemployment rates.21 The experience of western market economies also shows that passive and active policies affect and strengthen each other if properly designed, and the recent refinements of their labour market policy packages take this into account.

Another important reason in favour of a single Employment Fund, generated by contributions from employers and workers, separated from the state budget and used for all types of labour market policies, is the real danger of the state budget being in a constant deficit. In this case, it can hardly be possible to devote sufficient resources to employment promotion policies (however, in case of high unemployment, the state budget can supplement the Employment Fund, as any decrease in unemployment will save funds which would otherwise be spent on poverty alleviation).

The expenditure side of the Employment Fund is presented in Table 4.4.

**Table 4.4** Expenditure of the Employment Fund of Ukraine, 1991–1996 (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total expenditure</th>
<th>Active LM policies,* of which:</th>
<th>Passive LM policies**</th>
<th>Administrative expenditures</th>
<th>Capacity building of the SES***</th>
<th>Research, international cooperation, etc.</th>
<th>Total expenditure as per cent of total EF income</th>
<th>Total expenditure as per cent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>100.0</td>
<td>4.5</td>
<td>2.4</td>
<td>31.1</td>
<td>61.8</td>
<td>0.2</td>
<td>20.5</td>
<td>n.a.</td>
</tr>
<tr>
<td>1992</td>
<td>100.0</td>
<td>20.5</td>
<td>7.2</td>
<td>45.5</td>
<td>12.0</td>
<td>14.8</td>
<td>20.9</td>
<td>0.12</td>
</tr>
<tr>
<td>1993</td>
<td>100.0</td>
<td>31.7</td>
<td>5.0</td>
<td>33.0</td>
<td>28.9</td>
<td>1.4</td>
<td>28.0</td>
<td>0.12</td>
</tr>
<tr>
<td>1994</td>
<td>100.0</td>
<td>21.0</td>
<td>4.4</td>
<td>25.1</td>
<td>22.5</td>
<td>27.0</td>
<td>37.9</td>
<td>0.21</td>
</tr>
<tr>
<td>1995</td>
<td>100.0</td>
<td>10.8</td>
<td>0.2</td>
<td>23.9</td>
<td>22.2</td>
<td>35.8</td>
<td>62.8</td>
<td>0.24</td>
</tr>
<tr>
<td>1996</td>
<td>100.0</td>
<td>19.8</td>
<td>0.2</td>
<td>33.0</td>
<td>9.3</td>
<td>2.4</td>
<td>41.7</td>
<td>0.14</td>
</tr>
<tr>
<td>1997</td>
<td>100.0</td>
<td>9.6</td>
<td>0.0</td>
<td>21.9</td>
<td>2.9</td>
<td>0.4</td>
<td>40.7</td>
<td>0.21</td>
</tr>
</tbody>
</table>

* Apart from labour market training and additional jobs, this item covers expenditure on public works, interest-free business start-up loans, organization of job fairs, etc.

** This covers unemployment benefits, unemployment assistance and income support to families of unemployed persons.

*** This includes purchasing buildings and premises for the SES, creation of the labour market information system, staff training, etc.

Source: State Employment Service

The first striking fact is that very high levels of unspent resources were left on the account of the Employment Fund until 1996. Before 1995, the main reason for this was the anticipation of a dramatic increase in unemployment, for which it was necessary to create a reserve. This did not happen, and the unspent money was partly lost due to high inflation. While in 1995 two-thirds of the Fund’s income was spent, mainly due to higher expenditure on research, international cooperation and similar items, in 1996 total expenditure again declined to only 42% of total income. This was a consequence of the inclusion of

21 A programme for unemployed school leavers and other youth without work experience, adopted in 1996, abolished unemployment benefits for this group and replaced them with an entitlement to a wage subsidy for employers who provide educationally appropriate employment of at least four hours a day to such persons for one year, supplemented by training, if necessary, the costs of which are also reimbursed to the employer. This policy would not be possible without the merger of the funds, due to state budget constraints and regulations of expenditure from the funds.
the Fund in the state budget and significant cuts and delays in spending. In 1997, after repaying outstanding debts from 1996, expenditure finally reached nearly 91% of the Fund's total income.

Until 1995, expenditure on unemployment benefits and other forms of income support was low, due to the low level of registered unemployment. Since then, the allocation for benefits has sharply increased, to 36% in 1996 and 65% in 1997. The resources allocated for active labour market policies have been very modest, with a declining tendency both in absolute and relative terms. Regrettably, persons who are still employed but threatened with unemployment, who are actually out of work due to administrative leave, or who are jobless but not registered with the SES, cannot benefit from labour market programmes except public works (however, even in that case the Employment Fund cannot contribute to the costs for the worker).

The SES has often been criticized for a very high proportion of expenditure spent on its own functioning and capacity building, particularly when comparing this share in total expenditure with similar budget items in other countries. Although these expenditures may seem quite high (e.g. 62% in 1993), higher initial expenses should be attributed to the fact that the Service was built from scratch, and has had to computerize the information and administrative system, which is very expensive and still far from complete. Also, the SES has had to purchase or rent premises throughout the country, equip them, and so on. It may be assumed that this item of expenditure will decline in time; indeed, it already dropped to 25% of total expenses for labour market issues in 1997. It is also more important to consider the expenses as a proportion of GDP. In the case of Ukraine, they have approximately equalled 0.05% of GDP, clearly proving that the SES is not expensive. As total expenditure from the Employment Fund on labour market policies and on administrative and other costs for the functioning of labour market institutions has not even reached 0.25% of GDP, it is clear that with increasing unemployment Ukraine will need to devote considerably more resources to employment promotion.

In 1999, the Ukrainian system of financing labour market policies is planned to be transformed into an insurance system, with insurance contributions shared between employers and workers. The level of contributions from both parties and eventually from the state budget are currently under discussion. As the state budget is unlikely to contribute much due to the need to reduce its currently large deficit under the pressure from the IMF, an increase in the contribution rates from employers and workers is probably unavoidable. In the case of employers there is a limit, since total overhead costs are already high. Therefore, any increase in the payroll tax for employment issues should perhaps be compensated by a decrease in another part of the overhead costs, in order to avoid encouraging the further informalization of labour. However, more resources could be raised through better tax collection, if control over tax collection is strengthened and tax evasion gradually reduced. An increase in the contribution rate from workers is still possible, as their present contribution (0.5% of wages) is very low by international standards. Equally important is that the funds collected should also be effectively spent on reasonable, well-targeted labour market policies. In this respect, independent, tripartite control of the SES and the Employment Fund are indispensable measures.

4.5 National employment programmes

The priorities of activity for labour market institutions and the targets, extent and mix of labour market policies over a certain period are specified in a national employment programme, based on predictions of labour market developments and the identification of needs.

22 For comparison, spending on employment services in the OECD countries in 1987, i.e. before a sharp increase in unemployment in the early 1990s, was typically between 0.06 and 0.23% of GDP. See OECD, Employment Outlook (OECD, Paris, 1989).

23 For example, Hungary devoted 2.8% of GDP to labour market policies in the period of high unemployment (1992–1993), while decreasing it later to 1.2% in 1996. Poland allocated 2.2% of GDP to labour market policies in 1996, and Slovakia 1.3%.

24 In Germany, workers contribute 3.25% of their wages to the employment insurance system, in France 2.97%, in the Netherlands 2.3%, in Portugal 3.5%, in Spain 1.6%, in Hungary 2%, etc.
4.5.1 The preparation of a national programme

Preparation of a national employment programme starts with a decree of the Minister of Labour, specifying the time horizon of the programme and the main targets to be addressed. A designated working group is headed by the Director of the Employment Department, and consists of specialists from the Ministry of Labour and Social Policy, the State Employment Service, academics and one representative each from the Ministries of Economy and Finance (in order to ensure linkages to economic policy). The working group prepares a work plan and coordinates its implementation. The basic elements are district and town employment programmes, worked out by the respective employment centres in close cooperation with local enterprises, schools, training centres and similar institutions, under the supervision of local authorities. The district and town employment programmes are collected, checked and balanced by regional institutions, such as regional employment centres and regional administrations. The social partners are also involved in the formulation of employment programmes, through tripartite bodies. When regional employment programmes are completed, they become the basis for a draft national employment programme, for which the national employment centre takes responsibility.

The draft programme takes into consideration both proposals from the regions, reflecting their specific problems and potential solutions and suggesting required financial resources, and priorities set by the national centre, based on aggregate predictions of labour supply and demand development, the identified labour market needs and envisaged financial resources. The programme sets employment goals for the given period and specifies concrete targets for labour market policies in terms of the main target groups and priority regions, the number of participants and the funds available for each measure. It also assigns responsible coordinators and collaborating institutions. The draft programme, approved by the Ministry, is submitted for discussion to the government. Since the Employment Fund was merged into the state budget, the Ministry of Finance has the role of adjusting the funds made available for the programme. When the national employment programme is approved, the adjustments in both contents and funding go back to the regions. There, appropriate adaptations in the regional and local employment programmes are made, which are then approved by the regional and local governments.

In general, the process of formulating national employment programmes appears commendable, as it endeavours to reflect and balance both regional and national needs and priorities in the framework of available financial resources. A critical point is of course whether these needs are correctly assessed, whether the proposed measures to address them are rightly selected, properly designed and targeted, and implemented to such an extent as allows them to achieve the desired goals, given the hard financial constraints. The substance of employment problems is very complex, and therefore the implementation of the employment programme requires the close collaboration of labour market institutions with governments (national, regional and local), employers, workers and other institutions dealing with education, economic and social policy, etc. All these issues will be tackled further, when the current national employment programmes are assessed.

4.5.2 Employment Promotion Programme for 1997-2000

The current medium-term Employment Promotion Programme defines the general framework of a medium-term employment promotion strategy: its main goals, measures for their achievement, responsible institutions and a time horizon. This rather general framework is to be further elaborated and concretized in annual employment promotion plans.

The Programme sets the following main goals: support for new job creation and productive employment; formulation of an effective structural and regional employment policy; a differentiated approach to layoffs and the provision of assistance to redundant workers; improvements in public works schemes to make them more attractive and accessible to non-employed persons; assistance in labour mobility; skills upgrading for both employed and non-employed persons through vocational orientation and training; promotion of self-employment; and improved income support for unemployed persons. The Programme rightly emphasizes that all these goals should be achieved in the national and regional labour markets
through the concerted action and close cooperation of central and regional governments, enterprises and employers’ associations, trade unions and the SES.

The policies envisaged to promote new job creation (including jobs for more vulnerable groups of workers), entrepreneurial activity and flexible forms of employment are of an economic, educational and employment character. They include the upgrading of obsolete jobs and creation of new, productive jobs through appropriate economic policies and promoting foreign investment (without, however, specifying concrete measures for achieving these goals); access of non-employed persons, students, apprentices and underemployed persons to temporary work; establishment of a pilot training centre for youth training in small business management; and vocational training of unemployed people for self-employment.

Mass unemployment is to be prevented or relieved through improved job matching, training of unemployed persons in an effective job search, assistance in retraining and redeployment of laid-off persons, and other measures. In this respect, special attention should be paid to job generation and unemployment prevention in regions with high unemployment, specified as ‘territories of preferential development’ in the Programme. The Programme sets the following concrete targets for a new job creation: (i) around 200,000 jobs should be created for 215,000 persons in 65 rural and mountainous districts and municipalities characterized by excessive labour supply, located mainly in western and south-western Ukraine; (ii) 21,000 vacancies are needed for 31,000 jobseekers in nine districts or six towns expecting production cuts in connection with the exhaustion of natural resources, closures of large enterprises and structural changes in production; (iii) 113,000 persons should be re-employed in 40 towns and four districts situated mainly in eastern Ukraine, where employment depends on one or two industries (mainly coal-mining and steel production) creating imbalance in job opportunities – 95,000 jobs are needed; (iv) 3,700 new jobs should be generated for 4,400 persons in regions suitable for receiving persons re-settled from territories affected by radiation from the accident at the Chernobyl nuclear power station, and in regions that are the former homelands of nations deported under Stalin’s regime who are now returning to Ukraine; and (v) around 6,000 vacancies are needed for more than 8,000 officials in four districts, due to reductions in the armed forces.

The policies used in territories of preferential development range from state or regional assistance in creating jobs from various resources (including additional jobs financed by the Employment Fund), to retraining and public works. The Programme also stipulates the new possibility of providing certain privileges to enterprises and institutions creating new jobs in these regions, the concrete form of which depends on legislation and the decision of local regional councils.

Vulnerable groups of persons, unable to compete on equal terms with other job applicants in the labour market, are to receive more intensive assistance in employment, mainly through the 5% quota but also using other policies. Attention will particularly be paid to the promotion of employment for young people. Youth without professional education are to be preferentially offered vocational guidance and training, and those possessing professions that are not in demand are to receive retraining. Schools and training centres providing narrow specializations that offer few job opportunities to school leavers are requested to broaden their orientation.

The Programme further plans to expand public works schemes to provide temporary employment and income to non-employed and underemployed persons, as well as to apprentices and students during their leisure time and pensioners and disabled people upon their interest. Problems in financing such schemes must therefore be solved, and their attractiveness for people of different skill levels must be improved.

Non-employed persons, and particularly those made redundant, should be broadly informed on possibilities to obtain professional orientation and psychological assistance in employment centres. The Programme considers this most important in the case of apprentices in specialized boarding schools and disabled children, to assist them in selecting appropriate professions. As the system of adult training is still in its initial stages in Ukraine, the Programme intends to establish an information bank collecting data and methodologies for adult training, and to create foundations for an effective system of vocational training and retraining.
The Programme also obliges the Ministry of Labour to continue cooperating with international organizations and partner labour market institutions in a number of countries on issues such as improving labour legislation; strengthening labour inspection in order to bring informal labour more under control and improve working conditions in enterprises; developing a labour market information system; training the State Employment Service staff; improving working conditions of Ukrainian migrant workers abroad, and so on.

4.5.3 Annual Employment Programmes for 1997 and 1998

The Annual Employment Programme for 1997 was based on an estimated 1,612,100 persons seeking jobs in the course of the year, of whom 504,000 were redundant, 376,000 voluntarily quit their jobs, 102,000 were school leavers, 72,000 were new entrants to the labour market, and 140,000 were other types of jobseekers. The number of vacancies was estimated at 331,000. The Programme envisaged that 331,000 unemployed persons would be placed in jobs, of which 8,400 would be created at the cost of the Employment Fund, 100,000 involving participation in training and retraining, and 61,000 in public works. A further 904,000 persons were to receive unemployment benefits. Altogether, the number of de-registered persons was projected at 486,000 so that the level of non-employment at year-end was to be 795,000, of whom 661,000 would have unemployment status.

The actual developments on the labour market were slightly better than the Programme predicted. The number of non-employed persons registered with the Employment Service was 1,455,000; of these, 1,028,000 had unemployment status. This lower level of unemployment was mainly a consequence of fewer redundancies (enterprises had originally reported 800,000 redundancies to employment centres, but the actual number of layoffs was merely half of this figure – 427,000 – of whom 371,000 turned to the Employment Service for assistance). There were also fewer new job entrants, and many more persons quit their previous jobs voluntarily. \(^\text{25}\) Although de-registrations were also much higher (777,000) than anticipated, only 303,000 persons were placed in jobs – the others terminated their cooperation with employment centres for other reasons. As a result, ‘only’ 678,000 persons were registered as non-employed at the end of December 1997, of whom 637,000 had unemployment status.

Severe cuts and delayed availability of funds for labour market policies greatly reduced the number of jobseekers able to benefit from these measures. Labour market training was provided only to a half of the planned 100,000 persons. While in total 97,000 persons participated in public works, only 52,000 of these were non-employed and 40,000 had unemployment status, i.e. this target was not fully met either.

The envisaged 84,178 new jobs to be created for 85,973 persons were not fully achieved; the actual number was 10,000 jobs lower. Of 8,438 vacancies planned to be generated at the cost of the Employment Fund,\(^\text{26}\) only 91 were actually created. Therefore, the share of jobseekers placed in all newly created jobs with direct assistance of the SES was less than 10%, which did not allow the SES to provide sufficient support in employment to more people in real need. In line with the 5% quota of jobs reserved for vulnerable groups (in total 186,000 jobs), 55,000 persons were newly employed in such jobs.

For 1998, the annual Employment Programme predicts that 2,422,000 persons will register with the SES in the course of the year, of whom around 853,000 will be laid-off workers, 886,000 persons who voluntarily quit their jobs, and 185,000 school leavers. The Programme foresees job placement only for 373,000 persons, while 121,000 are planned to participate in labour market training and 88,000 should be non-employed jobseekers in public works. According to reports from local employment centres, the number of newly created jobs is estimated to reach 118,000. In addition, the Employment Service intends to generate 11,700 jobs at the expense of the Employment Fund.

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25 As mentioned earlier, in many cases their departures were forced by persistent non-payment of wages or income losses in connection with administrative leave or short-time work.
26 The Annual Report of the SES mentioned only 2,500 jobs to be created by the Employment Fund.
In line with the anticipated sharp increase in registered unemployment, the total expenditure of the Employment Fund is envisaged to be significantly redistributed from administrative and other costs of the SES to the benefit of income support - 71% of funds should be allocated to unemployment benefits and assistance, while active labour market policies will account for almost 13% (of which 12% will be for training and retraining). The rest is to be spent on the administrative costs of the SES (10%), renting of premises and construction of new premises (3%), development of the labour market information system (2%), and other costs.\textsuperscript{27}

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As emphasized previously, the formulation of national employment programmes as relatively consistent documents reflecting local and regional labour market needs as well as national priorities is to be positively valued. Comparing recent programmes with those from early stages of economic transformation, the learning process has been quite successful. Programmes are now more realistic in predicting employment and unemployment flows in the labour market as well as in suggesting the right policy answers to the identified needs. The programmes can be improved, however, both in the formulation and implementation stages. Implementation, particularly, is very much dependent on a further capacity building for national labour market institutions and tripartite institutions dealing with employment issues. The sufficiency of financial means devoted to employment issues and their proper distribution in accordance with needs are also crucial for the successful implementation of the programmes. In order to increase the impact of the national employment programmes on labour market developments, a shift towards a more active approach and an expansion of active labour market policies are desirable, as are improvements in the design and targeting of labour market policies. Some recommendations in this regard are provided in Chapter 8.

\textsuperscript{27} The original budget proposal, based on requests for labour market funds from regions, was cut by 93 million hryvnya, i.e. by 13%. Unfortunately, the reduction concerned mostly active labour market policies, construction of new premises for the SES and administrative costs of the SES, which will further restrict the capacity of the SES to assist unemployed and under-employed persons in re-employment.
CHAPTER 5: IMPROVING INCOME PROTECTION FOR WORKERS

5.1 Introduction

This chapter will tackle two issues of high importance for workers in contradiction of their basic rights: the non-payment of wages and the lack of income and social protection for workers on administrative leave and short-time work. These practices are increasingly used by employers - including the major employer, the state - as temporary solutions to their economic and financial problems. However, substantial income losses suffered by workers have a demotivating effect on their work performance and contribute to a further decline of labour productivity in enterprises. On the one hand, this negatively affects productive efficiency and competitiveness in the enterprise sector. On the other hand, it contributes to an increase in informal-sector activities, as workers are forced both to become active in the informal market and to spend their meagre incomes there. This chapter describes the extent of the phenomena of wage arrears, administrative leaves, and short-time work and provides reasons for their widespread occurrence. It also offers ideas and policy recommendations for their solution.

5.2 Wage arrears in Ukraine: Recent developments and possible remedies

For millions of people in Ukraine, the social burden of transition - already heavy, with sharp falls in real wages and living standards\(^1\) - has recently become even more unsustainable with the generalized and uncontrolled non-payment of wages. In fact, official statistics on real wages are misleading, since they refer to contracted wages, not to wages actually paid. These statistics conceal the substantial non-payment of wages; the situation is in reality even more dramatic than the figures suggest.

5.2.1 The extent of the phenomenon

The non-payment of wages began in 1994, but rapidly accelerated in early 1996. As of 10 September 1996, according to data of the State Statistical Committee, wage arrears in Ukraine had already reached the astonishing level of 3.2 billion hryvnya (nearly USD 1.8 billion).\(^2\) Within the first eight months of 1996, wage arrears had increased 2.7 times. Although the rate of increase fell considerably in the final four months of 1996 as a result of measures taken by the President and the government, the process further accelerated in 1997. As of 1 July 1997, total wage arrears amounted to 4.66 billion hryvnya, including 3.54 billion hryvnya in the non-budgetary sector - that is, 1.3 times more than at the beginning of 1997. Despite another slowdown at the end of 1997, in early 1998 wage arrears again grew to more than 5 billion hryvnya (see Table 5.1). This amount is greater than a six-month wage bill for the entire country of Ukraine. In total, nearly 200,000 enterprises reported an inability to pay wages.

This inability to pay applies just as much to the government as to enterprises. As of January 1998, arrears of 781 million hryvnya had been accumulated in the budgetary sector alone. The government itself was unable to meet its financial obligations - workers in the defence industry, for instance, did not receive their wages for months. At the same time, pension arrears had reached 64.77 trillion karbovanets by August 1996. After government measures at the end of 1996, renewed at the end of 1997, wage arrears in the budgetary sector were reduced by 28% during 1997 and seem to have stabilized at a level below one billion hryvnya.

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\(^1\) See section 2.4 on wage developments and incomes policy.

\(^2\) As mentioned in Chapter 2, in September 1996 the former currency - the karbovanets - was replaced by hryvnya at the exchange rate of 1 hryvnya = 100,000 karbovanets.
In the non-budgetary sector, Table 5.1 shows that a large amount of wage arrears have been accumulated in the agro-industrial complex – 1.2 million hryvnya, corresponding to 27% of total wage arrears in the non-budgetary sector. The arrears of agricultural enterprises controlled by the Ministry of Food and Agriculture are mainly caused by difficult financial and economic conditions. Despite stronger controls over wage payments by the Ministry and local authorities, wage arrears in agriculture increased by 68.1% during 1997. In industry, they increased by 35% over the same period – the coal industry alone contributed 24% to overall wage arrears in the non-budgetary sector in 1997. Wage arrears increased substantially in construction as well – by 38% over the course of 1997.3

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3 Analysis of Macroeconomic and Social Trends, op. cit.
On 1 July 1997, wage arrears corresponded to an equivalent of 1.8 months of the total wage bill of enterprises belonging to the Ministry of Industry - more precisely, 1.8 months for enterprises in ferrous metallurgy, 1.5 months in the chemical and petrochemical industries, 4 months in wood, and 2.4 months in light industry. Total wage arrears in enterprises belonging to the Ministry of Engineering amounted to more than 4.4 months of their average wage bill, and remain the highest in the electrotechnical industry, transport engineering and the machine-tool industry. The situation in the transportation industry is similarly serious.

The regional distribution of wage arrears is also very unequal. In 1997, the increase in wage arrears was particularly strong in the Autonomous Republic of Crimea, and in the oblasts of Donetsk, Luhansk and Chernihiv. On 1 July 1997, average wage arrears per one worker amounted to 327 hryvnia, with higher rates observed, for example, in the oblasts of Dnipropetrovsk (479 hryvnya), Poltava (419), Luhansk (405), Ternopil (388) and Cherkasy (381).

This financial crisis has forced many managers to pay their workers in kind - with the products of the enterprise, or with what they can obtain from barter exchange, which workers usually use for sale in the street. To partly reduce outstanding wage arrears in January–May 1997, enterprises sold products at the cost of more than 240 million hryvnya to workers. This type of in-kind remuneration is widespread in industry, where more than 123 million hryvnya were given to the workers in 1997, but also in construction (13 million), and transport (9 million). In 1997, 40% of wage payments were made in this form.

This practice is particularly used on a large scale in the regions of Donetsk, Poltava, Kharkiv, Dnipropetrovsk, Kherson, Vinnytsa, and in the Autonomous Republic of Crimea. Although such compensation can certainly contribute to easing social tensions and limiting workers' demotivation, it is impossible to expect the wage arrears problem to be solved by this means alone.

5.2.2 The factors of the crisis

The problem of non-payment of wages seems to derive from a great variety of factors. The first is, of course, the collapse of demand and the problem of production and profitability: many enterprises in Ukraine are still operating at less than 50% of their production capacity. Sales and financial difficulties have resulted in the mounting of debts between suppliers and customers, leading to the illiquidity of enterprises and the replacement of cash payments by barter trade. Similarly, the state has difficulties in paying wages to public employees and pensions to pensioners, because of the non-payment of taxes and social contributions by employers. Many enterprise managers do not place paying their workers high on their scale of priorities.

The monopolistic behaviour of some enterprises - for example in the energy sector - also contributes to the problem by fixing artificially high prices which do not leave margins for other enterprises to generate profits and thus pay wages. Another contributing factor is heavy taxation, which has not only reduced the capacity of enterprises to renew their capital assets and production potential, but has also seriously limited their ability to pay wages, taxes and social security contributions.

Finally, the very restrictive monetary and budgetary policies implemented by governments in the region to curb inflation also seem to have played an important role. Wage arrears significantly increased in Ukraine in early 1996, after the signature of a macroeconomic memorandum with the IMF introducing very strict conditions for bank loans to enterprises, along with other restrictive monetary measures aimed at controlling inflation before the introduction of hryvnya in September 1996. Although this policy has helped to reduce inflation, it has also contributed to the expansion of the non-payment crisis. In this regard, we may question the relevance of a low inflation rate in an economy in which not only wages, but also other incomes are simply no longer paid - a fact which is further stimulating the parallel, informal
economy, including black market activities and corruption. The growth of informal activities reduces income for the state budget and again aggravates the non-payment of wages in the budgetary sector. In a way, we may wonder whether the non-payment of wages has perhaps replaced wage controls as the new ‘macroeconomic variable’ used to keep inflation and other macroeconomic trends under control.

5.2.3 Social protest and government action

This phenomenon of the non-payment of wages is clearly in contradiction with ILO Convention No. 95 on the Protection of Wages, which stipulates that wages should be paid on a regular basis and not be subject to delay once this basis has been fixed by legislation. The Ukrainian government has ratified this Convention, and implemented a new Law on Wages in 1995; nevertheless, the problem has worsened even since then.\(^7\)

The widespread non-payment of wages has led to a growing number of strikes. An important protest action was organized by the Federation of Trade Unions of Ukraine on the occasion of the official UN day against poverty on 17 October 1997. This demonstration was followed all over the country and, according to the trade unions, more than 1.5 million people took part. Another protest action was organized on 19 February 1998. At the same time, Ukrainian trade union organizations from the worst-affected sectors submitted several official complaints to the ILO regarding the contravention of Convention No. 95. In particular, the Committee of Experts of the ILO has received comments from the Ukrainian Trade Union of Educational and Science Employees, emphasizing that their appeals, protests and negotiations with the government concerning the non-payment of wages have not led to more positive results. Similarly, the Central Trade Union Committee of Geology, Geodesy and Cartography Workers stated in a comment received in April 1997 that the government's debt to the workers in that sector has grown to 25.8 million hryvnya (USD 13.5 million). The Crimean Republican Trade Union Committee of Health Care Workers also complained in a comment received in April 1997 that no wages have been paid for more than five months. The Kharkov Committee of the Trade Union of the National Academy of Science also attracted the Committee's attention in its communication of 9 July 1997 regarding the situation of non-payment of wages for state employees of the National Academy of Science, who have not been paid for more than six months.

In order to solve the problem, the government concluded a protocol with sectoral trade union federations on 4 April 1997 (signed by the president of the Trade Union Federation of Ukraine and the Chairman of the Ukrainian Committee of the Trade Union of Employees of the National Academy of Science) on ensuring the prompt payment of wages and wage arrears, giving priority to wage payments and enforcing with labour legislation. The government has taken various measures to implement this agreement.

The Cabinet of Ministers of Ukraine adopted a comprehensive Resolution No. 879 on 13 August 1997, which envisages the complete (100%) financing of current wage payments, the obligatory allocation of at least 75% of the resources of bodies financed by the state budget to the payment of current wages and the settlement of wage debts, and the preparation of draft legislation regarding the immediate allocation of grants and subsidies from the state budget for the settlement of wage debts.

A General Agreement for 1997–1998 was also signed on 18 October between the Cabinet of Ministers, the Ukrainian Union of Industrialists and Entrepreneurs and the associations of trade unions of Ukraine. The parties to this agreement committed themselves, among other things, to guaranteeing effective monitoring of laws and other standards concerning the payment of wages, to approving a procedure for the compensation of workers for the loss of earnings in connection with the non-observance of deadlines for payment, and to guaranteeing the punctual payment of current wages to workers in organizations dependent on the state budget.

A more strict system of penalties and compensations has also been implemented. At the ILO Conference Committee of June 1997, the government representative stated that, following a decree

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\(^7\) Article 34 of the Law of Ukraine on Wages, which deals with compensation for wage losses due to delays in payment, has been in force only since recently.
of the President of Ukraine, the managers of state enterprises are now obliged by virtue of their contract to ensure the timely payment of wages and the strict compliance with the timetable for settling wage debts, and that the failure to fulfil this requirement is considered sufficient grounds for terminating the manager’s contract – which actually occurred to a number of managers in several sectors. In a letter dated 22 August, the government indicated that it is preparing a draft law on the increase of criminal and administrative responsibility for directors of enterprises and organizations that utilize funds intended for the payment of wages inappropriately. In the first half of 1997, the courts examined over 36,000 private appeals concerning the non-payment of wages; 28.4 million hryvnya were exacted by court decisions in the workers’ favour, and at least another 10,000 cases relating to wage debts are under examination. During the same period, it was revealed that approximately 13,000 violations of labour legislation and over 2,000 directors were charged with administrative responsibility.8

The government also reinforced supervision machinery. In the first half of 1997, the State Labour Inspectorate conducted more than 10,000 inspections, with immediate results – 15,623 violations of labour legislation were revealed, about 6,500 injunctions issued and 12,500 proposals made to eliminate the violations.9 The results of such inspection visits are examined by the government and transmitted to other ministries concerned as necessary.

Finally, in the most affected sectors, specific actions have been undertaken. In the coal industry, for example, an interdepartmental commission that includes trade union representatives was created to take operational steps for the timely payment of wages and government financial aid to this industry.

A series of government decrees were adopted to improve the use of funds in research institutions. The government has also undertaken concrete steps, for example for the health care workers in Kerch (Crimean Republic), by setting up a timetable for settling wage debts to municipal workers and by ruling that over 80% of cash coming into the budget should be used for wage payments and the settlement of wage debts. Employees in health institutions now receive payments through special bank accounts, and in each transfer, the amount paid with respect to 1996 wage arrears is specified.10

The drastic measures taken by the President and the government aimed at arrears reduction had some positive effect, first observed in the second half of 1996 and then in the second half of 1997. While during the first half of 1996, total arrears increased by 4.5 times, in July–December of that year the rate of growth slowed to 1.5 times. Similarly in 1997, while in the first six months wage arrears increased each month in all sectors of the economy, in the July–September period they were reduced in absolute terms, although they again renewed their growth so that their total amount increased by 9% in the second half of the year. In organizations dependent on state or local budgets, wage arrears were reduced by 29.3% in July–September 1997. By sector, the total amount of wages owed at the beginning of October had decreased by 45.7% in educational establishments, 32.4% in cultural organizations, 28.7% in the public health sector, and 23.3% in social care establishments. According to the government, 22 out of 25 provinces of Ukraine were not only ensuring 100% payment of current wages to workers in the budgetary sphere at the beginning of October 1997, but they were also paying off 1996 wage arrears.11 In research institutions, wage debts were reduced by 15.4% in July–September 1997, which made possible the full payment of accumulated wages for the current year. However, despite these significant results proving that concrete solutions can be worked out, the non-payment of wages remains an important problem, considering the huge amounts of wage arrears still outstanding.

9 Ibid.
10 Ibid.
11 The government’s letter to the ILO Committee of Experts, dated 6 November 1997.
5.2.4 Policy priorities: For a continuous and multi-dimensional action programme

The above-mentioned actions of the government clearly show that the problem cannot be solved by a single ‘miracle solution’, but instead must be approached using a range of measures which might together progressively cure the fundamental disease. The Ukrainian government must therefore launch an ambitious, coherent and multi-dimensional policy, to be applied by all ministries in close cooperation with trade unions and employers’ representatives.

The first priority is undoubtedly to restore a monetary economy and to put a halt to barter trade. The vicious circle of inter-enterprise debts must also be stopped. Even if the barter process, particularly widespread in agriculture, might appear as a workable solution in the short term, its generalization to the economy as a whole could lead to uncontrollable consequences of which workers are the main victims. In enterprises, priority must be given to the payment of wages, which should be supported by the banking system, with the whole process monitored closely by the government.

Decisions regarding bankruptcies should also be taken in a more systematic way by the government, and supported by the trade unions. It is equally important to reduce taxation in order to help enterprises increase their capital and improve their production capacity and economic performance, enabling them to pay taxes and social contributions on time. Better control of the price fixing system in monopolistic enterprises also seems warranted, especially when these operate in key sectors for production, such as energy and raw materials.

Strict budgetary policies have often been imposed at the price of the non-payment or delayed payments of wages to public servants. Discussions should take place with those responsible for national monetary policy to consider a relaxation of exaggerated and counter-productive strict financial conditions. For this reason, the ILO organized a seminar jointly with the IMF in November 1996 – for the first time in the region – with the aim of discussing these issues with representatives of employers and trade unions, as well as with high-ranking officials of the Ministries of Economy and Finance and the Prime Minister’s office. One of the main conclusions of the seminar was that strict monetary conditions should also be moderated in order to take into account the problems of non-payment and to provide more flexibility to enterprises and other economic agents.

In many regions of Ukraine, teams of labour inspectors – often with the participation of trade unionists, employers representatives, experts, local authorities and sometimes national ministries – have been created in order to analyse in detail the situation of enterprises with regard to wage payments. Finally, legislative action is needed on several fronts, such as the priority given to wage payments, the responsibility of employers, monopolies, indebtedness and the banking system, bankruptcy, and related issues. In this context, the ILO has strengthened its advisory role in the wage area and is closely monitoring the application of Convention No. 95 on the Protection of Wages. The work of the Committee of Experts of the ILO will continue to examine the problem and issue statements of non-conformity with Convention No. 95 when necessary.

In this regard, the government should multiply its efforts to develop a better and more transparent information system on this problem, by collecting data on the extent of the problem in a more systematic way by sector, industry and region. It should also provide information on the various measures implemented to ensure the regular payment of wages and rapid settlement of wage arrears, as well as data on the results of such measures.

It is also time for trade unions, employers’ organizations and government officials to unite their efforts in keeping the payment of wages at the top of their agenda. Wage indebtedness has reached astronomical levels; in fact, it is now approaching the point of no return, after which the government and enterprises will clearly never be able to pay back accumulated wage arrears. If not urgently addressed, this problem could rapidly lead to a social explosion, as illustrated by the widely supported demonstrations over the last two years. This trend also contributes to the production and productivity crisis. All means should therefore be used to solve this problem as soon as possible, including a schedule for the payment of wage arrears. In this regard, the government should plan for the payment of arrears in its 1999 budget allocation, if it would like to halt widespread social discontent and avoid undermining the country’s future economic recovery.
5.3 Protection of workers on administrative leave and short-time work

5.3.1 The extent of the problem

Chapter 3 pointed to the phenomenon of hidden partial unemployment in the enterprise sector, widespread in all CIS countries. Table 5.2 gives a more detailed view on the number and sectoral distribution of workers on administrative leave and short-time work.

Table 5.2  Number of workers on administrative leave and short-time work by sector in 1997

<table>
<thead>
<tr>
<th>Sectors of the national economy</th>
<th>On administrative leave</th>
<th>On leave for more than one month</th>
<th>Working partial working days or weeks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>thousand workers</td>
<td>as percent of workers in sector</td>
<td>thousand workers</td>
</tr>
<tr>
<td>Total</td>
<td>2862.6</td>
<td>21.9</td>
<td>818.5</td>
</tr>
<tr>
<td>Industry</td>
<td>1518.1</td>
<td>33.1</td>
<td>519.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>80.2</td>
<td>20.8</td>
<td>18.1</td>
</tr>
<tr>
<td>Forestry</td>
<td>8.3</td>
<td>12.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Transport</td>
<td>220.6</td>
<td>22.4</td>
<td>36.3</td>
</tr>
<tr>
<td>Communication</td>
<td>11.1</td>
<td>4.1</td>
<td>0.2</td>
</tr>
<tr>
<td>Construction</td>
<td>398.7</td>
<td>43.8</td>
<td>147.9</td>
</tr>
<tr>
<td>Trade</td>
<td>59.9</td>
<td>10.4</td>
<td>10.3</td>
</tr>
<tr>
<td>Public catering</td>
<td>23.0</td>
<td>20.2</td>
<td>4.8</td>
</tr>
<tr>
<td>Maintenance supply and sales activity</td>
<td>22.1</td>
<td>23.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Procurement</td>
<td>14.9</td>
<td>21.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Information and computer services</td>
<td>0.8</td>
<td>7.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Other production services</td>
<td>20.6</td>
<td>24.5</td>
<td>5.9</td>
</tr>
<tr>
<td>Housing services</td>
<td>8.1</td>
<td>5.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Municipal economy, public utilities</td>
<td>40.6</td>
<td>9.1</td>
<td>6.8</td>
</tr>
<tr>
<td>Public health</td>
<td>94.6</td>
<td>8.0</td>
<td>10.3</td>
</tr>
<tr>
<td>Culture</td>
<td>43.2</td>
<td>20.1</td>
<td>7.2</td>
</tr>
<tr>
<td>Science and research services</td>
<td>51.2</td>
<td>22.5</td>
<td>17.5</td>
</tr>
<tr>
<td>Public education</td>
<td>176.2</td>
<td>11.3</td>
<td>14.3</td>
</tr>
<tr>
<td>Financial services</td>
<td>6.0</td>
<td>3.7</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Source: Rinok praci Ukraini v 1997 roci

Table 5.2 gives evidence that in absolute terms, industry accounts for more than half of all ‘cases’ of administrative leave in Ukraine. One in three industrial workers was put on administrative leave without pay in 1997, of whom one-third, i.e. 11.3% of all industrial workers were on leave for more than one month. In addition, 22.6% of workers in industry were requested to work shorter hours with reduced pay. The sector hit hardest by de facto redundancies was construction, where 43.8% of all workers were temporarily sent home on unpaid leave (one-third of whom – or 16.2% of all construction workers – were
affected for an extended period). Another 21.8% of all construction workers were working on a short-time basis. This means that nearly two-thirds of all workers in construction faced irregularities in work and substantial losses in income.\(^{12}\) Other sectors with large numbers of workers on administrative leave or short-time work on the initiative of administration during 1997 included transportation, maintenance supply and sales activities, education, science and research and some others. The extent of the problem was thus substantial.

There are two main reasons for these practices. First, in the case of lay-offs for economic reasons, enterprises are obliged to pay severance pay equal to three months’ wages. By putting redundant workers on unpaid administrative leave or short-time work rather than laying them off, they can reduce labour costs (both wage and overhead costs, such as contributions to the social protection system, the provision of certain social services, etc.). They also save the amount of severance pay, while keeping workers on the payroll in case of production recovery. There are no other conditions or obligations for enterprise management concerning time limits on administrative leave or short-time work, compensation for income losses, redeployment, and so on. Second, workers themselves opt for administrative leave in order not to lose access to social and other services provided by the enterprise, particularly if there are no employment alternatives in their place of residence. The practice also allows them to maintain hope of being recalled when the enterprise recovers.

In the short run, these practices may seem beneficial for the country, as they slow the rate of redundancies, decrease open unemployment and seem to be less costly for public funds while moderating tensions in the labour market (since both sides agree on these terms). However, in the longer run, economic and social losses resulting from the absence of sound economic restructuring and the redeployment of redundant workers (unfortunately so frequent in the Ukrainian enterprise sector) may be substantial and detrimental to economic growth, productive employment and social development. As a result, enterprises are increasingly unprofitable and uncompetitive, while workers are partly or fully deprived of their wages, left without compensation for suffered income losses, and have no access to social welfare or to employment promotion programmes. Moreover, they face the real danger of becoming de-skilled and socially marginalized. Quite understandably, after a certain period many of them resign from their jobs, but because they quit quasi-voluntarily, they are not entitled to severance pay or to the higher income support in unemployment reserved for workers displaced for economic or organizational reasons.

At the moment, there are no special social protection schemes for workers on administrative leave. In these circumstances, workers tend to resort to many different means of supporting themselves and their families. Many grow their own food on private plots of land, others take up activities in the informal sector, trying to avoid paying taxes with the result that many transactions are conducted in cash or barter. Social protection for workers on administrative leave as well as support policies for their redeployment to productive jobs are thus urgently needed.

### 5.3.2 Envisaged income protection measures

As mentioned in the previous chapter, amendments to the Employment Act to be put into effect as of 1 January 1999 may bring an important change to this problem. Instead of the three months’ severance pay which enterprises have had to pay so far in the case of lay-offs, the obligation of the enterprise will be reduced to only one month, while the other two months will be covered by the Employment Fund. In addition, a ceiling will be placed on the level of monthly benefits, which cannot be higher than the national average wage. Expectations are that this will encourage enterprises to reduce labour hoarding and lay off redundant workers, in particular those on administrative leave and

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12 Theoretically, in case of no overlaps between administrative leaves and short-time work. In reality, many redundant workers experience both in the course of a single year.
short-time work. The extent of these forms of partial redundancy would thus be reduced, resulting in a steep increase in open registered unemployment.\textsuperscript{13}

The draft Law of Ukraine on Compulsory State Social Insurance in Case of Unemployment suggests that social benefits on partial unemployment will be provided to insured persons who (i) have lost part of their salary as a result of a temporary reduction of their normal working hours; (ii) had worked not less than 26 weeks paying contributions during the 12 months prior to the reduction of working hours; and (iii) whose idle time is at least 20% of their normal working time. The benefit on partial unemployment amounts up to 50% of the average salary that the worker earned during the two months prior to the reduction of working hours. The sum of salary and benefits on partial unemployment may not be higher than the average wage in the economic sector in the region, nor can it be lower than the subsistence level established by law. The duration of payment of this benefit may not exceed 180 days a year. The benefit is delivered by the enterprise, and financed by the Employment Fund. This draft Law has recently been submitted for consideration to the Government of Ukraine. It has been agreed that this part of the Law will be implemented only after the national economy achieves sustainable economic recovery in order to 'afford' this measure – i.e. certainly not before 2000.

These envisaged measures are steps in the right direction. First, they will improve income protection for partially redundant workers. Second, the change in the financing of severance pay will help reduce overemployment in enterprises, and thus release resources for increasing motivation for the core enterprise staff. Besides direct effects on labour productivity in enterprises, these measures should also have other positive macroeconomic effects. The labour market will become more flexible and responsive to structural changes in production, as redundant workers will leave unprofitable enterprises and declining industries and seek new employment in sectors and economic activities promising better jobs and safer incomes. Obviously, demand for labour is still rather weak, and therefore not all of them will succeed. However, as the remaining two months of severance pay are provided only under condition of registration with the labour office, the displaced workers will be encouraged to do so and will benefit from the placement assistance and eventual participation in appropriate labour market policies. Although this will increase the workload for the SES, the potential ability of the SES to regulate the labour market and stimulate sound employment restructuring will be strengthened – an important fact which should not be overlooked.

However, both measures place disproportionate financial and other obligations on the Employment Fund and burden workers with hardships connected with income losses and higher incidence of redundancies. Meanwhile, enterprises remain relatively free of obligations, except for the payment of one month’s severance pay in the case of economic redundancy. This might seem to be justified in the current economic and financial situation of many Ukrainian enterprises, which has been one of the main reasons for the decision of the state authorities to take over a larger part of the costs of redundancies to avoid hidden partial unemployment. Nevertheless, the absence of economic pressure on enterprises to find longer-term solutions to their economic problems through viable restructuring programmes is not reasonable, considering the structural character and persistence of economic recession and unemployment in Ukraine.

In Western European countries, there are two types of short-term schemes: anti-cyclical and structural. The first type of scheme provides temporary assistance to enterprises suffering from business cycle problems, to help them prevent layoffs in downswings and subsequent hirings in the following upswings, which would be costly for the enterprise as well as for workers and the society (especially in the case of large-scale layoffs). The second type offers intervention in cases when an enterprise is hit by structural crisis. The goal is to avoid, or at least postpone, mass redundancies and help the enterprise in restructuring and economic recovery by taking over a part of labour costs during the transformation

\textsuperscript{13} The SES has already made some calculations of the total amount of funds needed for income support, taking into account both the payment of the additional two months’ severance pay and an estimated increase in redundancies. According to estimations, the level of contributions for employment issues should be raised from the current 2% to 5.3% of the wage fund in order to cover these financial obligations. This may not be feasible for employers, due to already very high tax levels. Thus, another delay in putting this amendment into effect may result unless another solution is found, e.g. through more equal sharing of contributions between employers and workers.
period. The endeavour is to make these external funds available not only to enterprises of high
importance for the regional labour market, but also to provide other potentially viable enterprises a
guarantee that they will succeed in restructuring and minimize job losses. In some countries, such as
Italy and France, there are incentives to combine short-time work with training to upgrade or extend the
skills of workers. In both types of short-time schemes, workers receive compensation for incomes lost
due to short-time work, paid partly by the enterprise and partly from unemployment insurance funds, from
the state budget, or from special funds generated for this purpose (as in Italy, for example). In case of
serious economic problems in the enterprise, external funds may cover such costs in full, and in addition
the enterprise is usually exempted from social security contributions for short-time work.\(^\text{14}\)

Even in cases where such short-time schemes are not available, an agreement may be negotiated and
reached at the enterprise level. The workers’ organization may agree with a temporary short-time
schedule and a partial loss of workers’ incomes when management commits itself to elaborating a viable
enterprise restructuring strategy leading to economic revival of the enterprise and minimum job losses,
and providing workers’ representatives enough power to control the implementation of this strategy.
There is evidence that even though short-time schemes may only postpone layoffs for a part of the
enterprise workforce, the commitment of the enterprise to restructure and bring about the recovery of the
enterprise while attempting to avoid dismissals and provide partially redundant workers with income
compensation improves the loyalty and motivation of workers that do remain, and has a positive effect
on increasing the flexibility of the workforce.

A growing number of large enterprises try to solve the problem of redundancies connected with structural
adjustment by utilizing reserves for internal redeployment of redundant workers to productive jobs, often
combining this with retraining and skills upgrading. Despite efforts to minimize them, dismissals of a
certain number of redundant workers are usually unavoidable during enterprise restructuring. Some
enterprises feel a responsibility to provide assistance for the new employment of their redundant
workers. Below, some good examples of socially responsible attitudes of large enterprises towards
redundant workers in Western European countries and in some transition countries are provided. It
should be emphasized that such policies are usually initiated by trade unions and negotiated and agreed
between the social partners. When there is a need, i.e. in cases when large-scale layoffs may occur in
connection with economic crises affecting whole industries, or when the enterprise is of key importance
in the local labour market, national and regional governments support these enterprise endeavours. This
approach is usually feasible only for large enterprises, and may involve only a part of redundant workers,
while others may deliberately prefer to collect income compensation and quit the enterprise. Therefore,
it should supplement rather than replace traditional labour market policies and job placement assistance
provided to those who have already lost their jobs.

5.3.3 Employment plans and related policies

Employment plans, invented and first used in Germany in the mid-1980s, aim to stimulate internal
structural changes in enterprises while providing redundant workers with reasonable income and
employment protection or assistance in redeployment.\(^\text{15}\) They may be fully funded from internal
resources, but usually combine internal and external resources, the latter provided by national
employment funds, state or regional budgets, etc. They are negotiated between the enterprise
management and the trade union organization (in Germany, the works council) and become part of a
collective agreement. If externally sponsored, they are also agreed between the company and the

\(^{14}\) For more on short-time work in economically advanced countries, see H. Mosley and T. Kruppe, ‘Employment Stabilization
through Short-time Work’, in G. Schmid, J. O’Reilly and K. Schoemann, International Handbook of Labour Market Policy and

\(^{15}\) Employment plans were developed from so-called social plans, negotiated and agreed between the social partners in
enterprises forced to lay off large numbers of workers due to economic problems (the first social plans were concluded in
enterprises of the mining and steel industries in the mid-1950s). They stipulated conditions under which redundant workers
could be released from the enterprise and usually took the form of financial compensation above a level determined by law, and
eyear retirement for elderly workers (usually covered jointly by the enterprise and the state or regional budgets, the employment
fund or social insurance).
supporting institution involved (e.g. regional government or regional labour office). The idea is to stimulate the enterprise restructuring and economic recovery programme and gain support for the programme from workers under the condition of no immediate mass layoffs, but preferably of internal redeployment of redundant workers, complemented by retraining (if necessary), or assistance in external redeployment.

Several types of employment plans have been implemented so far in practice, by steel works such as Krupp or Saarstahl in Germany or Voest-Alpine in Austria, and also by many large enterprises in other industries. The first type provides retraining to redundant workers, which may be followed by a new job offer within the enterprise or at least improve the worker’s chances for employment in the labour market.

The second type is based on the creation of a training and employment company as a subsidiary establishment, where redundant workers are temporarily placed with an option to obtain further training, assistance in permanent or temporary redeployment inside or outside the company (in this case using personal contacts), providing orders to subcontractors on the condition of hiring such workers, loaning workers to other enterprises or organizations, etc. The third type uses so-called personnel deployment departments, which take care of re-employment or other arrangements for redundant workers transferred to this department. The department may assign such workers to temporary jobs (e.g. in the case of temporary labour shortages or vacancies due to maternity leave, etc.) or to permanent jobs in the enterprise, offer them retraining, and so on. In all cases, redundant workers obtain either regular pay, a training allowance, or similar income support. Although the arrangements are usually only temporary, they give some workers a chance to find a new job with or without a short unemployment spell, to acquire new skills demanded in the labour market or otherwise maintain and improve their employability or to bridge the period necessary for gaining eligibility for early retirement while providing them with reasonable social protection.

This type of policy has also been successfully applied in the Czech Republic, in several steel works (Vítkovice, Nova Hut, Trinec Zelezárny) and a coal-mining company (OKD). Although these enterprises substantially reduced their workforce, they managed to do so without significant social resistance, thanks to the implementation of the above-mentioned practices. They contributed significantly to the redeployment of redundant workers within the enterprise, offered them retraining to improve their re-employment chances, or provided severance pay above the level stipulated by the Labour Code. In all cases, the approach was negotiated and agreed with the enterprise trade union organizations and fully self-funded; only in the case of OKD did the state cover a part of the social costs associated with redundancies. All the steel works applied the idea of personnel deployment departments, offering redundant workers either direct redeployment within the enterprise, retraining or severance pay.

The Czech coal mining company created two types of establishment dealing with the redeployment of redundant workers. The first one, a job shop, assisted redundant workers in redeployment within the enterprise. If there were no suitable vacancies within the enterprise, it also assisted in external redeployment, utilizing contacts with other enterprises in the region, mainly with those created through financial assistance supplied by the company or through direct job creation. If necessary, workers were also offered appropriate retraining before new placement. In addition, the coal mining company established two business centres, providing assistance to redundant workers wishing to start their own business. Besides preferential loans, starting entrepreneurs were offered premises and equipment no longer used by the enterprise under advantageous conditions. Similar advantages, including contracts for production and services for the enterprise, were provided to other firms if they committed themselves to hiring redundant workers.

The above-mentioned idea of employment and training companies was also applied to employment restructuring after reunification in East Germany, following pressure from IG Metall, the most influential

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16 For more on these topics, see G. Bosch, ‘Company-internal restructuring and retraining: Employment plans and employment companies in West and East Germany’, in W. Sengenberger and D. Campbell (eds.), Creating Economic Opportunities: The Role of Labour Standards in Industrial Restructuring (International Institute for Labour Studies, Geneva, 1994).
German trade union of metalworkers. However, the approach was adjusted to the East German reality, where the restructuring of enterprises was combined with their privatization and resulted in mass redundancies of workers. After intense political discussions, it was decided to establish so-called companies for employment promotion and structural development (known under the acronym ABS), which were made responsible for offering new employment opportunities to workers displaced from restructured and privatized enterprises who were transferred to these companies. Enterprises provided material support for the employment companies in the form of premises, workshops, machinery, etc. The employment companies supported the establishment of new firms in available premises utilizing leased or granted machinery, provided retraining to employees, subsidized new job creation in existing firms to place their workers, organized environmental and other projects providing temporary work assignments for the employees, etc. Later, the original idea was extended to combine job creation, retraining, subsidized employment and other active labour market policies with regional economic development, and key regional actors were directly involved in these employment promotion schemes.\(^{18}\)

The main message of this approach is that through social dialogue and close cooperation between employers and workers in enterprises, economically feasible ways can be found for the enterprise to strengthen the social protection of redundant workers and improve their chances of obtaining good new jobs inside or outside the enterprise. These measures are not in contradiction with enterprise restructuring strategies, but rather support them in promoting redeployment of redundant workers to productive jobs inside or outside the enterprise, improving the quality of human resources, and positively affecting labour productivity through optimal sizing, improved allocation and better motivation of the workforce.

The applicability of this approach in Ukrainian conditions can be manifold. First, enterprises should seek all possibilities to redeploy partially redundant workers internally, to more productive jobs. If there is a need for retraining, redundant workers should have this possibility, and their retraining can be co-funded by the enterprise and the Employment Fund, or in certain cases by state or regional budgets. Second, due to large drops in production, many Ukrainian enterprises dispose of un- or underutilized premises and equipment. Following the above-mentioned example of the Czech mining company, these premises and equipment may be cheaply leased to redundant workers interested in starting up a business activity, or to firms committed to hiring workers displaced from the enterprise. The enterprise may also enhance these possibilities by providing such firms with orders for certain products and services, or through preferential loans, marketing and sales services, etc. In order to ensure just access of redundant workers to these opportunities, the enterprise trade union organization should be fully informed on the personnel situation within the enterprise, and share decision-making power in these issues. These are only some examples of possibilities for the assistance of redundant workers in addition to severance pay and other income compensation. They are also feasible under Ukrainian conditions, and should become an important subject of social dialogue within enterprises.

\(^{18}\) Ibid. This idea will be developed further in Chapter 7, on local labour market restructuring.
CHAPTER 6: CREATION OF NEW JOBS THROUGH SMALL ENTERPRISE DEVELOPMENT

6.1 Introduction

Since 1997, increasing attention has been devoted to the role small enterprises could play in Ukrainian society. Parliament passed the Law on Entrepreneurship in 1997, and other laws promoting small enterprises are in preparation. In February 1998, President Kuchma issued a decree aimed at further easing the life of entrepreneurs. In addition, the State Entrepreneurship Committee (SEC) was established in July 1997 under the leadership of Mr. Yekhanurov, with the aim of implementing state enterprise support policy. Since then, the SEC has been fervently promoting small enterprises, arguing that it is time for Ukrainian society and the government to start realizing that the country’s economic future depends to a large extent on the development of enterprises, and starts dealing with the often openly hostile attitude towards business.¹ The main reason for the renewed attention devoted to small enterprises seems to be that after seven years of transition, the country has not been able to create economic dynamism and growth. Nor do the presently active large enterprises seem to be able to continue to provide employment at the scale they do now. Many observers and policy makers see small enterprises as a promising alternative for Ukraine. They normally base this view on the important role this sector has played for decades in industrialized and developing countries, and also in many Central and Eastern European countries since the start of transition. For the time being, the Ukrainian small enterprise sector is still rather underdeveloped, and questions arise about what is needed to promote its growth. In this chapter, we will review the development of the sector since the start of transition, analyse the obstacles small enterprises face at the moment, and discuss options to promote the sector and increase its employment-creating capacity. First, however, we will take a brief look at the position of small enterprises in international perspective.

6.2 Small enterprises in international perspective

In many countries, the small enterprise sector has become a major player over the past decades. The role the sector plays in various countries, including its success in promoting economic growth and employment creation, is nevertheless quite diverse, depending to a large extent on specific characteristics of the society and economy. In western countries, the small and medium-sized enterprise (SME) sector started to gain importance at the beginning of the 1970s. Its growth has been associated with a variety of developments, including sectoral shifts towards services, decentralization and down-scaling of large companies, combined with increased outsourcing and externalization of ancillary activities and the formation of regional agglomerations of small firms. These can largely be interpreted as responses to changes in product and labour markets, including increased demand for differentiated or customized goods and services; heightened competition in markets for standardized products; the spread of microelectronic technology for production and communication; and the changing composition of the labour force.² In industrialized countries, small enterprises have proved to be capable of responding flexibly to these changes, incorporating new technologies and production strategies, innovating products and services, and developing new methods of inter-firm cooperation and coordination. On the other hand, there is also a substantial group of persons who are rather forced to become self-employed in less attractive, low-skilled jobs because of the lack of employment alternatives. Today, the overwhelming majority of firms in Western Europe, the USA and Japan are SMEs, and although there are great differences between countries, they invariably account for a large share in both GDP and employment, generally between 50% and 70%.

In Central and Eastern Europe, the small enterprise sector has experienced explosive growth in the first years of transition, as many new small private businesses have been established.\(^3\) For example in Hungary, with a population of 10.2 million, there were 633,427 small businesses active in mid-1996 (meaning they had tax declarations). Of these, 96% had 10 or fewer employees.\(^4\) On the other hand, in the countries of the former USSR the small business sector is still very small, and growth has not met expectations.

Small businesses are generally considered an essential element of the transition to a democratic, market-based system. They constitute a vehicle of freedom of choice regarding socio-economic activities, give possibilities for initiative, provide an element of competition to the economy, and decrease the monopoly of (former) state enterprises. They may also serve as poverty buffer in difficult economic times. Transition would also seem to provide good opportunities for small businesses. With the start of transition, both the production levels of large state enterprises and traditional trade relations with the former socialist countries came quickly under pressure, leaving important gaps which could potentially be filled by SMEs. According to the OECD, this applies in particular to consumer and production-oriented services, the productive artisan trades, professions, transport and construction – in short, to those firms that principally supply local and regional markets, the development of which was particularly restricted by the centrally planned economic system.\(^5\)

It is somewhat difficult though to speak of the small enterprise sector as a single, unified phenomenon. In all countries, we observe it is extremely heterogeneous, and has multiple economic and social dimensions. Size being the common denominator, the sector has a very mixed sectoral composition. Trade and services usually make up a large share, but industry and agriculture may be important as well. Likewise, small enterprises include both innovative, high-technology enterprises in expanding industries, and enterprises in stagnant industries characterized by low technology, low productivity and low pay. Different small enterprises may also have different goals or aspirations, with some aiming at growth and reinvesting profits in the enterprise, and others serving rather as a vehicle for consumption or survival for the owner’s family. A related differentiation within the sector may be between enterprises operating in the formal and those operating at least partially in the informal economy.

These last two differentiations have traditionally been especially characteristic of developing economies, e.g. in Latin America and Asia, where large parts of the population are involved in small-scale, less productive, informal activities which have little to do with the formal economy and which are not growth oriented but rather aimed at keeping one’s head above water. In most Central and Eastern European countries and the CIS, the informal sector has grown rapidly in the 1990s. For the time being, however, few comprehensive studies have been made of this phenomenon in transition countries, and important differences may exist with the informal sector in developing countries.

Despite the diverse character of small enterprises, a common feature in many market economies is that specific laws, policies and institutions have been developed to promote the creation and growth of small enterprises. It is generally considered that in comparison with larger enterprises, small enterprises face certain specific obstacles, particularly during the start-up phase, but also later in their existence (e.g. they are particularly vulnerable to economic cycles and unfair competition). These obstacles can be difficult for them to overcome without temporary support. Such support is generally justified with the argument that small enterprises are an indispensable element in the economy and society providing flexibility, competition, new initiative, opportunities for self-realization and jobs.

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3 In some countries, (semi-) private small enterprises appeared already much earlier.
4 This figure includes 425,484 self-employed persons. See ILO-CEET, Hungary: Employment and Sustainable Livelihoods (ILO-CEET, Budapest, 1997).
6.3 Small enterprises in Ukraine

6.3.1 Small enterprises in the formal economy

The criteria defining small enterprises are stipulated in the Law on Enterprises in Ukraine of March 1991. The Law refers to small enterprises (as opposed to large ones), but does not specify criteria for either medium-sized or micro-enterprises. Therefore, the latter two categories are not taken into account in the statistical information elaborated by the State Committee for Statistics. According to the Law, criteria for small enterprises are based on both the sector of activity and numbers of employees, and include the following:

- Industry and construction up to 200 employees
- Science and scientific services up to 100 employees
- Other production (excluding retailing) up to 50 employees
- Non-productive activities up to 25 employees
- Retailing up to 15 employees

However, there are other categories of productive organizations which are worth incorporating in the present analysis, especially cooperative societies, farms and the self-employed. Almost all of these organizations can be considered small enterprises. Cooperative societies include less than 20 workers on average, while farms employ 2.5 workers on average. The self-employed seem to provide employment mainly to themselves. Table 6.1 shows the number and growth of these four types of small entities since 1991.

Table 6.1 Development of small enterprises and self-employed in Ukraine, 1991–1996

<table>
<thead>
<tr>
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<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Small firms</td>
<td>19,598</td>
<td>50,496</td>
<td>75,003</td>
<td>79,827</td>
<td>91,601</td>
<td>93,091</td>
</tr>
<tr>
<td>% increase</td>
<td>100</td>
<td>257.7</td>
<td>148.5</td>
<td>106.4</td>
<td>114.7</td>
<td>101.6</td>
</tr>
<tr>
<td>Cooperatives</td>
<td>27,486</td>
<td>17,243</td>
<td>9,777</td>
<td>5,972</td>
<td>4,418</td>
<td>3,179</td>
</tr>
<tr>
<td>% decline</td>
<td>100</td>
<td>62.7</td>
<td>56.7</td>
<td>61.1</td>
<td>74.0</td>
<td>72.0</td>
</tr>
<tr>
<td>Farms</td>
<td>2,098</td>
<td>14,681</td>
<td>27,739</td>
<td>31,983</td>
<td>34,778</td>
<td>35,353</td>
</tr>
<tr>
<td>% increase</td>
<td>100</td>
<td>699.8</td>
<td>188.9</td>
<td>115.3</td>
<td>108.7</td>
<td>101.7</td>
</tr>
<tr>
<td>Self-employed</td>
<td>-</td>
<td>200,292</td>
<td>426,594</td>
<td>672,257</td>
<td>859,579</td>
<td>&gt;1,000,000</td>
</tr>
<tr>
<td>% increase</td>
<td>-</td>
<td>100</td>
<td>213.0</td>
<td>157.6</td>
<td>127.9</td>
<td>-</td>
</tr>
</tbody>
</table>

Notes:
1. The table refers to active businesses which provided accounts to tax and statistical authorities.
2. Increase or decline indicates the number of subjects as a percentage of the number from the previous year.
3. Self-employed refers to the registered self-employed. An estimated 70–80% of these persons pay taxes.
Source: Based on data from the Ministry of Statistics

The number of active small enterprises has increased rapidly since the start of transition. Growth was particularly fast in 1992, when their number more than doubled. In following years, their number continued to

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6 Currently, the Ministry of Economy is preparing a new law on state support to small businesses which will include new criteria defining micro, small, medium-sized and large enterprises, more in line with international practice.
7 Cooperative societies include production and consumer cooperatives, and are distinct from agricultural cooperatives.
8 In fact, small businesses already began to appear in the 1980s in Ukraine. In 1987, the Law on Individual Working Activities of USSR Citizens was adopted, legalizing a kind of self-employment. In 1988, the Law on Cooperative Societies was adopted. These cooperatives were rather similar to small private businesses, and their number grew explosively even before the start of transition.
9 The data here presented only refer to the so-called formal sector, as they are based on registration and tax data. Later in this chapter (and also in other chapters of this report) more attention will be given to the phenomenon of the informal sector.
grow but at a much lower rate. In 1996, however, almost no net growth was observed, as the number of active small enterprises increased by only 1490, or 1.6%. By then it had reached just 93,091, a rather disappointing number for such a large country. A similar pattern is observed concerning farms and the self-employed. The number of farms also increased explosively in 1992 – almost sevenfold. Then growth slowed down, and in 1996 it had fallen to 1.7%. The growth rate of the registered self-employed also declined over the years, although it is still quite high. The absolute increase per year continues to be relatively stable, around 200,000. It is nevertheless important to be cautious in the interpretation of data on self-employment, taking into account that we talk here about registered data. Other sources present rather different figures. For example, the Statistical Committee’s publication Labour in Ukraine reports 1,864,000 persons working full-time on subsidiary plots, and 2,363,500 persons employed in ‘other spheres of economic activity’. It is likely that the status of the vast majority of these persons is equal or similar to self-employment. Also, the Labour Force Survey of October 1997 suggests that some 4,000,000 self-employed were active at that time, equal to 17% of the labour force. Many of these may not be registered. Meanwhile, cooperatives seem to be on the verge of extinction. Since 1991, the number of cooperative societies declined from almost 27,500 to a mere 3,179 – an 88.4% drop. The yearly decline in the number of cooperatives has never been under 25%.

The evolution of the number of small entities is to a large extent reflected in the number of people engaged in these entities (see Table 6.2). The number of employees both in small enterprises and on farms grew rapidly in 1992, while in the following years growth rates declined. However, while growth was even negative for employment in small enterprises in 1994, it later picked up again. In 1996, it reached 11.3%. As mentioned earlier, the number of self-employed persons has constantly been growing, and although growth rates are slowing down, they remain quite high. As far as cooperatives are concerned, employment declined by 93.2% between 1991 and 1996, again indicating that this organizational form is rapidly becoming obsolete. As a result, total employment in the four types of small entities has been steadily increasing since 1992, by 7–15% per year.

Table 6.2 Numbers and growth rates of persons engaged in small entities in Ukraine, 1991–1996

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Small enterprises</td>
<td>636,986</td>
<td>910,856</td>
<td>1,038,227</td>
<td>986,443</td>
<td>1,042,425</td>
<td>1,159,700</td>
</tr>
<tr>
<td>% increase</td>
<td>100</td>
<td>143.0</td>
<td>114.0</td>
<td>95.0</td>
<td>105.7</td>
<td>111.3</td>
</tr>
<tr>
<td>Cooperatives</td>
<td>811,778</td>
<td>337,148</td>
<td>193,520</td>
<td>117,906</td>
<td>82,467</td>
<td>55,259</td>
</tr>
<tr>
<td>% decline</td>
<td>100</td>
<td>41.5</td>
<td>57.4</td>
<td>60.9</td>
<td>69.9</td>
<td>67.1</td>
</tr>
<tr>
<td>Farms</td>
<td>5,300</td>
<td>36,700</td>
<td>69,400</td>
<td>80,000</td>
<td>86,700</td>
<td>88,100</td>
</tr>
<tr>
<td>% increase</td>
<td>100</td>
<td>692.5</td>
<td>189.1</td>
<td>115.3</td>
<td>108.4</td>
<td>101.6</td>
</tr>
<tr>
<td>Self-employed</td>
<td>-</td>
<td>200,292</td>
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<td>&gt;1,000,000</td>
</tr>
<tr>
<td>% increase</td>
<td>-</td>
<td>100</td>
<td>213.0</td>
<td>157.6</td>
<td>127.9</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>1,454,100</td>
<td>1,484,992</td>
<td>1,727,741</td>
<td>1,856,606</td>
<td>2,071,171</td>
<td>± 2,310,000</td>
</tr>
<tr>
<td>% increase</td>
<td>-</td>
<td>102.1</td>
<td>116.3</td>
<td>107.5</td>
<td>111.6</td>
<td>± 111.5</td>
</tr>
</tbody>
</table>

Notes:
1. The table refers to active businesses which provided accounts to tax and statistical authorities.
2. Increase or decrease indicates the number of employees as a percentage of the number from the previous year.
3. The number of employees on farms is based on expert estimates.
4. Self-employed refers to registered self-employed. An estimated 70–80% of these persons pay taxes. It is assumed that the self-employed create employment only for themselves.


10 The number of active small enterprises, that is, the number of registered small enterprises that provide accounts to tax and statistical authorities, is substantially lower than the number of registered small enterprises. In 1992, the number of registered small enterprises was double the number of active ones. In 1995, it was three times as high, and in 1996 around five times as high.
11 For comparison, in the same year in Hungary, with a population around 20% of the size of Ukraine’s, some 200,000 small enterprises were active.
12 One of the reasons for this decline is that due to certain tax incentives many cooperatives were liquidated, and their property used to establish new small enterprises.
Over the years, there have been enormous changes in the property forms of small entities, especially when we look at small enterprises. In 1992, 25.6% of persons working in small enterprises were employed by small state-owned enterprises, 34.9% in collective forms of property, 33.5% in private enterprises, and 6% in other property forms. By 1996, this distribution had changed significantly, and the respective percentages were 2.6% in state enterprises, 69.2% in collectives, 28.1% in private enterprises, and 0.1% in other property forms. Small privatization has been more or less completed, and new small firms are privately or collectively owned (e.g. as joint-stock companies). It is interesting to note that the average number of employees in small enterprises fell over these six years, from 32.5 workers in 1991, 18.0 in 1992, and 12.5 in 1996. This reflects, among other things, a shift towards services. The same is true of cooperatives, where the average number of employees fell from 29.5 in 1991, to 19.5 in 1992, and 17.4 in 1996. Meanwhile the number of employees per farm has continuously been around 2.5.

As far as the sectoral distribution of employment in small enterprises is concerned (not taking into account the other small entities), in 1996 the lion’s share (around 60%) was absorbed by the service sector. Trade alone was responsible for 34.1%. Industry provided 20.6% of employment, while employment in small construction enterprises amounted to 17.3%. The dominance of the service sector, and particularly of trade, is consistent with developments in other transition countries, where in some cases it is even much stronger. On the one hand, the large share of services seems to indicate that small enterprises have succeeded, at least to a certain extent, in taking up one of the primary roles expected from them in the transition process – i.e. filling the service development gap from the past. On the other hand, it may rather indicate that the small enterprise sector is dominated by small-scale trade and related activities, which require little investment and provide little dynamism to the economy. The small share of industry in overall statistics clearly shows that small entrepreneurs are not (yet) taking up the role of innovative and flexible manufacturers. This reflects higher start-up costs for small enterprises in the manufacturing sector, the need for manufacturing enterprises to make longer-term investments necessary to be innovative, and overwhelming competition from larger enterprises and imports.

There is marked regional differentiation in the formation of small enterprises. While employment in small enterprises amounted to 4.8% of total employment in January 1997, in Kiev it reached 12.7%, in Sevastopol 10.1% and in Crimea 7.1%. On the other hand, in Chernigivska oblast it amounted to only 1.6% of total employment, in Ternopilska oblast 2.3% and in Sumska oblast 2.7%. This suggests that local circumstances may have an important influence on small enterprise development, an important factor to take into account when discussing small business promotion policies.

Based on the above, we can conclude that for the time being the formal Ukrainian economy and labour market are still very much dominated by large enterprises. The number of active small entities has remained very low and, as a consequence, so has the number of jobs created by them. Total employment in formal small entities reached around 2,310,000 in 1996, some 10% of total formal employment in the country. However, while employment in large enterprises continues to decline, in small entities it is growing, even if this growth is not strong enough to make up for the losses in large businesses. Unlike in many other transition countries, the small enterprise sector in Ukraine has not been able to act as a substitute for large enterprises. In section 6.4 (below) we will attempt to explain why this is the case. Before doing so, we should first say a few words about the informal sector.

### 6.3.2 Small enterprises in the informal economy

The informal economy consists above all of activities of unregistered entities which operate entirely outside the formal system. It also includes registered entities that report only part of their activities and

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13 Taking into account the peculiar definition of small enterprises in Ukraine, which favours the inclusion of industrial and construction enterprises over service-oriented enterprises, a ‘real’ sectoral distribution in Ukraine would also show a much higher share of service employment.

14 Apart from this, it is likely that a substantial share of included self-employment consists of second jobs, which would further diminish the importance of small entities in total formal employment. However, as mentioned above, other definitions suggest self-employment may be much higher, but labelled differently.
transactions to tax or social security authorities. As mentioned in Chapter 2, the number of informally self-employed persons is estimated at 4 million, four times the number of the formally self-employed.\(^\text{15}\) A survey of 200 small private businesses conducted in the fall of 1997 showed a severe underreporting of profits. Of the surveyed businesses, 44% reported only 50–70% of their profits, 16% reported only 30–50% of their profits, and 10% reported only 10–30% of their profits.\(^\text{16}\) Apart from this, the informal economy includes a large share of subsistence or ‘survival’ activities. More attention is given to the informal economy and its importance for the labour market elsewhere in this report. Below, we will touch upon the question of drawing more informal activities into the formal sphere.

6.4 Obstacles and policies for small enterprise growth

6.4.1 Obstacles for small business development

Slow development in the small business sector, especially in the formal sector, and its modest employment-creating capacity raise the question as to why it has lagged so far behind developments in other transition countries. At present, many factors have a negative influence on the creation and success of small enterprises in Ukraine. First of all, the development of the small business sector is seriously hampered by the general economic depression the country has been suffering since 1991. Depending typically on local demand, both the crisis in the large (former) state enterprises and decreasing real incomes in the population have made it more difficult for small enterprises to reach profitability and prosper. Also, economic instability and downturn have created a very unfavourable investment climate, with potential domestic and foreign investors being reluctant to risk their money in this unpredictable environment. The availability of investment credits is very constrained because commercial banks require very substantive collateral, interest rates are very high, and alternative credit institutions are underdeveloped. It is very difficult to obtain credits, especially for small enterprises.\(^\text{17}\)

But this is only one of many factors. The quality of the business environment depends to a large extent on the quality of the business rules and regulations set by the government, and on the way these are enforced. In this respect conditions have been quite adverse in the past seven years. The regulatory environment has been very unfriendly to business in general, and to small businesses in particular. The cost of operating in the official economy is thus unacceptably high in many cases, both in financial terms and in terms of time spent on dealing with issues related to government regulations.

Table 6.3 presents an overview of the obstacles to small enterprise development in Ukraine as they are perceived by small private enterprises. By far the most important obstacle of all is the level of taxes to which small enterprises are subject. This is consistent with the results of many surveys, and many government officials (from e.g. the Ministry of Economy), the SEC and employers’ organisations agree on this point.\(^\text{18}\) Small enterprises are treated in the same way as large enterprises, and it is repeatedly confirmed that the taxes they are required to pay at present (including 47.5% tax on the wage fund, a highway tax, 30% profit tax, etc.) make doing business in the formal economy too expensive and unattractive for them.

Apart from constituting too high a financial burden, the tax system is also very volatile and complex. This affects small enterprises much more than large enterprises, because generally they do not have the resources to follow the constant changes in tax laws or to manage a complex tax administration. Until recently, the self-employed were affected by similar problems.

\(^{15}\) Varnali, op. cit.
\(^{16}\) International Finance Corporation, Small Business Problems in Ukraine: Results of the Survey of Small Private Businesses in Dnipropetrovsk, Lviv, Khariv and Vinnitsa (Draft report, end of 1997).
\(^{17}\) This situation is also due to the immaturity of the Ukrainian banking system, which has a traditional bias in favour of large enterprises and does not (yet) consider small businesses as interesting clients. It is also attributable to negative experiences in the past seven years with unsuccessful small businesses unable to repay their loans.
\(^{18}\) It is almost ‘natural’ for entrepreneurs to complain about high taxes, and this is the case in almost every country in the world. However, the Ukrainian situation is generally recognized as quite extreme by national and international experts.
Further obstacles include excessive regulations concerning business registration and licensing, and the exaggerated frequency of inspections by various authorities. Registering an enterprise may be expensive, very time-consuming and complicated, and leave the future entrepreneur at the mercy of inexperienced and often arbitrary local officials. Until recently, licenses, equally time-consuming and expensive to obtain, were needed for 112 activities and more than 1000 sub-activities, an extremely high number. In a bold move, the number of activities requiring licences was reduced to 42 at the end of 1997, and further reduction is envisaged. Apart from this, small entities may be subject to inspections by numerous government agencies. Figures from the previously mentioned International Finance Corporation survey show that on average, small enterprises were inspected 78 times in 1997. The most frequent inspections were performed by the State Sanitary Service, the Committee on Protection of Consumers' Rights, the customs authorities, the Fire Safety Inspection and the tax inspection, on average six times or more per year.

Even more serious is the fact that entrepreneurs are frequently forced to make unofficial payments for official permits, licences, and so on. According to Kaufmann, in 1996 the average unofficial payment for enterprise registration was $176, for the installation of a phone line $894, for each visit of the tax inspector $87, for each visit by the fire/health inspector $42, etc. The persistence of such ‘implicit taxes’ further deteriorates the business environment and stimulates informality (according to Kaufmann the situation has worsened since 1994). Apart from unofficial payments to local government agencies, small businesses are also subject to racketeering by criminal organizations. Both show that the rule of law is not really guaranteed for small entrepreneurs.

Apart from the factors discussed above that form part of the business environment, direct support measures and institutions for small businesses are also scarce in Ukraine. For the time being, no

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**Table 6.3  Obstacles to small business development in Ukraine**

<table>
<thead>
<tr>
<th>Obstacles</th>
<th>Percentage of respondents indicating factor as obstacle to business</th>
</tr>
</thead>
<tbody>
<tr>
<td>High taxes</td>
<td>95</td>
</tr>
<tr>
<td>Many different taxes</td>
<td>82</td>
</tr>
<tr>
<td>Frequently changing tax reporting</td>
<td>70</td>
</tr>
<tr>
<td>Frequently changing legislation</td>
<td>60</td>
</tr>
<tr>
<td>Large number of regulations</td>
<td>47</td>
</tr>
<tr>
<td>Low demand</td>
<td>47</td>
</tr>
<tr>
<td>Clients who do not pay</td>
<td>32</td>
</tr>
<tr>
<td>Obtaining licenses</td>
<td>18</td>
</tr>
<tr>
<td>Difficulty in obtaining credits</td>
<td>16</td>
</tr>
<tr>
<td>Pressure from local administration</td>
<td>9</td>
</tr>
<tr>
<td>Insufficient knowledge of management</td>
<td>9</td>
</tr>
<tr>
<td>Pressure from criminal elements</td>
<td>5</td>
</tr>
<tr>
<td>Insufficient business information</td>
<td>4</td>
</tr>
<tr>
<td>Poorly developed real estates markets</td>
<td>2</td>
</tr>
</tbody>
</table>

Note: The table present results from a survey of 200 private small enterprises.


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comprehensive structure of institutions aimed at assisting small entrepreneurs through advice, training, information, incubator services or in other methods exists, in contrast with the situation in several other transition countries.\textsuperscript{20} International donors such as USAID and TACIS have established a number of business-centre type organizations, but their capacity is still very limited when compared to the size of the Ukrainian economy.

Finally, the (potential) small entrepreneurs themselves are of course also an obstacle to the further development of the small business sector in Ukraine. They have little experience in doing business and taking initiative, after a long history in which this was discouraged vigorously. Also, although it is clear that many small entrepreneurs are forced into informality, there is also a group which are not truly interested in developing productive, competitive of sustainable economic activities, but which rather try to make quick profits, deliberately exploiting deficiencies in regulations and enforcement. Some of these are established by managers of large enterprises, and benefit from the monopoly position of the mother enterprise.

Small entrepreneurs have until now also had limited success in self-organization and interest representation. Employers' organizations have had many difficulties in lobbying and convincing the government and especially parliament to improve entrepreneurial conditions. Still, employers' organizations have been very active in trying to promote business, both through strengthening the business environment and through direct support to small enterprises. In this respect, an important role has been played by the Federation of Trade Unions of Workers of Cooperatives and Other Forms of Enterprise, which has been playing a double role of protecting workers in small businesses and promoting the development of small businesses. Also noteworthy are the Union of Small, Medium-sized and Privatized Enterprises; the Ukrainian League of Industrialists and Entrepreneurs; and the Yednannya Association, a small business NGO.

The above analysis shows that conditions are rather unfavourable for the small business sector in Ukraine. The general depressed state of the economy limits business opportunities, as do the numerous rules and regulations. This has severely constrained the growth of the small business sector and has led to a significant flight to the informal sector. Most people operating in the informal economy do so because they see it as their best chance to make a living, which is hard enough under present circumstances. Apart from this, a genuine structure of support institutions is lacking and the capacity of small entrepreneurs is limited, which is also unfavourable to small business development. Below, we will discuss government policy concerning small business over the past few years, and how it could be improved.

\subsection*{6.4.2 Small business promotion policies}

Until 1996, a comprehensive small business promotion policy was largely absent in Ukraine, although several promotional measures were undertaken. Possibly the main shortcoming was a lack of clear direction in state policy and no clear commitment from the government to truly support small business development. Government policy was subject to frequent changes, had no clearly pronounced objectives and priorities, and the financial means available were very limited. Nevertheless, in the first years of transition the basis for enterprise development was laid down in several laws that made private enterprising, considered a crime in Soviet times, possible. Also, the State Committee on Enterprise and Small Business Support was established in 1991, the functions of which were transferred in 1995 to a special department of the Ministry of Economy. This body had a positive influence on small business development. In addition, the National Fund for Business Support and Development of Competition was founded in December 1991 with the aims of attracting and utilizing funds for the financial support of small enterprises, cooperating with international and national enterprise promotion organizations, and participating in international agreements on business promotion.\textsuperscript{21} This Fund, which became the Ukrainian Fund for Business support in 1995, has not yet become the important player it was meant to

\begin{flushright}
\textsuperscript{20} For example, both Poland and Hungary have developed an effective structure of small enterprise supporting institutions. The importance of such structures in the development of the small business sector is widely accepted and well documented.
\textsuperscript{21} Varnalij, op. cit.
\end{flushright}
be. In the years 1992–1995, it provided financial support to only 179 enterprises, in the total amount of 1.7 million hryvnya. Also, as mentioned in the previous chapter, the Employment Law now enables the possibility of promoting small business development through interest-free loans from the Employment Fund. The SES now also promotes the establishment and functioning of business incubators in some oblasts. For example, the deputy director of the Kyiv City Employment Centre reported in an interview that the Business Incubator in Kyiv, established with the help of the Rehabilitation Fund for Soldiers in 1997 and sponsored by the German government, has already trained 26 soldiers in business management. In seven small enterprises opened by the retrained soldiers, a total of 40 jobs have been created so far.

In 1996, things began to change somewhat. In April of that year, the Cabinet of Ministers approved the Concept of the State Policy on Small Enterprise Promotion, affirming that small enterprise development should be considered an integral part of socio-economic policy. Later, in June, an important step was taken by securing the constitutional freedom of enterprise. But it was not until 1997–1998 that the government really confirmed the importance of supporting small businesses and small business promotion. These years were marked by several potentially important events for small businesses in Ukraine.

In July 1997, through Presidential Act No. 737/97, the State Entrepreneurship Committee (SEC) was established. The SEC, a central body of the executive branch, has the aim of coordinating and implementing state enterprise promotion policy. Eventually, the SEC should have some 85 employees, 50 of whom were already in office in the beginning of 1998. For the time being, the SEC sees its primary task the creation of a favourable environment for business through the removal of obstacles and deregulation. To this end, it has been equipped with the power to modify regulations at the national or local level. The SEC will examine normative and legal acts at both the central and local levels, and if these are deemed obstructive to entrepreneurial development, the relevant entity will receive one month to adapt the regulation accordingly. If this is not performed in time, the act will be suspended pending adaptation.

This has raised great expectations among interest groups although some are also sceptical regarding the real effect of the SEC, taking into account for example that it cannot affect parliamentary laws. The focus on removing obstacles to business development, rather than on direct support to entrepreneurs, is not only a question of priorities but also of financial means. The SEC hopes in the near future to receive an entitlement to 5% of privatization revenues to finance its activities, and hopes to attract substantial funds from international sources. If successful, it wants to become active as well in micro-financing and establishing business centres, technology parks and other support institutions. For the moment, however, it has quite a limited budget, with which such activities are not feasible. Nevertheless, the SEC is now working together with several other government entities on a draft small business promotion policy valid until 2000. This policy is to include the creation of a support infrastructure, new job creation and the definition of priority sectors for small business development.

At the end of 1997, the Law on Entrepreneurship was adopted by parliament, making the registration of economic activities simpler and decreasing the amount of activities requiring licenses from 112 to 42. Also, in March 1998 a much simpler tax system was adopted for entrepreneurs, by requiring the payment of one single fixed tax per month of 20–100 hryvnya, to be determined on an individual basis by local governments. Apart from this, a proposal was sent to parliament to simplify the tax system for small enterprises, to grant certain privileges to small enterprises that invest in their business, and to levy a kind of fixed tax similar to that on the self-employed and on micro-enterprises with up to 10 employees. As mentioned earlier, at the beginning of 1998 the tax system for the self-employed was made much simpler, and similar improvements are proposed for small enterprises. Finally, in February 1998, President Kuchma issued a decree further urging deregulation and making this a priority of government reform efforts.

22 The fact that the SEC was formally established in July 1997 does not mean it became effective as of that date. In March 1998, it was still in the start-up phase.
In 1998, Ukraine’s economy is still based mainly on large enterprises. Small businesses play a modest role in the formal sector and provide approximately 10% of formal employment for the time being. However, there is also extensive development in the informal, unregistered sector. No doubt, a faster-growing small business sector with an increasing tendency towards formality should definitely be part of the strategy to lead the country out of the crisis it has been experiencing since the start of transition. Small business promotion should have three objectives: the creation of more small businesses, the sustainability of existing small business, and a gradual shift of small businesses operating partially in the informal sector towards the formal sector.

We can divide the promotion of small businesses into two dimensions: the creation of a supportive or enabling regulatory and political environment, and the direct support of small businesses. Although the two dimensions are complementary, for the moment the priority seems to be the improvement of the enabling environment. The recent publicity of the government in favour of private business development as well as the recent business promotion policies and further plans for the future are very welcome, but it is still to be seen how they will be translated into far-reaching reforms and stability. Political statements and decisions are not always backed up with implementation in practice. For example, it is not so clear how the SEC, which is now supposed to be the main institution for business promotion, will function or from where it will obtain the necessary funds to finance its intended actions.

Related to these factors is that government policy sometimes lacks a degree of legitimacy, in the sense that entrepreneurs do not feel they are sufficiently involved in policy making. In order to be effective, business promotion policies should be developed in close cooperation with entrepreneurs and their representative organizations, to increase acceptance and to assure they attend to the actual problems with feasible measures. Such efforts should be made at the central, regional and local levels, taking into account the importance of local conditions for business development. Dialogue should be given priority in the development of regional and local development and employment programmes. This may include the further development of regional and local departments of the SEC, and of employers’ organizations, which could take the lead in analysing local obstacles for entrepreneurs and defending their interests.

There is also a need to strengthen business development services and to provide preferential credits for small businesses. However, such measures typically are more time- and resource-intensive, and are much more effective when overall conditions are favourable for business development. In strengthening direct support to small businesses, both the Polish and the Hungarian experience of the last eight years could be very interesting for Ukraine. Both countries have developed a dense network of local enterprise agencies, business and innovation centres, local development agencies and other support institutions, complemented by a range of preferential credit services. The establishment and initial financing of such institutions and programmes is often handled by the government, in some cases with support of international donors such as the EU or the World Bank. Financing is also often partially covered by other existing funds, such as employment funds (e.g. for training), or regional development funds.
7.1 The need for local development initiatives in Ukraine

As in all Central and East European countries, the general economic and social crisis experienced in Ukraine since the start of transition shows different faces in different regions and localities of the country. There are two major types of differences. First, certain regions are doing better than others. They are relatively more successful in terms of income per capita, employment and unemployment, investment, or other variables – and these differences tend to be increasing. On many variables, the western regions are doing worse than average while the north and centre are doing better. In absolute terms, however, even the more prosperous regions may still be in a very difficult position. Second, the nature of the crisis itself differs between regions. For example, certain mining regions or regions previously dependent on the defence industry are faced by the fact that the activities which have dominated the local economy for decades are rapidly becoming obsolete, and the region has to develop replacement activities. Other regions with more diverse economies or that are focused on more promising industries may rather be worried about the upgrading of productivity and modernization of existing industries. Underdeveloped agricultural regions may face the task of preserving and upgrading their agricultural activities, while simultaneously attempting to develop new industries and attract investors.

Regional differences are generally a result of both ‘objective’ and ‘subjective’ factors. Important objective factors can be location (proximity to large cities or borders), urbanization, the age composition and educational level of the population, quality of infrastructure, entrepreneurial tradition and the type of industrial development during Soviet times which has established the existing structure of the regional economy. Among the subjective factors are local policy-making capacity, the kind and quality of local development initiatives, cooperation between local actors, and support received from national and international sources. Particularly the subjective factors have become more important since the start of transition, since development opportunities are of little value if not acted upon. Also, while obstacles to development may be high, they may be overcome with good, proactive policies combined with adequate resources.

One of the main conclusions from the above is that every region in Ukraine has its own particular problems and opportunities. National-level socio-economic policies often fail to take these differences into account and are therefore insufficient to fully explore various regions’ development potential or to attend to many problems faced at the decentralized level. Promoting economic growth and employment creation requires that national-level policies be complemented by a decentralized approach, based on the variety of local economies and promoting local initiatives. Therefore, local development strategies are needed that can combine a range of policy responses in a comprehensive programme tailored to the situation of a particular region. Experience in other transition countries as well as in western countries shows that, to be effective, local development strategies require the involvement of a broad range of local actors representing the interests of the local community and providing the necessary knowledge and experience in all relevant policy areas. Also, they should be primarily endogenous in nature, aiming to improve the local economic and social infrastructure, develop the area’s own resources, and create a high-quality enabling environment that stimulates economic activity and employment growth.

To a certain extent, local and regional programmes already play a role in Ukraine, inter alia through the development of regional Employment Programmes, as required by the Law on Employment of the
Population. Local governments, employment centres and the social partners are involved in the development of these programmes, and there is a growing awareness of the need for decentralized initiatives. Also, regional branches of national institutions involved in elaborating employment policy often participate in the development of regional programmes and in securing their funding. Such institutions include the Regional Coordinating Committees for Employment Promotion, regional branches of the National Council for Social Partnership, and the Coordinating Committee for the Social Reorientation of Labour Resources. Still, the impact of regional programmes is limited, their scope is often restricted to one particular policy area (e.g. labour market policies falling under the financial responsibility of the Employment Fund), and available resources are very meagre. In addition, there is simply little experience with decentralized policy making, and decentralization of decision making is a slow process. Promoting local development is not only a task for local actors – national actors, above all the national government, also have an important role to play. It is their responsibility to provide local actors with the necessary capacity and means to develop and implement local development initiatives.

We will now turn to a discussion of a local labour market development strategy based on the concrete case of the Chernobyl region. In particular, we will concentrate on the town of Slavutich, which suffers from very particular problems and deserves much more attention and support that it has been getting since the 1986 accident.

7.2 Development problems in the Chernobyl region

In April 1986, the world was shocked by the tragic accident in reactor 4 of the Chernobyl Nuclear Power Plant (CNPP), directly affecting the lives of millions of people in Ukraine, Russia and Belarus. Now, twelve years later, Chernobyl is still a matter of deep concern for the countries directly affected as well as for the international community. Continuous discussions and negotiations are being held between Ukraine, the EU and the G7. Negotiations focus mainly on reducing the danger of further accidents through closure of the plant, in exchange for international support to finance this operation and several further measures aimed at reducing the negative effects of the accident. Production of electricity at Chernobyl is supposed to stop completely by 2000, and at present only one of the four reactors is active. Securing the damaged reactor and decommissioning of the other three will still take an estimated 20 years.

However, negotiations do not always go smoothly, hampering the closing process and obstructing the financing and implementation of projects aimed at improving the socio-economical and ecological situation in the Chernobyl area. While the G7 and EU expect prompt closure, the Ukrainian side complains about a lack of financial commitment from the international community and of slow procedures in drawing up loans, especially from the EBRD. At present, the EBRD has managed to raise 50% of the required funds for the closure. Meanwhile, the Ukrainian government warns that the condition of the damaged reactor is worsening, and the risk of further contamination is growing.

Meanwhile, the population of the region suffers great problems, as their quality of life deteriorates and the prospects for the future are bleak. This concerns both the population still living in the Chernobyl area and the people evacuated in the aftermath of the accident.

The Chernobyl area has an agricultural tradition, and the population still living in the area mainly dedicates itself to agricultural production, now principally for its own consumption. Especially in zone

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3 See Chapter 4 of this Review, and Yatsenko, op. cit.
4 After the accident, the area affected was divided into four zones. Zone 1 is the plant itself, zone 2 its immediate surroundings (which were completely evacuated and where it is forbidden to live), zone 3 an area which really should be evacuated as well because of hazardous circumstances, and zone 4 which is declared safe. According to official statistics, the number of persons living at present in the Chernobyl zones is 2.35 million, of which 523,000 are children. Although forbidden, 11,171 persons live in zone 2, including 2000 children, while another 643,174, including 156,000 children, live in the third zone, which ideally should also be evacuated. The remaining 1,691,000 reside in zone 4, including 364,000 children. During the years 1986–1990, there were 90,784 persons evacuated from the area, and in 1991–1997 another 65,526 were moved to other regions. However, many persons do not want to leave their homes, and a substantial number of evacuees have returned to their former places of residence.
2 and 3, this causes great health problems because of the consumption of contaminated food. Although the inhabitants of the Chernobyl zones have certain privileges, such as the right to early retirement, in general one of the major problems of the area is lack of alternative employment possibilities. The main alternative offered is evacuation, but this has often not been very successful as the general economic crisis makes it rather complicated for most localities to absorb the inflow of evacuees.

Little specific attention has been given to alleviating the employment problems resulting from the Chernobyl accident, and for example neither the Ministry of Labour nor the State Employment Service have any special employment-related activities in the area. Both national and international aid focus mainly on safety, health, ecology and certain forms of social protection, obviously vital areas of attention but not sufficient. Any longer-term solution for the victims of the Chernobyl accident would have to incorporate actions to provide them with new opportunities to improve their living conditions. Access to productive employment in or outside the region is an important aspect of such a solution.

### 7.3 Local development promotion in Slavutich

Within the Chernobyl area, a very particular position is held by the town of Slavutich. The town, presently with a population of around 26,000 including 9000 children, was built after the 1986 accident just outside the contaminated area. Its aim was to house the workers of the CNPP and other evacuees. At that moment, the complete closure of the CNPP was not foreseen yet. The fate of Slavutich is very intimately connected with the future of the Chernobyl plant. In 1995, 12,000 persons (or 69.8% of the local labour force) were employed by the CNPP, in production or in other activities (see Table 7.1). Taking into account that most other jobs in the town depend on the income of the CNPP workers, Slavutich could be considered an extreme example of a mono-industrial or company town. According to projections, and assuming the plant will be gradually closed down and production will stop completely in 2000, the CNPP and related projects will provide only 4040 jobs in 2001, i.e. only 33.7% of the number of jobs in 1995 for only 22.2% of the local labour force. The number of jobs in the plant will decline rapidly, and is expected to reach zero around 2008.

<table>
<thead>
<tr>
<th>Table 7.1</th>
<th>Slavutich labour resources and projected employment in the CNPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour force, total</td>
<td>17,200</td>
</tr>
<tr>
<td>CNPP industrial personnel</td>
<td>6,500</td>
</tr>
<tr>
<td>CNPP non-industrial personnel</td>
<td>5,500</td>
</tr>
</tbody>
</table>

Source: Action Plan, Ukraine/EU/USA, Slavutich 1997

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5 However, many people prefer to continue to work because of the low level of pensions.
6 The State Employment Service has granted 19 of the districts determined to receive evacuees the right to obtain priority assistance in employment creation in the period 1997–2000. However, because of limited resources, the number of jobs to be created through this assistance meets a mere fraction of the needs. Evacuees may receive preferential treatment from local employment offices for placement in available vacancies. Their situation is far from satisfactory, though, and many have returned to the Chernobyl area.
7 However, in 1997 the EU, UNESCO and the ILO began some (so far limited) assistance in the area of economic development and employment promotion.
8 At present, very diverse opinions exist on the dangers of remaining in the Chernobyl area. While some argue evacuation combined with social benefits and assistance in searching for a job is the only feasible solution, others rather claim that those who wish to remain in the area should be able to do so and should receive access to clean food and medical assistance combined with support in developing small-scale productive activities.
9 Other activities include various services to the plant and its personnel which are owned by CNPP, such as housing and road maintenance, kindergartens, food and goods supply, etc.
Other jobs are being generated at present in related projects - mainly in waste management, decommissioning, securing the damaged reactor, etc. These jobs fall under the CNPP closure agreement laid down in the Memorandum of Understanding between the Government of Ukraine, the EU and the G7 in December 1995. These projects are expected to have a duration of over 20 years, providing around 2200 jobs at their peak (in 2002) and between 1200 and 1500 jobs in the period 2006–2026, when most will have finished. Also, part of the service activities of CNPP will be transferred to the municipality, and will continue to provide jobs if the municipal budget will be able to finance them.\textsuperscript{10}

Still, the net loss of jobs caused by the closure of the plant will be enormous in the coming years. For the moment, registered unemployment is still in line with the national average, amounting to 534 persons (or 2.42\%) in 1997. This was, however, already more than double the figure of 1996 (220 registered unemployed, or 0.82\%), and a rapid increase is foreseen by the local employment centre. According to its estimations, at the end of 1998 unemployment may exceed 16\% - also because it appears that many lay-offs were postponed until after recent elections. Little alternative employment is available, and currently there are only two other employers of some size - a transport company and a laser company with 500 and 80 employees, respectively. There are also a number of small enterprises in the town which are mainly dedicated to trade and commerce.

The danger for the town is clear: within a few years, it may lose its main source of employment and income, which may lead to very high unemployment, low incomes and poverty. This, in turn, is likely to lead to outward migration of the young and the highly educated, further undermining the future prospects for the town. Recognizing this danger, the local community is trying to develop activities aimed at diversifying the economic base of the town and at creating new productive jobs. The Slavutich Economic Development Council was established, comprising the municipality, the CNPP, entrepreneurs and trade unions, and serving as a forum to discuss and elaborate strategies for future development. In September 1997, together with TACIS and USAID, the town elaborated an Action Plan which analyses the problems faced and outlines a future strategy.\textsuperscript{11} It also presents detailed and comprehensive recommendations on creating an organizational and financial base for development in Slavutich and on starting the process of diversification, including a series of specific investment proposals aimed at outside investors.\textsuperscript{12} These proposals contain, among other things, a number of ideas for economic activities which can be developed to supply the projects planned under closure activities in the framework of the Memorandum of Understanding. To promote investments, the establishment of a local investment guarantee fund is also envisaged, combined with micro-credit provisions for local entrepreneurs (e.g. former CNPP workers) and improved access to other types of credits. Other included initiatives are an energy-efficient industrial park and a business incubator.

The Plan is mainly based on the belief that it will be possible to attract investors and funds to the town by offering favourable conditions. As argued by the town’s mayor, Mr. Udovichenko, such conditions exist for three main reasons: the positive attitude of the local government; good conditions for investment resulting from the fact that a special economic zone is being established in Slavutich with the support of the national government, offering tax and other privileges to investors; and the high educational level of the local population combined with the readiness of the town to offer necessary retraining for workers employed by new companies.

To support the implementation of the Action Plan, a Business Development Agency was established. The Agency is expected to play a significant role in promoting local small enterprises, attracting investment, attracting funds from national and international sources for other activities, and managing these funds.

The Action Plan is well conceived, and covers most important areas of attention. It provides a balanced view of a possible direction of development for the town and proposes a wide variety of initiatives for institutional and enterprise development, aimed at upgrading the environment for

\textsuperscript{10} The closure of the CNPP also means the tax income of the municipality will be drastically reduced.

\textsuperscript{11} Action Plan, Ukraine/EU/USA, Slavutich 1997.

\textsuperscript{12} The Action Plan includes a list of 19 investment projects ranging from the production and sales of fire extinguisher powders to the development of a local telephone network. Together, these would require an investment of around USD 118 million and would create 2424 jobs.
economic activity through specific investments in production and services. In this sense, it seems to meet the requirements of a development strategy. Unfortunately, as repeatedly mentioned by representatives of the local community, it is not more (nor less) than a plan, without the necessary financial or investment commitments, and does not guarantee implementation. One of its main pillars, the attraction of high-quality investments, may prove quite difficult for Slavutich. Offering tax and other incentives through the establishment of a special economic zone may make investment more attractive to certain enterprises.\footnote{The experience in other countries with such initiatives is mixed. Some have been successful, while others have not. The enterprises established through such incentives are not always the most viable ones, and are not always interesting in terms of longer-term development. In some cases enterprises attracted by financial incentives turn out to be rapidly unprofitable once the incentive is abolished. Also, they sometimes do not have a real long-term commitment to the local economy, and may move away as soon as better incentives are offered elsewhere. See e.g. W. Sengenberger and M. Keune, 'The Role of Proactive Policies for Employment Creation at the Industrial and Regional Level: International Experience', in For More and Better Jobs in the Russian Federation (ILO-CEET, Budapest, 1996).}

The attractiveness of a town or a region for investment depends on many factors, and Slavutich has both stronger and weaker sides. The factors mentioned above by the Slavutich mayor, the positive and business-oriented local government and the pro-active attitude of the local community in general are indeed advantages, which have already led to the establishment of important bodies such as the Economic Development Council and the Business Development Agency and to the elaboration of a strategy for development. They are an expression of the fact that the local population is attempting to forge its own destiny and taking responsibility for its own future. Concerning the available human resources, the educational level of the local population is indeed high. This would suggest that enterprises may find the Slavutich labour force attractive, especially when retraining is offered at subsidized rates. On the other hand, the professional orientation of the local labour force is restricted to a limited range of professions. Also, the workers of Slavutich are used to higher-than-average salaries, which may make negotiations with new enterprises more difficult.

Unfortunately, many other factors seem to make the town less favourable for investment activity. First of all, many investors will be scared off by the simple fear of contamination and health problems. Also, the fact that Slavutich is situated in a rural area some two hours away from Kyiv may prove an obstacle, as well as the limited infrastructural development in the region. Due to the extreme mono-industrial character of the town, another major disadvantage is the lack of other enterprises. There are only few enterprises offering business services, and few that could be potential suppliers or clients of newly established companies. To a certain extent, this may be overcome by the future activity of enterprises participating in the decommissioning and securing of CNPP, but this effect will be limited and temporary. In this sense, Slavutich is not very interesting as a market, and external markets will have to be accessed by companies operating from the town.

Employment creation through enterprise initiatives or the self-employment of the local population is confronted with similar difficulties. There is only a rather small consumer market, and only few enterprises to which goods and services can be offered. Apart from this, it is difficult to obtain credits, little experience exists with business and management, and few support institutions are present to assist starting businessmen. For the time being, the main activity of the new small enterprises is retail trade (74%) and only 2% of small firms are dedicated to manufacturing.

Taking into account its recent history, it is no surprise that it is unlikely the town will be successful without further assistance from the national government and international aid. A more specified participation from their side in the future development of Slavutich would also be more than appropriate. There has been a good deal of understandable criticism from the side of workers and trade unions that no suitable social plan has been elaborated for the (former) CNPP workers to soften or compensate for the loss of employment and income. The exceptional case of the CNPP demands that both the Ukrainian government and the international community, which is pushing for closure of the plant, take a certain responsibility for the future of its workers and their families. There are two main ways of assistance open to aid initiatives.
The first means of assistance is (temporary) income compensation for redundant workers and the promotion of their re-employment. This may include a variety of measures, ranging from financing social benefits and early retirement for older workers, to subsidizing retraining, employment creation and self-employment. There are many good examples of redundant workers receiving this kind of assistance as part of the lay-off process in other transition countries.\footnote{See Chapter 5 of this Review. Other examples from transition economies can be found in G. Hansen and M. Heidkamp, ‘Innovative Approaches to Worker and Community Adjustment in Hungary’ and A. Nesporova, ‘An Active Approach towards Regional Restructuring: The Case of Ostrava, Czech Republic’, both in M. Keune, op. cit.} It is both important to prevent the workers from falling into poverty and to secure at least a certain level of local demand, vital for the development of new, small enterprises or self-employment. Such assistance could be funded through a special social fund, partially financed from the Chernobyl Fund and partially from international sources.

The other possible means of assistance is to make a general contribution to sustainable economic development and job creation in the town. The Action Plan presents many good opportunities for this, including financial support to the planned Investment Fund or Business Incubator, preferential treatment of local companies in CNPP closure and decommissioning projects, institutional support to the local employment centre or Business Development Agency, and investment in local and regional infrastructure. The main objective of such assistance would be to improve the conditions for enterprise development and investment promotion. Through the investment fund, for example, particular investment projects with attractive employment-generating effects can also be supported. A recent Decree of the President, establishing a free economic zone in Slavutich, is another important step forward towards creating a stimulating environment for business development, with potentially positive effects on economic restructuring and on the generation of new employment opportunities if this initiative is properly enhanced.

Further assistance to Slavutich is imperative, and the actors involved should accept their responsibilities in the implementation of the Action Plan and in making full use of the favourable conditions provided by the free economic zone.

7.4 Concluding remark

Even though the situation in the Chernobyl region and the town of Slavutich is exceptional and extremely difficult, it is not the only problem region in Ukraine. As mentioned earlier in this chapter, there are many regions and towns experiencing severe social and economic crises. In particular, the situation has become extremely difficult in regions where the regional economy is dominated by companies of the coal mining and defence industries facing large-scale staff cuts. Unlike the Chernobyl region, many such regions receive little attention or assistance from national or international institutions. Still, they have to develop an answer to the crisis, even though they are lacking the necessary resources and knowledge. Developing such solutions will have to start by bringing the local actors together and discussing the region’s problems and opportunities. Based on such discussions, a local action plan – or, in a more refined sense, a local development strategy – can be elaborated. Such a plan will outline activities aimed at economic revitalization, job creation and income generation, specify how scarce resources will be used, and suggest how additional resources may be obtained. The government and other national and international institutions can promote such processes by providing local actors with the necessary knowledge and information and by directly or indirectly providing support to development initiatives.
CHAPTER 8: TOWARDS IMPROVEMENT OF NATIONAL
EMPLOYMENT POLICIES

8.1 Introduction

The previous chapters have analysed a variety of economic, employment and social problems faced by Ukraine which have led to diminishing employment opportunities and a deteriorating quality of jobs, including widespread ‘informalization’ of the economy. Some important labour market problems have received special attention and policy suggestions have been provided to contribute to their solution. These include the non-payment of wages, the absence of income protection for workers on unpaid leave and short-time work, as well as employment problems in crisis regions and unsatisfactorily low job creation by small enterprises (which would be expected to create most new jobs, as in other countries around the world). Detailed recommendations have also been given with the aim of improving the functioning of labour market institutions.

This chapter will suggest some major elements of a national employment policy which could result in an enhancement of demand for labour and improvement of job creation. Employment policy is considered in a broad sense here, as a comprehensive multidisciplinary policy approach towards the country’s employment-related problems. These problems cannot be addressed by traditional employment and labour market policies alone; rather, policy responses should have an economic, structural, educational, income and social dimension.

Accordingly, improving the employment situation is not only a task for the Ministry of Labour and Social Policy and the State Employment Service. Employment goals should take a central place in all economic and political decision making. At the governmental level, the Ministry of Education and all economic ministries have a clear responsibility, as well as regional and local governments. Apart from these, regional labour market and social institutions, enterprises, educational facilities, and of course the social partners have an important part to play. While the role of each of these actors in the process of employment promotion may differ depending on their specific interests and responsibilities, they should all share the major objectives of economic and social development of the country and act in concert in order to overcome the existing problems and achieve the desired objectives.

A broadly based employment policy has well-identified short-, medium- and long-term objectives. The short-term objectives are mainly oriented towards the social protection of displaced workers and assistance in their re-employment, facilitated by active labour market measures, employment assistance to new labour market entrants, and support for new job creation. In the medium term, national employment policy should concentrate on: promoting labour demand by stimulating economic growth and forming a supportive environment for business and investment, able to create new and productive jobs; upgrading human resources and improving of the quality of the labour supply; promoting employment restructuring to make employment more productive; and guaranteeing reasonable wages and incomes. In the long term, the goal will be the achievement of full, productive and freely chosen employment of good quality, with equal opportunities for all workers, regardless of their age, gender, or ethnic and social origin, in an economically and socially prosperous country.

8.2 Beyond macroeconomic stabilization

In the three years after the new economic programme was launched in 1994, Ukraine achieved some remarkable successes in stabilizing its national economy. Consumer price inflation was curbed from a five-digit level in 1993 to just 10% in 1997. In the same year, the balance of foreign trade returned from red figures to a small surplus, and retail trade turnover increased for the first time since 1991 despite a further fall in real wages. These achievements clearly show that despite the many problems still faced by Ukraine, economic stabilization is gradually gaining momentum. However, this is not enough. Macroeconomic stabilization is the first step on the way to sound, balanced and sustainable economic and social development in independent Ukraine. The achievement of sufficiently high and sustainable
economic growth, accompanied by a significant restructuring of the national economy, is now necessary for a recovery of demand for labour and employment. Increased production levels will lead to more jobs of better quality, higher wages for workers and improved profits for enterprises. Higher employment, incomes and profits will then stimulate demand for investment and consumer goods, with a positive feedback on production and employment. Economic growth should be actively promoted and should based on both external demand and on the domestic market.¹

A substantial amount of investment is needed to replace old equipment and upgrade the technological level of production in enterprises. Investment is also necessary for enterprise restructuring directed towards diversification of production and product innovation in accordance with changing demand in the market. Enterprises in general lack their own resources for investment, due to low sales revenues. Bank credits at high real interest rates are too expensive and unaccessible for many enterprises, particularly smaller ones. Domestic investors prefer to invest abroad due to high political risk and low returns on capital at home. The amount of capital flight from the country has been estimated at USD 15–20 billion in the period 1991–1995.² For the same reasons, the inflow of foreign direct investment to Ukraine is very low as well. The economic policy of the government has a dual task in promoting investment activity and job creation capacity in the enterprise sector – the overall business climate needs to be improved to make investment safer and more profitable, while at the same time directly stimulating investment and economic restructuring through a sound industrial policy. Below, only some principal ideas will be highlighted, since a more detailed discussion of these issues would go beyond the scope of this Review.

Achieving a favourable business environment is dependent on a viable monetary and fiscal policy as well as on the relative economic and political stability of the country. First of all, the state should guarantee the rule of law and the full exercise of property rights to all proprietors and investors, to convince potential investors that investing in Ukraine is safe. Second, tax rates on profits as well as other taxes imposed on enterprises should be lowered to reasonable levels to leave enterprises more resources for investment and to encourage them to invest. Third, the extent of administrative control over enterprises should be moderated, as it has proven to have counterproductive effects. A serious effort is necessary to reconsider the usefulness of many regulations and to gradually remove obstacles to business development and investment activity.³ Fourth, the access of enterprises to bank credits should be improved through better investment policies on the part of commercial banks. The banking sector in Ukraine is still very weak, both in terms of capital assets and know-how. Strengthening the banking sector through restructuring, privatization and recapitalization of commercial banks (with the help of domestic and foreign capital) would increase the confidence of both financial investors and the population in Ukrainian banks. This would result in higher savings, which could be converted into credit resources for investment. This will be particularly important for SMEs, as large industrial enterprises have somewhat greater possibilities to obtain credits and subsidies.

Special attention needs to be devoted to prices, to prevent large fluctuations in the inflation rate which would increase inflation expectations for investors and discourage investment. It is also important to gradually remove persisting distortions in relative prices, as existing price relations give the wrong signals to economic subjects as well as to policy makers. As inflation is to a large extent generated by imbalances in public finances, one priority of the government is to make substantial progress in the reduction of the large state budget deficit. Similarly, as in other transition economies, budget revenues are lagging behind expectations as well as behind actual expenditure. Low budget revenues mainly result from the low level of economic activity, combined with poor tax collection. Tax rates in general are excessively high and selective. Therefore, there is a need to review the tax system with the aim of decreasing the tax burden for the enterprise sector, broadening the tax base, and simultaneously strengthening enforcement mechanisms.⁴

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¹ Promotion of external and internal demand will be discussed in section 8.3.3.
² Borodyuk, Turchinov, Prikhodko, op. cit.
³ See Chapters 2 and 6.
8.3 Industrial policy

Despite the urgent need for massive structural changes in the national economy, the Ukrainian government does not seem to have a clear industrial policy, except in certain sectors, such as coal mining. However, the experience of both economically advanced and newly industrialized countries shows that the state can play an important role in promoting structural adjustment of the national economy to changing market conditions and in strengthening the enterprise sector to become more competitive both in the domestic and external markets. Only economically strong enterprises can offer good, well-paid jobs to their workforce and eventually create new ones.

Industrial policy covers such important areas as the improvement of infrastructure, promotion of investment activity in the enterprise sector (and consequently sectoral and regional restructuring), stimulation of the demand side of the economy, promotion of SMEs, etc. In this way, industrial policy can play an important role in promoting increased competitiveness and creation of new enterprises and jobs, and thus in achieving employment objectives.

8.3.1 Investment in infrastructure

Ukraine is lagging behind most other European economies in transition in the development of infrastructure - not so much in quantitative terms, but in terms of quality. The necessary, regular maintenance of infrastructure has been neglected and existing capacities have not been upgraded, which discourages potential domestic and foreign investors from setting up new businesses or investing in existing firms. Since independence, Ukraine has gradually diversified its trade and other contacts from ex-Soviet republics in favour of its western neighbours and other countries, but these efforts are seriously impeded by underdeveloped transport connections and obsolete telecommunications. The modernization of one of the main railways connecting eastern Poland with western Ukraine and eastern parts of Slovakia and Hungary, recently agreed among these four countries, is the first important action to improve transportation connections. This may have a potentially large effect on the economic and social recovery of the most backward parts of the four involved countries, generating new employment opportunities there. It should be followed by many more efforts in the same direction.

A substantial increase in investment in all parts of infrastructure is very important. This investment may come from public (state or local) resources, or the state may encourage private investors and regulate the provision of services in order to prevent monopoly pricing and facilitate good access for all economic subjects to these services.

8.3.2 Promotion of regional and enterprise restructuring

The multiplier effect of infrastructure investments on business promotion and job creation in the involved regions can be further strengthened through incentives for private investment. This is particularly important in regions facing economic crisis and high unemployment due to, for example, their prevalent concentration on declining industries or their rural character. Ukraine has identified five groups of such crisis regions (called territories of preferential development), requiring special economic and social policies for recovery. Such policies may range from tax concessions for newly established or expanding businesses generating additional jobs, through other investment-promoting measures such as accelerated depreciation, indexation of fixed assets, tariff-free imports of high-technology investment goods or investment grants, to or the establishment of free economic zones. Active labour market policies can also significantly contribute to employment generation. The selection of regions as well as

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5 However, even though in the coal industry a restructuring strategy has been prepared that envisages the gradual closure of non-viable mines while restructuring viable mines with the aim of improving production efficiency, in reality the strategy is being implemented very slowly. The reasons are scarce financial resources, both for the technical and social costs associated with the closures of unprofitable pits and for the modernization of viable mines, as well as socio-political pressures. However, the fact that unprofitable coal mines are kept in operation is also one reason for the non-payment of wages in this sector.
the applied mix of policies should be based on transparent, well-justified criteria, taking into account specific local circumstances and problems. Policies should be designed in the context of broad regional development strategies with clear employment objectives, with the strong support of all key regional economic and political actors as well as the national government.\(^6\)

A similar approach would be useful for promoting enterprise restructuring and development. Selection criteria and concrete promotion measures should be based on the economic viability of projects submitted and assessed by qualified investment experts. Three general selection criteria should be applied. First, preference should be given to economically sound projects oriented towards output with higher value added. Second, promotion should focus on technologically advanced, effective production that would utilize the available skilled labour, accumulated know-how and modern capacities (e.g. of the declining defence industry), helping modernize the economy. Third, the employment effects of investment projects should be carefully studied.

Private investment can be further promoted through special financial institutions, often set up with the support of national and regional governments.\(^7\) These may take the form of investment funds, investment banks, guarantee funds, etc. and may specialize in certain sectors, types of activity or forms of enterprise. Their role is to assess the viability of submitted projects and credibility of investors, to facilitate the access of trustworthy investors to investment credits and guarantees, and to provide them with venture capital or even combine financial support with business counselling and other services.

In the period of transition and for some time to come, many enterprises will need assistance in their effort to adjust to new economic conditions and become competitive. Without assistance, many are likely not to be able to adjust rapidly enough to the new reality, leading to often unnecessary losses of employment. Assistance may include business management training, business counselling, assistance in access to resources and new technologies, human resources upgrading, retraining of workers with obsolete skills, marketing and sales, assistance in finding external investors and business partners, etc. Such assistance may be provided in cooperation with employers’ organizations, chambers of industry and commerce, labour offices, or other institutions. Also, state or regional governments may stimulate the establishment of specialized institutions offering such services (usually of a non-profit character, and particularly in crisis regions). The state may partially or fully subsidize the costs for enterprises in crisis regions or in one-company towns, on the condition that these enterprises are potentially viable in the longer term, and that they submit a feasible restructuring plan and make commitments concerning employment (e.g. no lay-offs for a certain period).

Special attention should be devoted to the support of SMEs, which are still underdeveloped in Ukraine and could become a major source for new job creation, as in other countries. The reasons for the very slow development of this sector are numerous: the persisting transition crisis; an unfavourable regulatory environment for business; high taxation; administrative obstacles; lack of business skills; absence of special credit schemes and support services for SMEs, and other reasons. If the sector is to contribute significantly to the generation of national wealth and productive employment, a consistent promotion policy of the state is needed. The main objective of such a policy is to create a supportive regulatory and political environment for SMEs and to develop a viable system of support institutions and policies aimed at strengthening existing firms and opening up opportunities for new firms.\(^8\)

Incentives should also be used to attract foreign direct investment, especially in certain regions or other fields of state priority. Besides a favourable general climate for private investment, tax reductions or other similar concessions could be offered to FDI that brings new technologies to Ukraine or that contributes to upgrading the technological level of domestic production, resulting in the better use of skilled labour and the higher utilization of existing capacities. Foreign investment in higher value-added production should be particularly encouraged. Apart from technological gains and innovations in the country’s

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\(^6\) The potential benefits and obstacles of this approach are discussed in Chapter 7 on regional labour market restructuring.

\(^7\) The experience in other countries shows this is more effective than direct support to enterprises, and also more likely to prevent the unjustified use of funds.

\(^8\) These issues are more fully discussed in Chapter 6, on SMEs.
production pattern, a larger inflow of foreign direct investment in new and existing privatized enterprises could bring in new working practices, improved work organization, modern management skills, better quality control and other non-investment factors improving productivity.

8.3.3 Promotion of external and internal demand

Ukraine is vitally dependent on its foreign trade performance. So far exports have been concentrated in coal, steel and other raw materials, products with low value added, and agricultural products and foodstuffs. As the world market for these commodities is saturated and therefore highly protected in most economically developed countries, the prices are rather low and profits marginal. Nevertheless, these are the areas where Ukraine currently has comparative advantages, and the state, through its export policy, should promote a further expansion of exports. The terms of trade for Ukraine will improve substantially after it joins CEFTA, as planned, while establishing more favourable foreign trade agreements with other CIS countries and concluding an association agreement with the European Union. In the longer run, however, it is in the interest of Ukraine to upgrade and diversify the commodity structure of its exports by increasing the level of exported products with higher value-added items that better utilize skilled labour. The success of such a strategy will depend on the scale and speed of improvements in the effectiveness and competitiveness of domestic production, but also on the intensity of trade contacts, skills of traders and the extent of provided export services.

Export promotion measures may also be an important factor for improving the country’s export performance. Economically advanced countries stimulate exports by providing exporters with special export credits and credit guarantees, especially for exports to less safe territories. Therefore, it is important to establish or strengthen specialized institutions offering such financial services to exporters. Similarly important are other services to exporting firms, such as information on markets, prices or trade connections; facilitation of contacts among firms; subsidies for participation of domestic firms in trade fairs abroad, etc. Particularly significant is institutional assistance for small and medium-sized firms, as their access to foreign markets is constrained by a lack of resources to explore new markets, obtain information on world prices and other trade conditions, exhibit their products at international fairs, and so on.

However, Ukraine also has a large domestic market, and enhancing domestic demand could be an important stimulus for economic growth and employment generation if the supply side reacts in time and with the required variety of quality goods and services. Although domestic demand, both for investment goods and consumer goods and services, is still rather depressed as a result of the modest real incomes of both enterprises and the population, the first symptoms of recovery are already visible. Domestic enterprises should use this chance and make every effort to satisfy internal demand as much as possible. Although it is basically the task of individual enterprises to find a way to adjust to these new market conditions and compete with imports, the state has an important role to play in facilitating and stimulating this adjustment by creating a business-friendly economic environment, supporting enterprise restructuring and attracting foreign investors to cooperate with domestic enterprises.

This could be accompanied through a reasonable policy, temporarily and under clearly defined conditions, to protect domestic producers against imports, particularly imports of consumer goods or less sophisticated machinery that are also produced in Ukraine. As mentioned before, domestic producers need a certain amount of time to adjust to the new market conditions and improve their competitiveness and the marketability of their products. Their premature exposure to an abrupt

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9 The question of whether to protect domestic producers or not is very sensitive. Although the Bretton Woods institutions and the WTO advocate free trade and the abolition of protectionist measures, in reality all countries, including economically advanced ones, protect domestic producers in industries which are significant for the country and where they do not have comparative advantages for various reasons. Ukraine, with its weak national economy, can hardly afford to refrain completely from protectionist policies.
competition of imports could cost too many jobs. Such a policy should be very selective, based on a deep assessment of the anticipated prospects for profitability of protected production segments in the short and long term, and should clearly specify time frames. The latter is necessary to avoid excessive, longer-term protection that would inevitably lead to unnecessary delays in enterprise restructuring, with negative impacts on productivity, product innovation and competitiveness – a pattern so well known from the past.

8.4 Need for an improved wage policy

The deep fall in real wages and incomes experienced by the Ukrainian population during the transition period has been reflected in a sharp decline in consumption. Large parts of the population have fallen into poverty as the real minimum wage, pensions and social benefits did not play their role of guaranteeing a minimum subsistence income. Moreover, the substantial wage, pension and benefit arrears accumulated after 1994, as well as increasing income losses in connection with administrative leaves and forced short-time work, further decreased real incomes. Although the negative trends in real incomes helped avoid mass unemployment over a certain period, they resulted in depressed demand in the formal market while stimulating the growth of the informal sector. Consequently, they have had a negative effect on production and employment, delayed employment restructuring and actually contributed to the prolongation of the transition crisis.

Although the minimum wage was substantially increased in early 1998, this was only a first step towards restoring its role as a minimum social guarantee for workers. The level of the minimum wage is even more important because wages in the public sector are connected to the minimum wage through a centralized wage tariff system, and because many social benefits are also linked to it. The minimum wage should therefore become a subject of regular negotiations with the social partners, with the aim of gradually increasing it to and above the level of the subsistence minimum.

Orientation figures for the enterprise sector on wage increases should be agreed in tripartite collective negotiations at the national level, while actual wage increases should be negotiated at the decentralized industry and enterprise levels in order to properly take into consideration the actual situation there. In general, payment systems should be more closely related to productivity and economic performance by integrating elements of profit-sharing, profit-related pay, etc. This may have a positive effect on wage flexibility and worker motivation in enterprises, while simultaneously promoting sound employment restructuring in declining as well as in more prosperous sectors and enterprises. The longer-term goal of decentralized wage fixing and a closer relationship between wages and productivity is to ensure the fair distribution of returns on production between capital and labour, while motivating both to higher performance and effectiveness. All these changes should consequently lead to a reversal of negative real wage developments, with positive impacts on domestic demand for goods and services, production, job creation and employment.

The problem of the non-payment of wages, pensions and social benefits is very serious, and its solution should receive the highest attention of the government. It is ultimately the task of the government to stop this unlawful practice, primarily by repaying its own arrears and thus providing a good example to the enterprise sector; indeed, the recent initiatives have brought some positive results. The government, in close cooperation with the social partners, should formulate and implement a multidimensional action programme, based on both economic measures and legislation. Economic measures should include strengthened financial discipline in the economy (inevitably leading to a steep increase in the number of bankruptcies of unprofitable enterprises), a reduction of taxation on enterprises, the elimination of barter trade, etc. Legislative actions should include increasing the responsibility of employers, giving more power to labour inspectors to impose appropriate sanctions, and improving capabilities for monitoring the problem of arrears and achievements in its solution in order to gradually bring the problem under control.\footnote{For a more detailed discussion of the problem of wage arrears, see Chapter 5.}
8.5 Need for upgrading of human resources

Structural changes in the national economy directly affect demand for skills in the labour market. Many professions, mainly in the declining industries, have become fully obsolete or their requirements have substantially changed, while many new professions connected with modern technologies and the functioning of a market system are in shortage and in high demand. These skill mismatches are partly reflected in the discrepancy between skill requirements for vacancies reported to the SES and the number and skill composition of jobseekers registered at the SES. However, as jobs requiring higher skills are frequently not reported to or occupied with the help of the SES (just as many skilled specialists are looking for new jobs through other channels than the SES), many of them remain less visible. These skill mismatches call for a proper response from the national education and training system.

An analysis of the educational system and developments after 1990 shows several important new trends, very similar to those in other transition countries. First, a tendency towards improvement in the level of education of the population aged 15 and over has continued. The 1979 Population Census found that 681 in every 1000 persons aged 15 and over had received secondary or higher education (both finished and unfinished); in 1989, this figure was 794. According to the Labour Force Survey, this number had increased to 857 persons by 1996. This is mainly the consequence of increasing numbers of students in secondary and higher schools and universities in the age group of 15-24.

Second, substantial shifts have occurred in the distribution of youths attending various types of educational facilities. In general, institutions providing education and training for blue-collar professions have lost trainees – some 40% between 1985 and 1996. In higher education (rather surprisingly in comparison with other economies in transition), the proportion of students in college education has fallen in relation to full university education. The interest of students has also shifted from technical disciplines towards economics, law, management, psychology and similar social disciplines.

Third, the range of educational facilities has been enriched by a number of new non-state institutions, which are competing with traditional state facilities. These new institutions specialize mainly in the provision of secondary and post-secondary education for new market skills – business management, marketing and sales, banking, economics, etc. In principle, they do not receive subsidies from the state, and rely primarily on fees from students. State-funded institutions have also been allowed to take up a number of students (particularly those who did not succeed in entry examinations) who pay for their studies. Adult training and skills upgrading is provided in certain schools, in training institutions that focus on youth and in specialized facilities. Training facilities may be funded by the state or large enterprises, or privately owned. The state monitors and controls the quality of education through an accreditation system, giving licences to schools for teaching, awarding diplomas, etc.

Nevertheless, the speed of changes in the system of education and training in Ukraine is still too slow. This is primarily due to a lack of funding for schools, and training institutions with poor equipment and largely outdated means of instruction. Many schools are forced to seek money elsewhere, thus orienting themselves more to short-term goals without proper attention to longer-term trends in the demand for skills in the labour market. This may further increase labour market tensions in the future. In addition, little is done to update methods of education and training, which are mainly based on passive memorization – active learning, directly leading to better utilization of newly gained knowledge in practice, is underdeveloped. Because of low salaries, teachers are not motivated to be innovative in their way of teaching or to acquire new methodologies. Often they have to devote much of their energy to earning additional income.

Apart from the above, overly narrow specializations of professional education and training seem to be persisting, although currently the list of specializations is being reduced and upgraded. Nevertheless, modular and flexible types of training, as well as interdisciplinary training and studies, are still very rare in Ukraine. This results in lower job placement chances for school leavers and a

need for their early retraining. Adult training still receives a low priority. Adult jobseekers and employees in need of retraining or skills upgrading often have access only to lower-quality training, and the special requirements of adults in contrast to youths are not yet properly reflected in the methods of instruction. All this makes the Ukrainian education system respond less effectively to new market challenges.

In terms of funding for the education system, Ukraine spent approximately 5% of GDP on education in 1996. This is about average in comparison both with economically advanced countries and with other countries in transition. However, the state could transfer a part of funding, particularly for vocational and adult training, to the enterprise sector. This would increase the sector's involvement and control over this part of education, which could be achieved, for example, by introducing a levy or grant system as in many market economies. In return, the state should stimulate greater engagement of the enterprise sector in professional training through appropriate measures (e.g. tax reductions or tax exemptions) and co-finance the retraining of workers with obsolete skills in enterprises undergoing restructuring – particularly in depressed regions, as suggested above. The motivation of teachers should be increased by improving their very poor salaries and upgrading their skills, while simultaneously reducing the excessive number of teachers to a level usual for middle-income countries.

It is also important to review the territorial distribution of schools and training institutions, in order to ensure that they will properly respond to the specific and changing needs in terms of their location, specialization, skills in demand by enterprises and institutions, accessibility for students, etc. The schools should be encouraged to become more responsive to the needs of their regional labour markets through close contact with regional labour offices and employers.

The system of adult training should be significantly strengthened in terms of methodology of instruction, the extent and quality of training, and availability (particularly in regions with high unemployment). For the SES, as the lead agency organizing adult training for unemployed jobseekers, it is very important to be well informed about changes in demand for skills, in order to orient the vocational training of jobseekers to those professions and skills that are in shortage on the labour market and that promise good job placement possibilities after completion.

8.6 Protection of migrant workers

Migration of Ukrainians for work abroad dramatically increased after 1991 – particularly to neighbouring countries. Many legal (and even more illegal) migrant workers are confronted with detrimental working and living conditions in the receiving countries. They have problems in accessing medical care and social protection, and little protection against low remuneration, dismissals, occupational accidents and diseases, and other risks.

Any substantial assistance by Ukrainian authorities to migrant workers is impeded by the lack of information on the extent of migration, both within and outside Ukraine. Official data on labour migration often underestimate even legal migration, not to mention illegal migration. Little information is available on the composition of migrant workers by age, gender, education, marital status, and other characteristics.

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12 Analysis of Macroeconomic and Social Trends in Ukraine, op. cit.
13 In the countries of the European Union, the share of education in GDP in the early 1990s was in the range of 4.25% (in Germany) to 7.5% (in Denmark). See OECD, Reviews of National Policy for Education: Hungary (OECD, Paris, 1995). Among the countries in transition, Hungary allocated 5.5% of its GDP to education and the Czech Republic 5.1% in 1995 (according to the countries' national statistical yearbooks for 1996).
14 Hungary can be used as an example of this system. Enterprises pay contributions or levies of 1–1.5% of their wage costs into the National Vocational Fund, which co-fines school-based vocational education and training and gives grants to enterprises which provide vocational training.
15 Information on the proportion of teachers and students in each level of education is not available, with the exception of primary schools, where in 1993 this proportion was 1 to 11. This represents a lower number of students per teacher than in many OECD countries. However, it is almost certain that higher-level schools have even lower student-teacher ratios.
destination of migration, employment status at home and in the receiving country, or length of work. Also important would be to share information with migrant workers after their return home on issues such as average hours of work per week required by employers, working and living conditions, assessment of received remuneration in relation to the required work performance, access to medical care, protection at work, legal protection, skill requirements in relation to the level of education of the labour migrant, and so on.

Therefore, it is very important for the government to obtain more reliable data on overall labour migration from sociological surveys. As labour migration is usually most intense in border regions, the surveys could be conducted in these areas first (such as the IOM study on the Zakarpatska oblast, mentioned in Chapter 3). Later, more systematic data collection could be introduced and regularly updated using data and findings from similar surveys carried out among immigrant workers and their employers in the receiving countries.

It would be useful to establish a national migration service (similar to the one in Russia), which would handle all migration issues. In the future, either the State Employment Service or this migration service, through their regional offices, could collect information on available vacancies in other parts of Ukraine or abroad, help migrant workers obtain the documents, medical check-ups and other items required for working abroad, and cooperate with similar institutions in the receiving countries with the aim of regulating migration and protecting migrant workers. These tasks may also be performed by private agencies supervised by the SES or the migration service. In this way, illegal trafficking and other unlawful or sometimes criminal practices by job mediators in treatment of migrant workers could be gradually brought under control. Migrant workers could then enjoy better working conditions and protection against hazards at work.

In order to reduce illegal migration, the Ukrainian government should negotiate with the governments of the receiving countries with the aim of extending labour migration quotas. Furthermore, it would be worthwhile to review the existing bilateral agreements of Ukraine with the major receiving countries, to determine to what extent they are effective in regulating labour migration. They could also be compared with similar inter-governmental agreements regulating migration in some Western European countries, with the aim of making improvements. Similar agreements should be concluded with the remaining receiving countries of Ukrainian labour migrants. It should also be taken into account that the national migration policies of the five Central European countries invited to accession negotiations with the European Union will soon be adjusted for compliance with EU practice. Therefore, bilateral agreements concluded with these countries must be modified accordingly.

8.7 Towards an ‘employment-friendly’ social policy

The social price of reforms has proven to be exorbitant for many Ukrainians. The economic crisis and budget deficit have made the system of social protection inefficient. The population cannot truly depend on the constitutionally guaranteed rights to life, safe working conditions, wages and salaries, protection of the family, rest and leisure, education, housing, health care and medical assistance, social security, and a safe environment.

The Ukrainian system of social protection is complex and universal, including old age, disability and survivors’ pensions; benefits and allowances for families with children; unemployment and disability benefits; compensation for care for elderly and helpless persons; compensation to victims of the Chernobyl accident; and subsidies for housing and communal services. Total expenditure on the social protection system is rather high in international comparison, although it declined slightly from 23.3% of GDP in 1992 (and even 27.7% in 1993), to 21.4% in 1996. The preliminary figure for 1997 is 22.9%.

The high expenditure level of the social protection system may be explained by the extraordinary burden of the Chernobyl catastrophe and by the high social costs of transformation for the Ukrainian population. However, the major problem is that its coverage is too wide – poorly targeted social
benefits are provided to almost half of the population, and are therefore very low. Consequently, those families and persons in real need - such as families with many children, young, single-parent families with very low incomes, disabled persons and others - are poorly protected and often not provided with minimum resources for subsistence. Moreover, social tensions are further aggravated by the delayed payment of wages, pensions, unemployment benefits and social allowances as well as the widespread use of administrative leave without pay.

Employment promotion and social protection are closely interrelated. Employment, when properly remunerated, is in principle the best protection measure against poverty. Social protection policy should endeavour to provide a decent income to those in need, while simultaneously encouraging able persons of working age to be economically active. This calls for mutually consistent and supportive labour market and social policies. Since economic activity is generally a better option than reliance on social benefits or assistance both for the individual and for society, labour market policies should be formulated for and targeted at persons experiencing difficulties in finding work. The objective should be to help such people become more competitive in the labour market, more attractive for employers and more active in searching for a job. Policies should also simultaneously support job creation and assist in direct job placement.

The social safety net needs to avoid two extremes. On the one hand, it should provide jobless persons with an incentive to seek employment, by not allowing longer-term social income to be higher than job earnings for persons who have the capacity to work. On the other hand, it should not allow persons relying on benefits to fall into extreme poverty, as this leads to their social marginalization and has irreversible effects on their ability to work. Proper employment policy should combine income support, skills training and employment creation, while the social protection system provides decent temporary assistance to unemployed persons, and encourages them to seek new employment. The need for mutual consistency in employment and social policies should be taken into careful consideration in the current process of reshaping the social protection system in Ukraine.

The Ukrainian social protection system needs to be substantially reformed to adapt its concept to these new challenges and to narrow its targeting to those in real need, while providing them with incomes that ensure a living standard above the subsistence minimum. The system should become effective, both in terms of poverty alleviation and long-term financial sustainability, while providing sufficient incentives to persons able to work to seek employment.

The strategy of the government's social policy is formulated in the Programme of Activities of the Cabinet of Ministers for 1996–1999, and further developed in the Decree of the President on the Main Directions of Social Policy for 1997–2000, which was issued in October 1997. It is emphasized that financial stability and economic growth cannot be achieved at the expense of curtailing social benefits or declining real incomes. The protection of incomes against inflation is viewed as the foundation of social policy and its key principle. Material and social benefits should not depend on professional or similar criteria, but rather on the degree of poverty or low income. The state should take direct care for the most vulnerable sections of the population - children, pensioners, invalids, and low-income families. Social security and the provision of pensions will undergo all-embracing reform, and targeted assistance to the most vulnerable sections of the population will be improved. Guaranteed wages paid on time, pensions, stipends, assistance and other social benefits need to be ensured, and efforts made to overcome the tendency of polarization in society by levels of income.

16 Poor targeting of benefits also applies to the Chernobyl Fund, which provides benefits to the victims of the accident but also finances the construction of new housing, schools, hospitals, etc. in other regions for persons resettling from the Chernobyl area. There is anecdotal evidence that criteria for benefit eligibility may be unevenly applied - not all those actually affected are receiving benefits, while some non-affected persons are eligible for them. The number of beneficiaries has thus far continuously increased. See S. Gupta, E. Harris and A. Mourmouras, ‘Reforming Ukraine's Social Safety Net’, in Ukraine: Accelerating the Transition, op. cit.
The following measures have been determined as priorities in achieving these principles until 2000:  17

• A large-scale programme of pension system reform will be implemented, introducing a three-level pension system:
  1. Obligatory state pension insurance, providing the necessary subsistence minimum for all those insured
  2. Obligatory individual insurance, ensuring greater differentiation in the amount of pensions (while conditions for the implementation of this second tier will be created before 2000, the full materialization of this programme will be possible only after 2005, assuming economic growth and increased real wages)
  3. A form of voluntary individual pension insurance
• In the course of pension reform, a higher level of pension insurance is to be ensured. The amount of pension benefits should be differentiated according to the level of work contribution, and the use of pension funds should be made rational and targeted. The reform of the pension system will ease the economic pressure on the employable population, according to the demographic situation.
• Improvements are planned in the provision of targeted assistance to needy sections of the population, along with efficiency enhancements in the system of payments for housing, public utility services and transport.
• Reform of the organizational structure of social assistance will be completed, with a transfer of these functions from enterprises to local executive bodies.
• A mechanism for planning a set of social items in the state budget, based on social standards and the adjustment of minimum wages, is to be introduced in 1998.
• Reforms in the system of social security aim at creating a financially stable system for the efficient protection of citizens against social and professional risks.

8.8 Labour market policies

Labour market policies have an important role to play in facilitating the re-employment of displaced workers and job placement for new labour market entrants. This includes job creation, improving skill profiles of jobseekers, incentives to employers that hire hard-to-place persons, and providing temporary income support to jobseekers. The impact and cost effectiveness of such policies increase considerably when they are designed in full accordance with economic goals both at the national and regional levels, and when they respond to the specific needs of the respective labour markets. Policies should also be implemented by labour market institutions in a concerted effort with state and regional authorities, the social partners and other important economic actors.

In order to better address new labour market challenges, improvements in the labour market policy would be desirable, as described in the following sections.

8.8.1 Activation of labour market policy

First, considering the anticipated rapid increase in open unemployment in the near future, there is a need for a further activation of labour market policy. Although financial pressures will intensify, encouraging a further shift from (already very modest) active labour market policies towards income support, it is important to give great attention to an expansion of active employment promotion measures. Such measures should reach a much wider range of unemployed persons and persons threatened by unemployment. Investigations of the ILO, OECD, the World Bank and other international organizations, as well as many research institutions, prove that higher allocations to active employment programmes lead to a significant shortening in the duration of unemployment, and thus to significant savings. Simultaneously, they contribute to greater flexibility and increased competitiveness of the labour force – important characteristics for the adjustment of national economies to the challenge of globalization and economic restructuring.

17 These priorities are in full compliance with ILO recommendations. See the forthcoming ILO report on the ILO/UNDP/World Bank project on social budget modelling.
In the European Union, besides a larger share of total labour market expenditure allocated to active policies (36% on average in 1995), a current overall trend is also to activate passive measures – i.e. to combine income support with increased obligations to actively seek employment or even to participate in some active measures such as training, temporary work, and so on. This is done, for example, in the United Kingdom, Ireland and Denmark, and among transition countries in Hungary. Also in France, within recently introduced cooperation contracts, unemployment benefits can be transformed into employer wage-cost subsidies. In order to increase the interest of unemployed people in speeding up their job search and accepting a wider range of jobs, these persons may be granted financial incentives – in the United Kingdom, for example, back-to-work bonuses or jobfinder’s grants may be provided, or in Ireland, back-to-work allowances.\textsuperscript{18}

8.8.2 Dealing with mass layoffs

Changes in the funding of severance pay and increasing economic pressures on enterprises to reduce labour hoarding will probably lead to mass layoffs of redundant workers. Ukraine belongs to the group of countries which do not have any special procedures for mass layoffs. However, experience from economically advanced countries (such as the United States) and transition economies (such as Hungary) shows that a programme of assistance to workers in cases of mass layoffs may be very effective in the redeployment of workers to other jobs without longer-term unemployment spells or in finding other acceptable solutions for them and thus reducing economic losses and social tensions caused by mass layoffs. Such programmes usually require the close cooperation of employers and workers with the local employment centre and the local community. Advance notice of mass layoffs to workers, their representatives and the local employment centre is very important for the timely preparation of a programme, which should include intensive job search assistance prior to the layoff, retraining for skills demanded in the market, assistance in business start-ups, mobility grants, etc.

8.8.3 Expansion of labour market training

Increasing skill mismatches and structural unemployment in the Ukrainian labour market call for a further expansion of labour market training. Recent assessments conducted in three Central European economies in transition of the effect of labour market training on improving job placement rates of certain groups of jobseekers revealed that labour market training is particularly important for promoting the employment of persons with low skills, youth and older workers, especially women.\textsuperscript{19} In order to improve the placement rates of retrained persons, it is important to convince both employers and jobseekers of the quality of adult training. Therefore, training institutions should closely cooperate with enterprises and with employment centres, to properly reflect labour market needs in the contents and methods of training, to tailor training to special requirements of concrete employers (who in return then should be obliged to recruit the retrained persons), and also to the needs of trained adults. A combination of training with public works also seems to be very useful, as it may extend public works to activities requiring better skills and improve prospects of public works participants to get permanent employment.

However, training supported by the SES should also be extended to employed persons threatened by redundancy. Training may help such persons acquire new skills which can be useful either for their current employer if he is unable to provide training himself due to financial problems or is able to do so only on a cost-sharing basis. Layoffs may thus be avoided in some cases. If redundancy is unavoidable, training can facilitate the more rapid re-employment of laid-off persons. Countries using such measures (e.g. Slovenia, Hungary, and more recently also the Czech Republic) have achieved good results, both in terms of job placement and cost-effectiveness.

\textsuperscript{18} More information on these and other approaches towards activation of labour market policies in the EU countries can be found in Employment Observatory: Trends No. 28, European Commission, summer 1997.

8.8.4 Policies for disadvantaged groups

The promotion of employment of disadvantaged groups of workers is unsatisfactorily handled in Ukraine. Although the quota system is supplemented by levies punishing employers who refuse to employ jobseekers belonging to the groups in need of special assistance and do not meet the quota, in reality employment centres do not have enough power to exact the levy. It is also well known that enforcement is in general less effective than incentives. In this respect, Ukraine could use the good experience of other transition countries by trying to solve such problems through positive stimuli for both employers and workers.

Disabled workers are now in a very bad situation in Ukraine, as they are not even listed among the categories of persons entitled to special assistance in job placement by the SES. In this respect, among the transition economies the experience of Poland could be instructive for Ukraine. Poland pays high attention to the employment of disabled workers, as regulated by the Law on Employment and Vocational Rehabilitation of Disabled Persons. A complex system promoting vocational rehabilitation and employment of disabled persons has been developed. The Polish system is also based on quota-levy financing; however, all enterprises that do not meet the quota must pay a levy into the State Fund of Rehabilitation of Disabled Persons. The Fund is used to finance the vocational rehabilitation of persons with disabilities, appropriate training and retraining, generation of suitable jobs by providing financial incentives to employers, support of sheltered workshops for severely impaired persons, grants to disabled persons wishing to start their own business, etc. Despite a number of problems, this system has contributed greatly to improving employment prospects for persons with disabilities.

As unemployment among young people is becoming a problem for Ukraine, youth employment programmes adopted by Hungary, Slovenia, Slovakia or the Czech Republic could also be an inspiration. The programmes facilitate first jobs for young people, especially school leavers, for a certain period through wage subsidies to employers. If necessary, the temporary job can be combined with training, the costs of which are also reimbursed to the employer. Some countries also provide incentives to employers to offer young people a permanent job after competing this internship. This is a good example of an employment promotion programme replacing the formerly paid passive income support to young people.

Special attention needs to be paid to long-term unemployed persons, the share of which in total unemployment in Ukraine is rapidly increasing. First of all, such people should receive intensive assistance in their job search, combined with participation in appropriate active employment programmes according to their individual needs. Such employment programmes may include (besides the above-mentioned policies such as labour market training): participation in public works, also preferably combined with training to improve their future prospects for regular employment; job creation schemes; and other measures such as job clubs, where long-term jobless persons are trained on how to improve their image, job search technique, and ability to ‘sell themselves’ in applying for a job. For those persons who have been out of job for a long period and have either lost or have not developed their ability to perform regular work, social integration programmes may be very useful. A good example of such social integration programmes combining social assistance and work with the gradual acquiring of basic skills and working habits through on-the-job training is found in the Czech Republic. Community-based initiatives may also be very important. These may combine such measures as the provision of charitable support to homeless persons or social care for elderly with community works performed by long-term jobless persons, as for example in Hungary.

8.8.5 Promotion of self-employment of unemployed persons

The increasing globalization of the world economy and technological changes in production result in diminishing traditional industrial jobs, while many new activities in all economic sectors are performed on
the basis of small private business. A growing number of persons will have to turn to self-employment or find a job in small firms. As small firms and self-employed persons are extremely vulnerable to changing economic conditions, many governments try to facilitate their start-up and access to support services to strengthen them economically and technologically. Special programmes are designed for unemployed persons wishing and able to start up their own businesses. Ukraine should revitalize its business promotion programme for unemployed jobseekers and improve its financial participation through the provision of preferential credits or credit guarantees from the Employment Fund. Its infrastructural role should be improved as well, through the establishment of consulting centres for small entrepreneurs; business incubators offering inexpensive premises, equipment and business services; technology centres providing access to new technologies, etc.\textsuperscript{21}

8.8.6 Need for regular monitoring and assessment of labour market policies

In order to improve the achievements, targeting and cost-effectiveness of labour market policies, it is important to extend the labour market information collected so far. Data are currently available on employment, unemployment, underemployment, and so on. Information is also provided on how many persons have been placed with the help of the SES, how many are receiving unemployment benefits and other income assistance, how many are participating in active labour market policies, and how much has been spent on these policies. However, no other information on job placements of participants in active labour market policies is available, apart from the placement rates of persons completing labour market training. (And it is not even clear whether these data refer to placements immediately after the course, or within a certain period of time – e.g. three months; nor is it clear how many of these placements were in regular or subsidized jobs.) It would also be desirable to know how many of these former participants placed in jobs are able to keep their employment after some time (e.g. after one year). Further, information on the composition of participants in different employment programmes by age, gender, education, duration of unemployment spell, etc. is useful, as it may help improve targeting of active policies at those most in need of assistance. For assessing the cost-effectiveness of different labour market policies, financial indicators, such as the unit costs of participation in each scheme and the unit costs of job placement should be made available. This type of information can be obtained from the local employment centres and then aggregated by region and for the whole of Ukraine.

For collecting and processing this information, the level of computerization in the SES needs to be strongly upgraded. However, some monitoring of the achievements of labour market policies can already be introduced at this stage. More sophisticated assessments of the cost-effectiveness of labour market policies can be launched much later, after the labour market information system becomes fairly complex and fully automated. These may be based on sample surveys using sampling techniques such as matched pairs, etc., in order to obtain relatively proper evaluations of the net effects of labour market policies on job placement within specific groups of unemployed persons (controlling for differences in their personal characteristics which could bias the results).

8.9 Conclusion

Ukraine has been confronted with tremendous economic and social problems during the process of transition to a market system and a democratic society. Therefore, the achievements in the adaptation of its national legislation and institutions to the new requirements, as well the recent positive results of policies oriented towards stabilization and a gradual improvement of the economic and social situation must be acknowledged. Nevertheless, many problems remain to be solved, primarily in the area of employment and incomes. This Review has been written with the aim of contributing to a gradual solution of these difficult tasks and to assist the government, employers’ organizations and trade unions of Ukraine in working together towards promoting productive employment, combating unemployment and social exclusion, and increasing the well-being of the Ukrainian population.

\textsuperscript{21} Chapter 6 is devoted to small business promotion.