ISSN:2229-6247
Jarosław Poteraj et al, Int.J.Buss.Mgt.Eco.Res., Vol 3(4),2012,598-606

Pension System in Ukraine

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Abstract
In his article the author presents a detailed analysis of the historical development and the present condition of the pension system of Ukraine, starting with an introduction containing some general information about the country. The author's research goal was to conduct an initial evaluation of the pension reform that had been introduced in the last quarter of 2011 in Ukraine and to find in it those solutions that would be worthwhile to use in international comparisons. The research was based on literature study in English, Ukrainian and Polish languages. The article is presented in the following order: 1. General information about the country, 2. The historical development of the pension system, 3. Its present state, and 4. Challenges and anticipated changes to the system.
In the summary the author concludes that the reform of 2011 had a merely parametric dimension which is not sufficient to stabilize the system. The notoriously high pension contribution level coupled with the large magnitude of the grey economy result in the basic level of the pension system being unable to reach self-financing and thus needing constant support from the government. The formally introduced II capital tier of the pension system has not so far been implemented in Ukraine. It is also difficult, at the present state of affairs, despite the decision to rise the pension eligibility age for women, to expect a quick arrival of the financial independence of the Pension Fund of Ukraine, what is a precondition for the introduction of the second tier.
Key Words
Pensions, pension systems, Ukraine, retirement
JEL Classification
G23, H55, J32

1. INTRODUCTION

This article is a part of the author's series of publications on pension systems operating in selected countries[1]. Globalization, the developments in information technology and telecommunications, and the freedom of movement in the European labour market result in many people taking interest in earning money in countries other than the homeland. This may implicate participation in foreign pension systems. These systems evolve constantly, primarily due to demographic, but also economic, reasons. The European Union provides for open coordination of pension systems in the member states, which means that there is no single solution that has been hailed the right one. In non-member states, the pension solutions vary even more. Therefore the large diversity of these systems, and the erratic knowledge thereof, even among the experts.
This article responds to the fact that the reform of the pension system that Ukraine made in the last months of 2011 calls for an evaluation. The author's research goal is twofold; first, it is to bring closer both historic and current solutions in Ukraine's pension system in order to possibly find those worthwhile of using in benchmark comparisons, second, to conduct an initial evaluation of the pension system reform that Ukraine made in the last quarter of 2011. The research was based on literature study in English, Ukrainian and Polish. Besides the printed texts, some Internet resources were used as well as Ukrainian legal acts and regulations. The article is presented in the following order: 1. General information about the country, 2. The historical development of the pension system, 3. Its present state, and 4. Challenges and anticipated changes to the system.

2. GENERAL INFORMATION ABOUT THE COUNTRY

Ukraine (Ukrainian: *Україна*) (Wydawnictwo Naukowe PWN, 2005: pp. 250 and following) is a country located in the South-Eastern Europe, on the Black Sea; it comprises 24 districts (Ukrainian: *область*) as well as one autonomous republic (the Autonomous Republic of Crimea) and two cities (Kiev and Sevastopol[2]) which have a

[1] At the time of the preparation of this article, the papers on the pension systems in Albania, Argentina, Austria, Belgium, Belorussia, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Island, Italy, Lithuania, Luxemburg, Latvia, Macedonia, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Serbia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the United Kingdom has been published by the author. Also, a book Pension Systems in 27 EU Countries by the same author has been published. The author will gladly respond to all inquiries in this scope on poteraj@neostrada.pl .

[2] The base of Russian Black Sea Fleet will continue to be in Sevastopol until 2047. Initially, the agreement in this respect terminated the residence in 2017, but in 2010 it was extended by 30 years.

special legal status. The state's currency is hryvnia (UAH[3], Ukrainian: *гривня*). The official language is Ukrainian. In July 2012, Ukraine was inhabited by 44,854,065 people (Central Intelligence Agency, 2012) with the following age structure: 0-14 years of age – 13.7%, 15-64 years – 70.8%, 65 and more – 15.5%. The average length of life at birth was 68.74 years, where the men's average was 63.07 years and the women's average reached 74.77 years. The largest ethnic group were Ukrainians, making up 77.8% of the population. The largest ethnic minority were Russians, amounting to 17.3% of the population. The largest religious group were Ukrainians Orthodox Christians joining the Kiev Patriarchate – 50.4%, and the Moscow Patriarchate – 26.1%. In accordance with the constitution of 1996, the President is the head of the state (from 25 February 2010: Viktor Yanuchovych,) and the Prime Minister (from 11 March 2010: Mykola Azarov). The largest political parties are the Party of Regions (*Партія регіонів*), Bloc Julia Timoshenko (*Блок Юлії Тимошенко*, BYuT), Our Ukraine – People's Self Defence (*Наша Україна-Народна Самооборона*, NU-NS) and Lytvyn People's Bloc (*Народний блок Литвина*). The gross domestic product (GDP) per person was estimated in 2011 at 7,300 US dollars, and the GDP growth rate at 5.2%. The unemployment rate was 7.0%. The public debt equalled 44.8% of the GDP. The current account for 2011 was closed with a negative balance of USD -5.695 billion.

The land of the present-time Ukraine (Central Intelligence Agency, 2012); (Wydawnictwo Naukowe PWN, 2005: 259-262) was colonized already in the ancient time by Greeks who set up their settlements alongside the coast of the Black Sea. In the period between 4th and 6th centuries AD, these lands were occupied by the Antes, and later their Slavonic descendants. In the early middle ages these lands were inhabited by Slavic tribes, and Kiev, a strong centre of their power, became the centre of the old Russian state. In the 13th century the Kingdom of Galicia-Volhynia was created there, which later subsided to Mongols. In the 14th and 15th centuries, the lands were gradually taken by Russian army from the east and Lithuanian army from the west. Between the 15th and 16th centuries, the Cossacks emerged as a group of identifiable identity. After the Union of Lublin in 1569 between Poland and Lithuania, the Ukrainian lands occupied by the Lithuanians became a part of the Polish-Lithuanian Commonwealth. In 1596 the Union of Brest took place, which united the Catholic and Orthodox Churches. The end of the 16th century started a wave of Cossack uprising, the largest of which, lead by Chmielnicki, turned into a war for independent Ukraine, which involved the Tatars that were at that time subjected to Turkey and Russia. In effect, the Ukrainian land was divided between the Commonwealth and Russia along the Dnieper river. In the Polish part, the union that was abolished by Chmielnicki was restored, and in the Russian Part the liquidation of the union was affirmed and Kiev became subdued to the Patriarchate of Moscow. After the I partition of Poland in 1772, the western part of Ukraine, which became part of the Commonwealth, was taken over by Austria. In 1775, the Cossack republic in the east was destroyed, and in 1783 east Ukraine and the Crimea, after the khanate of Crimea had been liquidated, were officially incorporated into Russia. After the II partition of Poland in 1793, and the III partition in 1795, the bulk of Ukrainian lands were under the rule of Moscow. In 1917 the Central Council of Ukraine was set up. After the October Revolution, the creation of the Ukrainian People's Republic in federation with Russia was proclaimed. The war with the Soviet Russia lead to the declaration of 22 January 1918 that Ukrainian People's Republic is an independent country. On 9 February 1918, the Central Council of Ukraine signed peace treaties with the central states. In Eastern Galicia, then a Polish territory, in October 1918 the emergence of West Ukrainian People's Republic was proclaimed; however, the military formations of this political entity were quickly expelled by the Polish army. On the 13 November 1918 a war started between the Ukrainian People's Republic and soviet Russia. On 6 January 1919, on the areas that had been taken over by the Russians, the Ukrainian Soviet Socialist Republic with the capital in Kharkov was proclaimed. In April 1920, the Ukrainian People's Republic formed an alliance with Poland, what was the reason of the Polish-Soviet war of 1920-1921. The Peace of Riga made in March 1921 ended this war, finally liquidating the Ukrainian People's Republic and legitimizing the Ukrainian Soviet Socialist Republic.

In the interwar period, some lands that form the present-time Ukraine belonged to its neighbours: Eastern Galicia and a part of Volhynia belonged to Poland, Carpathian Ruthenia belonged to Czechoslovakia, Bukovina and Bessarabia to Romania, and the Crimea at that time was the part of the Russian Federal Socialist Soviet Republic. In December 1922, with the Ukrainian Soviet Socialist Republic participating, the United Soviet Socialist Republics was created. Ukrainian capital was moved from Kharkov to Kiev in 1934. After the aggression of the Soviet army on Poland in September 1939, the terrains known by the name of Western Ukraine were incorporated into the Ukrainian Soviet Socialist Republic and the Soviet Union. In 1939, Carpathian Ruthenia went under the rule of Hungary. In August 1940, with the forced agreement of Romania, the Soviet Union took over the north part of Bukovina and Bessarabia and joined them with the Autonomous Moldavian Soviet Socialist Republic (at that time a part of the Ukrainian Soviet Socialist Republic), thus creating the Moldovan Soviet Socialist Republic. In 1941 the terrains of Ukraine were taken over by the German army but the occupant did not create a separate state, only an administrative authority. In 1944 Ukraine was captured by the Russian army, what was tantamount to the revival of the Ukrainian Soviet Socialist Republic.

[3] Abbreviation according to ISO 4217. On 23 July 2012, 100 Euro cost UAH 975.1460 (Національний банк України, 2012). In Poland, on 23 July 2012, 1 UAH cost PLN 0.4273 (Narodowy Bank Polski, 2012).

In 1945, the Ukrainian Soviet Socialist Republic became a co-founder of the United Nations Organization. In June 1945, following an agreement with Czechoslovakia, Carpathian Ruthenia was incorporated into the Ukrainian Soviet Socialist Republic. In 1954, the Russian Federal Soviet Socialist Republic transferred the Crimea to the Ukrainian SSR[4].

In July 1990, the Highest Council of the Ukrainian SSR passed an act that declared the republic's sovereignty from the Soviet Union. On 24 August 1991, the Highest Council proclaimed the independence of Ukraine. On 8 December 1991, Ukraine entered the Commonwealth of Independent States. At the beginning of 1992, the country officially adopted an anthem, a flag and a coat of arms. In November 1992, a temporary currency was introduced, called the Karbovanets (Ukrainian: *карбованець*) (Kurowski, 2006: 101). In the period of 1992-1993, the country experienced hyperinflation[5]. In 1994, the separatist Crimean Republic was proclaimed on the Crimean peninsula, which was in 1995 subdued to Kiev with the status of an autonomy. In the same year Ukraine became a member of the Council of Europe. In June 1996 a new constitution was enacted. The presidential decree of 2 September 1996 introduced a new currency, the Ukrainian hryvnia, which replaced the karbovanets with the relation of 1:100,000 (Недвижимость 5000, 2009). In 1997, an agreement was signed with Russia about the special status of Sevastopol in Crimea, as the basis of the Black Sea Fleet, valid until the year 2017. In 2010, this agreement was extended by the next 25 years, with the possibility of continuation for yet another 5 years, which is to the year 2047.

3. THE HISTORICAL DEVELOPMENT OF UKRAINE'S PENSION SYSTEM

The first social regulations in Ukraine date back to the time when at the beginning of the 20th century the country was under the occupation of tsarist Russia: the first one was made in 1912 and was concerned with the accident, sickness and maternity insurance (Social Security Administration, 2010: 312 and 313). In 1921, when the Ukrainian Soviet Socialist Republic was already established, the regulation on the unemployment insurance was made (Social Security Administration, 2010: 314). Year 1922 marks the beginnings of Ukrainian pension system, when in the whole Soviet Union a regulation on pensions for hired employees was adopted (Social Security Administration, 2010: 310). The regulation did not cover the agricultural labourers of co-operative farms, the kolkhoz. All benefits were paid from the state budget, and the pension eligibility ages were set at 60 years for men and 55 for women. The replacement rate was at the level of 55% for those with full employment qualification periods, i.e. 25 years for men and 20 for women. When a person decided to extend their employment, their replacement rate was increased by 1% for each extra year in employment, up to the level of 75% (Chemerys et al., 2000: 205). In 1944 the first regulation on family pensions was adopted (Social Security Administration, 2010: 314).

In 1964 a separate regulation was made in order to tackle pensions of agricultural labourers (Chemerys et al., 2000: 205). During the existence of the Soviet Union, there were five pension sub-systems in total, designed for: 1) labourers, employees of state administration, students, and their family members, 2) state farms employees and their family members, 3) employees of education, health service, civil aviation, miners, actors and stage performers, 4) prominent people and their family members, and 5) the uniformed services. In 1990 an act on old age provision for citizens of the Ukrainian Soviet Socialist Republic was passed (Надточій & Яценко, 2000: 12). In 1990, the replacement rate was 22% (Noel et al., 2006: 26).

In the beginning of the independence period, around 20 professions were granted special pension rights (Dobronogov, 1998: 6). At the beginning of 1992, the regulation from the previous year came into power (Закон України, 1991) which set the operation rules for the I tier of the pension system in the form of separate from the state's budget the Pension Fund of Ukraine (*Пенсійний фонд України*) (Пенсійний фонд України, 2012a). However, the division in the five sub-systems originating in the times of the Soviet Union was maintained (Riboud & Chu, 1997: 3). The total social insurance contribution, which included pension contribution, paid by the employer equalled 37% of the employees remuneration, and the employee paid 1% or 2%, depending on the height of the remuneration (Annycke, 2005). In 1992, the average replacement rate was 49% (Riboud & Chu, 1997: 11). 1994 was the first year of the operation of non-state pension funds[6], which were created basing on general legal regulations (Kurowski, 2006: 133). Many of them soon collapsed as they turned out to be nothing more than financial pyramids[7]. In 1997, the replacement rate for a public pension equalled 33% (Noel et al., 2006: 26). On 13 April 1998 a document titled *The Basic Directions of the Reform of the Pension System in Ukraine* was published (Вєнер & Яценко, 2000: 19), which had a formal approval of the president (International Centre for Policy Studies, 2000). In the same year the Association of Non-State Pension Funds was created

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[4] It was a symbolic gesture made 300 centuries after Chmielnicki had signed the Treaty of Pereyaslav in 1654, which gave Ukraine to the authority of Russia.

[5] The yearly inflation rates were 1.210% in 1992 and 4.735% in 1993 (Riboud & Chu, 1997: 6).

[6] НПФ „Добробут" was the first of them. (Kurowski, 2006: 212).

[7] The most spectacular was the bankruptcy of OBERIG fund, which hurt 194 thousand savers. (World Bank, 2000: 82).

(*Національна Асоціація Недержавних пенсійних фондів*) (Національна Асоціація Недержавних Пенсійних Фондів України та Адміністраторів Недержавних Пенсійних Фондів, 2012). In October 1998 an additional fee of 1% on all currency cash and non-cash exchange operations, was imposed, with the intention to finance the Pension Fund of Ukraine (Giucci & Bigdai, 2006: 2). In 1998, the average pension equalled UAH 54, while the minimum subsistence level declared for this year was UAH 118 (Noel et al., 2006: 26). In 1999, the average pension's purchasing power equalled 15.3% of that of 1990 (Chemerys et al., 2000: 205). In July 2001, a law on the governmental supervision over financial markets was passed (Закон України, 2001), and in December 2002 a president's order was published (Указ Президента України, 2002) which was the basis for the creation of the State Commission for the Regulation of Financial Markets (*Державна комісія з регулювання ринків фінансових послуг України*)[8]. In 2002, around 97% of pensioners received pension benefits that were lower than the official minimum subsistence level (Noel et al., 2006: 32). In the same year, there were special arrangements provided for representatives of certain professional groups: members of parliament, government officials, jugdes, district attorneys, uniformed services, veterans and customs officials (Lisiankova, 2002: 12). In July 2003, another two regulations were made (Kurowski, 2006: 133 and 134): 1) on the obligatory state pension system (Закон України, 2003b), which modified the operation of the I pension tier and provided for the Accumulation Fund (*Накопичувальний пенсійний фонд*) (II tier), and 2) on non-state (*недержавне*) pensions (Закон України, 2003a) (III tier in the pension system). The latter regulation provided for voluntary participation in state regulated private (non-state) pension funds. Additionally, a possibility was open for the accumulation of funds for retirement by life insurance companies and commercial banks. The voluntary funds could start operation on 1 January 2004. Institutions that managed these funds were required to possess own funds of at least €300,000 in the case of Ukrainian companies and €500,000 in the case for international companies (Noel et al., 2006: 36). The changes in the operation of the I tier were of parametric nature and referred to (Noel et al., 2006: 34):

- The increase of incentives for late retirement, by a 3% increase of benefit for each year of the deferral of retirement;
- The determination of the ratio used for the calculation of the benefit; it was set at 1% for each contribution year, instead of previously used 2.2% for men and 2.75% for women, for first 25 and 20 years of participation in the system, respectively;
- The extension of the period for the calculation of the benefit to 5 years from the period of employment preceding year 2000 and all years afterwards, or, alternatively, the last two years of employment;
- The valorisation of the existing benefits by a factor including 100% of inflation plus at least 20% of the growth of real income from work;
- The establishing that the maximum income on which the pension contribution will be calculated will be 7 times the average remuneration;
- Transfer of payment benefits to people who are not eligible to pension benefits from the pension fund to social welfare.

Moreover, the pension contribution was separated from the overall social insurance contribution. It was determined to be 32% of the gross remuneration payable by the employer and 1% or 2% payable by the employee (Annycke, 2005). Also, all those who were at least 20 years ahead of their retirement age were to join the Accumulation Fund. For those employees that were between 10 to 20 years before their retirement the participation in the Accumulation Fund was optional, and these employees who had less than 10 years of work before their retirement were excluded from the participation (Global Pensions, 2003). The fund's capital was to be accumulated by transferring a part of the pension contribution to the fund, and the maximum on the transferred amount was set at 7% of remuneration. The Accumulation Fund was to start operation on the condition that the following requirements were met (Kurowski, 2006: 136 and 137):

- Yearly GDP growth is not less than 2% in two years in a row;
- The budget of Ukraine's Pension Fund is balanced;
- Income of ensured by pensions is not lower than the official minimum subsistence level;
- Institutional and technical base for individual pension accounts has been created;
- Legal regulations necessary for the functioning of the capital tier have been created.

This way no particular date was offered for the start of the Accumulation Fund (Derbal, 2004), although according to some press information it was due to happen at the beginning of 2007 (Noel et al., 2006: 25); (McTaggart, 2003). After 11 years of the operation of this fund, its participants were to be granted the right to transfer the capital accumulated in their individual accounts to private pension asset management companies (Antonenko, 2005). From the beginning of 2004, the tax on conversion of currencies that was earmarked for financing the Pension Fund of Ukraine was limited to non-cash operations and increased to 1.5% of the value of the transaction (Giucci & Bigdai, 2006: 2). In August 2004, a new formula for pension calculation in the I tier was introduced. In September 2004, the authorities started a vocational voluntary pension scheme for all public

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[8] The first registration of pension funds was made by this Commission at the end of 2003 (*Державна комісія з регулювання ринків фінансових послуг України*, 2012).

sector workers (CMU, 2004). In the same month there was a significant increase in the value of the official minimum subsistence level, which rose to UAH 306 (Ministry of Labor and Social Policy of Ukraine, Pension Fund of Ukraine, 2008: 4). In 2004, out of the total number of 13.3 million pensioners as many as 11.7 million received the minimum pension benefit. At the beginning of 2005, social pensions stopped to be financed from the resources of the Pension Fund of Ukraine and became a part of welfare aid financed directly from the state budget (Ministry of Labor and Social Policy of Ukraine, Pension Fund of Ukraine, 2008: 4). On 1 March 2005, the system of yearly valorisation of pensions by the whole value of the increase in the consumer price index plus 20% of the pension increase started to operate. In 2005 the average pension was UAH 316.2, what equalled to 39% of average earnings (Noel et al., 2006: 33 and 35). The increase of pensions in 2004-2005 without rising pension contributions lead to an uncontrolled increase in the deficit in the Pension Fund of Ukraine (Accounting Chamber of Ukraine, 2005) and the level of pension liabilities in 2005 reached 17% of GDP (Spiteri Paris, 2007). At the beginning of 2006, the currency exchange tax used to subsidise the Ukraine's Pension Fund was reduced to 1.3% (Giucci & Bigdai, 2006: 2). The set up of the second tier, that was prognosticated to happen in 2007, did not take place. At the end of 2007, there were 51 private (non-state) pension funds registered, of which 41 were open voluntary pension funds, 7 were corporate pension funds, and 3 were occupational or professional pension funds (The World Bank, 2008: 5). In December 2007, the average pension benefit equalled UAH 590, and the minimum pension – UAH 415. On 1 January 2008, the factor used for calculating pensions rose from 1% to 1.2% for each contribution year. The change included also current retirees, whose pensions had been recalculated. In effect, in April 2008 the average pension equalled over UAH 777, and the minimum – UAH 481. On 1 October 2008 the benefit calculation factor rose again, to 1.35% for each year in employment (Ministry of Labor and Social Policy of Ukraine, Pension Fund of Ukraine, 2008: 7). At the end of 2008, the average pension equalled around UAH 900 (International Centre for Policy Studies, 2008). In August 2009, the government set up a commission whose role was to implement the pension system reform (Prozorov, 2009). In mid-2009, there were 108 voluntary pension funds, of which 74 started to operate and were joined by around 500 thousands participants (Prozorov, 2009). In the law of 28 October 2009 the following minimum subsistence levels was set forth, which also determined the heights of the minimum pension for the subsequent periods (Human Capital News, 2009): from 1 November 2009 – UAH 701, from 1 January 2010 – UAH 825, from 1 April 2010 – UAH 843, from 1 October 2010 – UAH 861, and from 1 December 2010 – UAH 875. In 2009 the expenditure on the pension system amounted to 18% of the GDP (Auyezov, 2010); (Atherton, 2010). In the budget for 2010 it was written down that 26.2% of the income of the Ukraine's Pension Fund was to come from a government subsidy (Тищенко, 2009).

On 15 December 2010, the government submitted to the parliament a bill on pension reform, in which a three-tier pension system was formulated in a realistic manner (PR Newswire, 2010). The project provided for a gradual increase the pension age of women to 60 over a 10-year period, a ceiling on the pension benefit value, and the creation of obligatory capital pension funds. In 2010, as many as 23% of the pension system expenditure was financed with a government subsidy (Lisenkova, 2011: 6). The reform was approved upon in a truncated shape by the parliament on 8 July 2011[9], the act was signed off by the president on 12 September 2011, and came into force on 1 October 2011 (U.S. Social Security Administration, 2011). The version of the reform that has been passed by the parliament[10] provided for the increase of the pension age of women from 55 to 60 gradually every 6 months starting from 1 January 2012, as well as a gradual increase of the number of contribution years required the eligibility for full pension from 20 to 30 years and from 25 to 30 years for women and men, respectively. By the same token, the number of contribution years required for partial pension benefit rose from 5 to 15, although the time frame for this change has not been clearly set forth. Moreover, the act determines that the pension age of government employees will rise from 60 to 62 years, starting on 1 January 2013 (OSW, 2011).

4. THE PRESENT STATE OF THE PENSION SYSTEM IN UKRAINE – AS OF 1 JANUARY 2012

The Ukraine's pension system consists of 3 tiers: 1) the basic pension, 2) the capital Accumulation Fund, and 3) voluntary pension schemes. The system covers all people employed or self-employed on the territory of Ukraine, whether they are citizens of Ukraine, foreigners, or individuals without citizenship. There is also a social old age pension benefit, which is payable to those men aged 63 and more and women aged 58 and more, who have not worked long enough to be eligible for the basic pension (Social Security Administration, 2010: 310). This benefit has a character of welfare payment financed by the state budget.

The basic pension (*Перший рівень*) functions in the pay-as-you-go framework and is applicable to hired employees and people in self-employment. As for the hired employees, the basic pension contribution paid by the employee equals 33.2% of gross remuneration, and the part that is paid by the employee equals 2.0 to

[9] The final amendments were approved upon by the parliament on 6 September 2011 (Chadbourne & Parke LLC, 2011).

[10] More on "slaughtering" of the government project during the parliamentary discussion in (Melnychuk, 2011).

5.0% of the gross remuneration, depending on its height. There is a top limit on the income taxable for pension[11]. The pension contribution also includes accident and family insurance (Social Security Administration, 2010: 310). The pension contribution of the self-employed is calculated as 33.2% of the minimum wage in the whole economy[12] and also serves as financing for family benefits. At the moment of writing, the pension age is 60 years for men and 55 years 6 months for women, on the condition that the pension contributions were paid for at least 5 years (Noel et al., 2006: 23). There are more favourable retiring conditions for persons who have worked for at least 5 years in hard or hazardous conditions, for mothers who gave birth to and rose at least 5 children, for mothers of handicapped children, for war invalids and for some other groups of people. Partial pension benefit is payable to those men and women who had less than 25 or 20 contribution years, respectively, but not less than 5 years. In the case of the elderly unemployed, the pension may be paid out starting 18 months ahead of the regular pension eligibility age. There is no restriction on postponed retirement. Those who leave Ukraine have their pension benefits paid for only 6 months, or for a longer time if a proper international agreement exists. The pension calculation base is established on the average remuneration for 60 months preceding 1 July 2000 and all contribution periods after that date. The pension benefit's value is calculated as 55% of the average individual remuneration in the five best years or, alternatively, in the two last years of the participation in the system, for people who have had at least 25 (men) or 20 (women) contribution years. If an insured postpones his or her retirement, the replacement rate gets increased by 1.35% for each year of extra employment, up to the level of 85% in total. The system provides for a minimum pension benefit[13] which is equal to the minimum subsistence level. The minimum pension is equivalent to 20% of the minimum pay in economy (McTaggart, 2003)[14] and is due to men with at least 25 and women with at least 20 contribution years (Noel et al., 2006: 24). There is also a limitation on maximum pension benefit: it cannot exceed 12 times the minimum pension[15]. Pensions are valorised with the consumer price index added to 20% of the corresponding growth in remuneration. The valorisation takes place on 1 March each year.
The Accumulation Fund (*Другий рівень*) is formally a capital-based structure. However, so far the fund has not start a proper operation. According to the law, 7% of employees' remuneration (paid by the employee) is to be transferred to the fund, and the employer's contribution is to be adequately adjusted.
Voluntary pension schemes (*Третій рівень*) are set up by three types of institutions: 1) commercial banks, 2) life insurance companies, and 3) non-state pension funds. Such funds can take one of three forms: a) an open fund (*відкритий пенсійний фонд*), b) a company's pension fund (*корпоративний пенсійний фонд*), and c) a vocational, or industrial, pension fund (*професійний пенсійний фонд*). One entity can start a number of open funds, but in the case of company's or professional pension funds thy have to be of only one type. There may be a number of pension plans with varying investment strategies within one fund. The professional management of a pension fund's capital is commissioned to a company called a fund administrator (*адміністратор недержавного пенсійного фонду*), which must be registered with the National Financial Market Regulation Commission. Each participant holds his or her assets in an individual pension account. The contributions paid to the voluntary pension plan are exempt from income tax to the level of 15% of the remuneration (Global Pensions, 2003). There are no incentives for employers. Pension funds invest the accumulated capital in financial markets, with the limitation that only 20% of the funds can be invested outside of Ukraine. The pension benefit (*довічна пенсія* or *довічний ануїтет*) is paid out on reaching the pension age. At the beginning of January 2012, there were 105 voluntary pension funds on the market (Державна комісія з регулювання ринків фінансових послуг України, 2012).

5. CHALLENGES AND EXPECTED CHANGES TO THE PENSION SYSTEM IN UKRAINE

The largest challenge that the Ukraine's pension market has to face is the low benefit. Paradoxically, the in comparison to other countries relatively high replacement rate is another problem. The rate equals 55% for men with 25 and women with only 20 years in employment, while in other countries this rate may be as high as 75%, but it is supported with 40 years in employment. Another big problem is the low pension age, typical for former Soviet-bloc countries. Yet another challenge comes from the significant difference between the average lengths of life of men and women. The eventual rise in the men's pension age to 65 years may shift this line two years past the their average length of life. There is a possibility under Ukrainian pension regulations that a person obtains a partial pension benefit before reaching the pension age providing that they have a required number of years in employment. It means that pension benefits are paid to relatively young people and consequently the

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[11] In June 2010 it was set at UAH 13,660.

[12] In April 2010 it was set at UAH 884.
[13] From 1 December 2010 it was UAH 875.

[14] From 1 December 2011 it was (*розмір мінімальної заробітної плати*) UAH 1,004 (Пенсійний фонд України, 2012b).

[15] From 10 October 2008 it was UAH 5,976 (Ministry of Labour and Social Policy of Ukraine, Pension Fund of Ukraine, 2008: 9).

whole system finds it difficult to balance expenditures with revenues. Such a situation imposes a heavy burden on the state's budget, as it eventually picks the tab and fills the gap in the financing of the pension system. The next problem results from a significant scope of informal employment, which not only impinges on the total amount of money collected by the pension system but also leads to significant delays in the payment of remuneration in general. But the reason for such a large informal employment may lie in the extremely high pension contribution that an employer has to bear, thus entwining the reasons and the causes into a vicious circle (Dobronogov & Mayhew, 2000: 6). All this is further compounded by an unfavourable demographic trend reflecting the shrinking number of young people in the population (Dobronogov, 1998: 7-9). In 2026, the dependency ratio is expected to be below 2.1 (Avery, 2002), and it is expected that in 2050 there will be 139 pensioners for 100 people contributing to the system (UNDP, 2008); (Góra, 2008: 8). Another obstacle is the lack of highly qualified staff and technical knowledge necessary for the application of individual capital account solutions in the pension system. The obligatory capital component of the pension system has not practically gone beyond the stage of a legal regulation (Ottawa, 2008). The recent studies highlight the following major problems of the Ukraine's pension system (Prozorov, 2009); (International Centre for Policy Studies, 2011):

- Delay in the implementation of the II tier;
- Less profitable investment options for pension funds due to the financial crisis;
- Lack of economic incentives for employers to start pension schemes;
- Low value of pension benefits;
- Growing operation costs of the pension system;
- High financial burden for employers;
- Unfairly high pension benefits for privileged professions[16].

The complicated political situation and economic hardship prohibit Ukraine from making serious systemic pension reforms, so much needed by the country's economy. The reform that was introduced on 1 October 2011 was limited to a number of parametric changes. In this situation, the venture to balance the account of the Pension Fund of Ukraine by the year 2015, seems highly unrealistic, even though it was originally hailed as one of the tasks for the current government (Lisenkova, 2011: 9). The promised in the media introduction of a significant improvement in this respect already in 2012 (Interfax, 2011) seems even more unattainable.

6. CONCLUSIONS

The Ukraine's pension system seems to be in a critical condition. The inflated pension contribution and resulting large scope of unregistered business activity in the country's economy do not allow for an economic independence of the base of the system, which requires constant subsidizing. Although the legal framework for the second tier is in place, the construction itself is not being implemented because some of the preconditions that have been set forth by the law of 2003 have never been fulfilled. It is also difficult to expect that the decision to rise pension eligibility age for women will shortly lead to the Ukraine's Pension Fund gaining self-financing, which is one of the pre-requirements for the implementation of the II tier. Low incomes of very many employees make it hardly possible for them to save money in voluntary pension funds, and the lack of tax incentives for employers also hampers the development of the III tier of the pension system. Comparing the Ukrainian pension system to those of other countries, it is difficult at present to find in it solutions which could be worth recommendation.

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[16] More on details in the recent publication of (Palmer, 2011: 5 and 6).

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