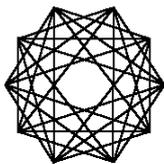


**USAID**  
**Social**  
**Sector**  
**Reform**  
**Program**  
**in Ukraine**

**POLICY**  
**REPORT NO. XX**

**OCTOBER 1998**



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# **STRATEGY FOR TECHNICAL SUPPORT FOR SOCIAL SECTOR REFORM IN UKRAINE**

## **PREFACE**

### **Abbreviations:**

- CoM = Cabinet of Ministers  
GosKomStat = State Committee for Statistics (formerly MinStat)  
GOU = Government of Ukraine  
MinFin = Ministry of Finance  
MLSP = Ministry of Labor and Social Policy  
SCACH = State Committee for Architecture, Construction, and Housing  
SSRT = Social Sector Restructuring Team in PADCO Kyiv Office  
STA = State Tax Administration  
TACIS = Technical Assistance for the CIS (program provided by the European Union)

Since January 1995, USAID has been sponsoring a program to assist the Government of Ukraine in the restructuring of social sector programs. The project began by concentrating on the design and nationwide implementation of the housing subsidy program and the accompanying increases in monthly payments by families for housing and communal services. It has expanded during the past year to include: 1) the creation of a full-scale welfare program to assist low income families; 2) the reform of state and non-state pension systems in Ukraine; 3) the development of collateral systems including auditing, and monthly reporting; and 4) the development of new methodologies for measuring poverty and establishing the poverty level.

The original work was conducted under contract to PADCO. After October 1, 1996, the social sector restructuring project was continued under a contract between USAID and The Bancroft Group, and, after December 1, 1996, additional work was supported by a contract between USAID and Chemonics. PADCO was the principal subcontractor on both contracts. On February 1, 1998, the program was continued under a direct contract with PADCO.

This report describes where Ukraine stands today in the difficult process of developing and implementing a social protection system compatible with the emerging market economy and how technical assistance from USAID can support the GOU in this task. The first part of the report describes pensions – what is needed for effective and efficient state pensions and non-state pensions in Ukraine. The second part describes social assistance programs – programs that are targeted at low-income families and also describes what is needed for an effective and efficient social assistance system in Ukraine. The final section outlines strategies for future USAID-sponsored technical support in the short-term and the medium term in the areas of pension reform and the refinement and development of the system of social assistance.

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# 1. EXECUTIVE SUMMARY

## 1.1 ECONOMIC REFORM REQUIRES SOCIAL SECTOR REFORM

Building market economies from the socialist rubble of the former Soviet Union is a monumentally difficult task. With no legal framework to create and protect private property or human rights, no tradition of democratic decisionmaking, no understanding of how markets work, no road map to show the best path to economic recovery, and split by deep political and social divisions, newly independent states have suffered devastating economic and social collapses.

While new economic opportunities have been created in gray economies for many people, for most the immediate consequence of transition has been poverty. As price controls were lifted, people dependent on government benefits and fixed wages could no longer afford food, housing, energy, and other basic goods and services. Explosions of inflation ignited by attempts to cover budget deficits by printing money eliminated family savings accumulated over many decades -- leaving the elderly with no cushion to protect them from the new economic realities. The abrupt end of the arms race placed millions of manufacturing employees on indefinite lay-off, in part-time employment, or waiting for long-delayed paychecks. The absence of a financial sector to redirect investment funds stifled the growth of new opportunities. Endemic corruption, punitive taxes, intrusive regulations, and xenophobia reduced to a trickle foreign investment, which had supported transition in Central Europe. And worsening budget deficits froze pensions and other government benefits far below subsistence levels. The newly poor resented the bewildering "reforms" that had destroyed their living standards. They turned to political parties calling for a "return to the normalcy" of socialism. These parties fought to

slow or even block reforms -- further exacerbating social and economic problems and discouraging foreign aid.

Socialist economies are ill equipped to combat poverty. The very reforms necessary to create a market economy stripped away the foundations of socialist social protection systems. Basic goods and services had been guaranteed to all by the very price controls that had to be dismantled to create market incentives. Enterprises that had provided their employees with health services, kindergartens, and even vacation sanatoria could no longer afford even to make payroll. Contributions to the state pension system, to unemployment benefit systems, and to disability funds fell precipitously. There were no programs intended to help poor people because acute poverty was a new phenomenon.

Economic reforms required the creation of new social protection systems if movement toward reform was to be sustained. New social protection systems must include restructured social insurance systems -- pensions, unemployment and health benefits, and, in Ukraine, systems to help those harmed by the Chernobyl catastrophe -- and social assistance systems to guarantee subsistence levels of goods and services to the poor.

But social sector reform -- like economic transition -- is a long process. The table on the following page outlines what could reasonably be achieved in Ukraine with a six-year program of USAID-sponsored technical support for social sector reform. The table describes USAID sponsored activities, the resulting changes in Ukraine's social sector and the economic reforms that are enabled by these changes in the social sector.

Year	USAID SOCIAL SECTOR Reform Activities	Structural Reforms in Social Sector	Economic Reforms Enabled by Social Sector Reforms
1	<ul style="list-style-type: none"> <li>• Assistance in design of targeted assistance programs</li> <li>• Assistance in implementation of targeted assistance programs</li> </ul>	<ul style="list-style-type: none"> <li>• Decontrol of prices of food, housing and utilities</li> <li>• Reduction of subsidies from State Budget to agricultural and housing sectors support low prices</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in budget deficit</li> <li>• Stabilization of prices through reduction of monetary emissions</li> </ul>
2	<ul style="list-style-type: none"> <li>• Assistance with automation of administration of social protection programs</li> </ul>	<ul style="list-style-type: none"> <li>• Introduction of auditing and financial reporting</li> <li>• Introduction of MIS systems</li> <li>• Reduction of administrative expenditures</li> <li>• Consolidation of local administrative staff and offices</li> </ul>	<ul style="list-style-type: none"> <li>• Further reduction of budget deficit</li> <li>• Incentives for privatization of housing and communal services</li> <li>• Improvement in local government accountability and administrative efficiency</li> </ul>
3	<ul style="list-style-type: none"> <li>• Assistance with improvement of social and economic statistics</li> </ul>	<ul style="list-style-type: none"> <li>• Improvement of targeting of social assistance benefits</li> <li>• Reduction or elimination of untargeted social entitlements</li> <li>• Stronger political agreement on issues of poverty</li> </ul>	<ul style="list-style-type: none"> <li>• Further reductions in budget deficits</li> <li>• Better measurement of economic performance</li> </ul>
4	<ul style="list-style-type: none"> <li>• Assistance with creation of personified reporting and record keeping by Pension Fund and other social protection programs</li> <li>• Assistance with restructuring of administration of State Pension System</li> </ul>	<ul style="list-style-type: none"> <li>• Improvement in compliance in payroll tax payments</li> <li>• Reductions in administrative cost of state pension system</li> <li>• Reduction in fraud and abuse in calculation of pension benefits</li> <li>• Increases in state pension benefits</li> <li>• Reduction in pension arrears</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in budget expenditures to cover state pension deficits</li> <li>• Reduction in gray economy</li> <li>• Strengthening of rule of law and reduction of corruption in administrative systems</li> <li>• Elimination of workbooks and enhanced labor market mobility</li> </ul>
5	<ul style="list-style-type: none"> <li>• Assistance in the design and implementation of mandatory funding of part of state pension system</li> <li>• Assistance in creation of safe private pension funds through design and implementation of regulatory structure</li> </ul>	<ul style="list-style-type: none"> <li>• Increases in state pensions</li> <li>• Improvement in quality of life of elderly and invalids</li> <li>• Decentralization of investment decisions</li> <li>• Reduction in payroll tax rate</li> </ul>	<ul style="list-style-type: none"> <li>• Development private of capital markets</li> <li>• Increase in long-term private capital investment</li> <li>• Evolution of mature capital market institutions</li> <li>• Improved capacity of governments to borrow in international capital markets</li> </ul>
6	<ul style="list-style-type: none"> <li>• Restructuring of housing and communal services sector</li> </ul>	<ul style="list-style-type: none"> <li>• Reduction in costs and tariffs for basic services</li> <li>• Improvement in the quality of management of communal services enterprises</li> <li>• Improvement in quality of services delivered to families</li> <li>• Reduction in environmental problems associated with communal services</li> </ul>	<ul style="list-style-type: none"> <li>• Ability to receive private and public credits for financing infrastructure improvements</li> <li>• Strengthened administrative capacity and accountability of local governments</li> <li>• Expansion of citizen involvement in tariff setting and local policymaking</li> <li>• Reduction in capital spending financed from State Budget</li> </ul>

## 1.2 BARRIERS TO SOCIAL SECTOR REFORM

Recognizing the need to reform of Ukraine's social protection systems, USAID began in 1994 providing technical assistance to the Government of Ukraine. The initial goal was to support reform of the chronically weak state pension system. In January 1995, USAID extended its assistance to help create a targeted assistance program to protect families from the impacts of rising prices for housing and utilities.

But supporting social sector reform faced daunting obstacles. Few Ukrainian officials understood how social protection systems should operate in a market economy. Neither the public at large nor government officials responsible for implementing new social protection systems understood what was wrong with the existing social protection system, nor what had to be done to improve the worsening situation. Most believed that Ukraine's problems were temporary and would disappear as soon as the economy recovered. In fact, economic recovery was impossible without economic reforms -- and economic reforms were impossible without restructuring social protection systems.

Unfortunately, the basic building blocks for a new social protection system were missing. Reliable data on the economic situation confronting Ukraine's population was almost wholly missing -- while inaccurate and misleading information abounded. The administrative infrastructure to manage social protection programs was also absent. Paradoxically, in the centralized social system, much of the responsibility for managing social protection programs had been delegated to state enterprises. For those few programs for which government agencies were responsible, management was primitive. "Caseloads" were handled at the local level, with only summary information -- or misinformation -- shared with higher levels of government or with other government agencies. There were no databases of program recipients or personal incomes, and few staff with any understanding of how to create the missing information. Decision-makers in Kyiv relied on anecdote and tradition. Computers, copiers, calculators, and communications systems were absent. Most offices lacked even stationary, bookshelves, and pens. Management systems had never been developed and neither financial flows nor program effectiveness were audited. Office procedures were learned by rote; offices lacked

training programs, manuals, and even copies of enabling legislation.

The Soviet system of central control had eliminated individual initiative from the enormous bureaucratic pyramid that ran social protection programs. Officials at all levels emphasized performing tasks according to the book rather than to achieve results. This is a bureaucratic failing in all nations -- but much worse in the former Soviet Union. Bureaucrats faced sanctions if their paperwork was not in order -- heavy sanctions since nearly 40% of annual take home pay was in the form of quarterly or annual bonuses that depended on paperflow not results.<sup>1</sup> With no timely and accurate data about what was happening in the field, managers had no idea whether programs were working well and innovation was more likely to result in punishment than reward.

Despite the size of the Soviet bureaucracy, it was without effective management. The top was bare -- large programs were administered in the center by a handful of officials. The entire Ministry of Labor and Social Policy in Kyiv housed no more than 120 people. They were responsible for overseeing local staff of more than 100,000 people who administered orphanages, homes for the elderly, childcare assistance, social services, and targeted assistance programs. They were also supposed to be responsible for developing new policies and programs. With no computers and no reliable reporting systems, theirs was an impossible role. When the Ministry created the housing subsidy program, which serves 4 million families and allocates benefits worth nearly \$500 million today, it set up a new department of 8 people -- including two secretaries -- to run the new initiative.

Soviet systems for administering social protection programs ignored the needs of "customers." Of course, the media was in no position to explore and publicize bureaucratic abuses. When the housing subsidy offices were about to open, and PADCO staff expressed concern over the potential for long lines of applicants if utility prices were raised sharply, a senior Cabinet official observed that "the Ukrainian people are used to standing in line . . .

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<sup>1</sup> One of the housing subsidy offices set up through the USAID/PADCO social sector restructuring project (see below), eliminated much of the paperwork when it was computerized. It maintained records -- backed up daily -- in its computer network. Needless to say, Ministry officials initially penalized the office for not having the required piles of hard copy littering its closets.

one more line won't hurt them." He was unable to understand the importance of minimizing problems during the introduction of a totally new means-tested program. In the end, the price increase was delayed by one month, and long lines were minimized.

Technical assistance did not succeed when it was limited to policy advice. However willingly GOU counterparts listened to foreign experts about how to design reforms, they lacked the institutional infrastructure and staffing skills to implement even modest changes.<sup>2</sup> In fact, GOU officials became adept at listening to the advice of foreign experts, cordially agreeing to implement whatever was recommended, only to abandon activity as soon as the expert left. With no paper, typewriters, or FAX machines, and unable to pay for long distance telephone calls, officials could do little without more comprehensive foreign assistance, no matter how strongly they supported reform.

Technical assistance, therefore, had to be comprehensive – not only pointing in the general directions of reforms, but also figuring out how to implement them. Technical assistance succeeds, therefore, only if it supports implementation. But most foreign experts do not enjoy the messy business of implementation -- it requires a level of knowledge that they prefer to leave to research assistants. But, as architect Mies van de Rohe observed, God is in the details.

How comprehensive donor assistance encourages systemic reform is illustrated by the speed with which the housing subsidy program was implemented. This contrasts which much slower progress on pension reform during 1996 and 1997, when assistance focused on policy recommendations rather than on a full-scale program of technical assistance. These contrasting stories are related in the following two sections of this summary. The final section describes what needs to be done to support continued progress in the social sphere. A list of the important activities and achievements under the USAID/PADCO Social Sector Reform Project are provided in Tables S.1.A and S.1.B at the end of this executive summary.

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<sup>2</sup> Even in well-run departments, it could take between two or three months for copies of new laws, decrees and instructions to trickle down into the field offices where they were needed.

## 2. AN OVERVIEW OF USAID'S SUCCESS IN UKRAINE

Social sector reform in Ukraine has been a successful collaboration between the Government and international donors – led and coordinated by the United States Agency for International Development. It has been characterized by its emphasis on supporting economic reforms and on creating systems that are fiscally sustainable. The table beginning on the following page lists the major USAID sponsored activities during the period 1995 – 1999 as well as the tangible outcomes achieved.

By any measure, Ukraine's achievements are impressive: despite severe economic adversity and deepening economic problems, the GOU managed to enact enabling legislation for the housing subsidy program within two months of raising tariffs for housing and communal services. It opened 750 offices within three months of enacting the decree, and enrolled one million families within five months of opening offices. It has also raised tariffs for housing and utilities from 4% of costs to 80% of costs within two years, reduced government subsidies for the housing sector by over \$1 billion annually, created audit and reporting systems, and has held program costs in tight control. At the same time, the automation of program administration has allowed administrative costs of the targeted assistance program to be kept below 1.5% of the value of targeted benefits distributed to low income families.

One way of measuring the extent to which the social sector reform program has met the needs of the Government of Ukraine is the extent to which the fiscally strapped GOU has committed its own resources to implementing the reforms supported by USAID. The major commitments by the GOU in the past three and one-half years include:

- The GOU created 756 Housing Subsidy Offices and approved and paid for the 7,000 full time staff for those offices;
- Oblast and local administrations purchased more than 600 computers and related equipment (printers, UPSs) from local resources to equip housing subsidy offices to match the 400 computers provided by USAID;

- The GOU created a department in the Ministry of Labor and Social Policy with a staff of 8 to manage the housing subsidy program;
- The Ministry of Labor and Social Policy has created an e-mail system using government lines to all oblasts and is now extending this system to all local offices in 609 raions and 145 oblast subordinated cities and towns, using the Ministry of Internal Security system;
- The Ministry of Finance has approved and financed the creation of an Office of the Actuary within the Pension Fund with 5 staff to support the development of the actuarial model of the pension system;
- The GOU has enacted over 50 Presidential and Cabinet decrees needed to implement recommendations of the USAID/PADCO social sector reform project;
- The GOU has implemented (and paid for) large scale pilot projects to develop new systems – including a nationwide audit of over 100,000 applicants for housing subsidies, the development of new reporting systems for the Pension Fund, and the linking of pension offices with housing subsidy offices; and
- The Ministry of Labor and Social Policy has created a permanent monthly training program in Ministry facilities, which every month trains 25 local social protection staff in the use of new computer software.

The success of the program of social sector reform has helped the USAID Mission in Kyiv meet four of its nine strategic objectives for its technical assistance programs in Ukraine. These are:

- Increased soundness of fiscal policies and fiscal management practices. Social protection programs account for nearly two-thirds of the Consolidated State Budget – therefore, the improvement in efficiency and effectiveness of these programs coupled with the elimination in wasteful subsidies for the housing and communal services sector is exerting a large impact on Ukraine's overall fiscal soundness.
- More effective, responsible, and accountable local governments. Two thirds of all spending for social protection programs is made by local

governments – out of the local portion of the Consolidated State Budget. The MIS and reporting systems developed over the past three years and the increased accountability embodied in them is improving local government practices.

- Improved sustainability of social benefits and services. Sustainability depends on tight targeting, cutting general entitlements, and on the creation of accurate fiscal forecasting models of the annual costs of social protection

programs. The actuarial model of the pension system and the monthly reporting system developed for the housing subsidy program allow accurate forecasting of program costs.

- Reduced human suffering and mitigating the impacts of economic and social crises. Targeted social assistance programs and social insurance programs have the greatest effect on reducing human suffering during the period of economic transition.

## SUMMARY OF ACHIEVEMENTS RESULTING FROM USAID TECHNICAL SUPPORT FOR SOCIAL SECTOR REFORM IN UKRAINE

Year	USAID Project Activities	Tangible Outcomes
<b>Focus in 1995 on : Development of Targeted Housing Subsidy Program</b>		
<b>1995</b>	<ul style="list-style-type: none"> <li>• Created legal and administrative basis for Housing Subsidy Program -- drafting 7 normative acts adopted by Cabinet</li> <li>• Supported implementation of utility pricing reform – beginning the process of raising payments from 4% to 80% of costs</li> <li>• Observational tour of 18 cabinet members to Nizhny Novgorod to view operation of USAID supported housing assistance program in Russia.</li> <li>• Office procedures manual provided for all local housing subsidy offices</li> <li>• Managed training of 6,000 local office staff and established office operating procedures for housing subsidy program</li> <li>• Educated public on need for targeted assistance and utility rate increases through numerous TV and radio advertisements and dozens of press conferences</li> <li>• USAID installs 40 computers in pilot housing subsidy offices</li> <li>• Developed first version of NASH DIM caseload management software, installed in 200 offices, and trained 200 staff in its use.</li> <li>• Conducted 3 observational tours in USA of 40 senior Ukrainian officials from MLSP and from oblasts to view social assistance systems in operation in Washington DC and Madison, WI.</li> </ul>	<p><b>February:</b> Cabinet Decree No. 89 issued, creating the housing subsidy program.</p> <p>Housing and utility payments raised to 20% of costs</p> <p><b>March:</b> Cabinet of Ministers sets up department in Ministry of Labor and Social Policy to manage housing subsidy program</p> <p><b>April:</b> Although the Cabinet was dismissed by Supreme Rada for failing to protect population from impacts of price reforms, two attempts by Supreme Rada to roll back tariff increases were defeated as a result of information package on housing subsidy program distributed to all deputies</p> <p><b>May 3:</b> 750 housing subsidy offices are opened nationwide and begin receiving applications</p> <p><b>June:</b> Housing and utility payments raised to 30% of costs</p> <p><b>August:</b> Housing subsidy program extended to cover rural families' purchases of liquid gas and heating fuel</p> <p><b>Sept:</b> Housing and utility payments raised to 40% of costs</p> <p><b>October:</b> One millionth family receives housing subsidy</p> <p style="text-align: center;"><i>Net budget savings for 1995 (in today's prices): 100 million Hrn</i></p>
<b>Focus in 1996 on: 1) Automation of Housing Subsidy Program and 2) Development of Information and Reporting Systems</b>		
<b>1996</b>	<ul style="list-style-type: none"> <li>• Seven additional normative acts drafted and</li> </ul>	<p><b>January:</b> Housing and utility payments raised to 60% of costs</p>

	<p>issued by Cabinet to improve housing subsidy program</p> <ul style="list-style-type: none"> <li>• Automated many local housing subsidy offices: <ul style="list-style-type: none"> <li>❑ Installed 355 USAID-purchased computers</li> <li>❑ Revised/installed NASH DIM caseload management and reporting software in 300 Offices</li> <li>❑ Fully automated applicant processing and report preparation</li> <li>❑ Trained 600 local staff in use of computers and software</li> </ul> </li> <li>• Linked social protection offices and housing subsidy offices to allow automatic enrollment in program of pensioners and invalids</li> <li>• Designed and tested auditing system of applicants for means-tested assistance</li> </ul>	<p><b>February:</b> Two millionth family receives housing subsidy</p> <p><b>August:</b> Housing and utility payments raised to 80% of costs</p> <p><b>July:</b> Ministry of Labor and Social Policy introduces monthly training sessions for housing subsidy local office staff</p> <p><b>October:</b> Three millionth family receives housing subsidy</p> <p><b>November:</b> Nationwide pilot audit of a sample of housing subsidy program applicants and offices conducted</p> <p><i>USAID/PADCO caseload software used in 300 local offices</i></p> <p><i>Local governments purchase 300 computers</i></p> <p><i>Net budget savings for 1996: 900 million Hrn</i></p>
<b>Focus in 1997 on: 1) Improvement of Housing Subsidy Program, 2) Design of Pension reforms, and 3) Design of Guaranteed Minimum Income Program</b>		
<p><b>1997</b></p>	<ul style="list-style-type: none"> <li>• Eleven major normative acts drafted and issued by Cabinet</li> <li>• Installed Local Area Networks in 130 oblast and local housing subsidy offices</li> <li>• Designed and implemented monitoring system of caseload and financial flows</li> <li>• Designed and tested individualized pension reporting system</li> <li>• Created Electronic Library of all normative acts, automatically updated, which is installed in all oblasts and in large local offices,</li> <li>• Created e-mail based communications system linking all oblasts and many local offices to the Ministry of labor and Social Policy</li> <li>• Created reporting system for State Committee for Statistics on utility indebtedness among families and local budgets</li> <li>• Developed automated system for linking housing subsidy offices, local social protection offices, and State Tax Administration</li> <li>• Developed plan for poverty monitoring system</li> <li>• Designed first stage of Targeted Family Assistance Program</li> </ul>	<p><b>March:</b> Automated system of monthly reporting created from 32 pilot housing subsidy offices to show financial accounts and caseloads</p> <p><b>June:</b> Ministry begins to use e-mail to issue instructions, rules and regulations to oblasts and local offices</p> <p><b>September:</b> Two-week seminar held on social statistics and reporting systems for GosKomStat and oblast officials</p> <p><b>October:</b> Nationwide program to audit incomes of applicants begun</p> <p><b>October:</b> Supreme Rada approves World Bank loan of \$2.6 million to computerize all housing subsidy offices</p> <p><b>November:</b> Pilot program to test computerized payments systems for ZHEKs completed in 5 test sites</p> <p><b>November:</b> State Committee for Statistics introduces new monthly reporting system on housing subsidies and utility indebtedness</p> <p><b>November:</b> Caseload of housing subsidy program reaches maximum and begins to decline</p> <p><b>December:</b> Completion of pilot program to create personified pension reporting system</p> <p><i>Local governments purchased 500 computers for housing subsidy offices</i></p> <p><i>Net budget savings for 1997: 2.4 billion Hrn</i></p>

	<ul style="list-style-type: none"> <li>Designed software for nationwide auditing</li> </ul>	
<p align="center"><b>Focus in 1998 on: 1) Refinement of Targeted housing subsidy program, 2) Reform of Pension System, 3) Measurement of Poverty, 4) Creation of Guaranteed Minimum Income Program</b></p>		
<p><b>1998</b></p>	<ul style="list-style-type: none"> <li>Drafted new law on family assistance (in collaboration with MLSP an TACIS)</li> <li>Designed and installed caseload management software for childcare assistance program</li> <li>Designed and installed monthly reporting system for Ministry of labor and Social policy for social protection programs</li> <li>Designed software and training program for oblast and local office management information systems</li> <li>Developed actuarial model for state pension system</li> <li>Analysis of poverty assessment methodologies with recommendations for reform</li> <li>Begin assistance to Pension Fund to create nationwide personified reporting system</li> <li>Begin assistance to MLSP to install and utilize 1,000 computers purchased with World bank credit</li> <li>Develop software for caseload management of targeted family assistance program</li> <li>Seminars held on pension reform issues</li> </ul>	<p><b>February:</b> Ministry successfully conducts first-ever competitive tender to purchase of 1,000 computers for housing subsidy offices</p> <p><b>March:</b> Mikolaiv Oblast transfers childcare assistance program to local social protection offices from enterprises</p> <p><b>July:</b> Ministry of Labor and Social Policy submitted draft law on Targeted Family Assistance to Cabinet of Ministers</p> <p><b>August:</b> Housing and utility payments raised to cover 100% but reversed by Supreme Rada</p> <p><b>August:</b> Family share of monthly utility payments for housing subsidies raised from 15% to 20%</p> <p><b>September:</b> Seminar conducted on Non-State Pension Systems for 26 senior officials</p> <p><b>October:</b> Pension Fund begins Office of the Actuary</p> <p><b>October:</b> <i>Pilot personified reporting programs begun in L'viv oblasts</i></p> <p><b>December:</b> Design and instructions for new Quarterly Survey of Family Income and Expenditures completed</p> <p><b>December:</b> Cabinet approves new targeted assistance program</p> <p>Local governments purchase 300 additional computers and Ministry purchases 1,000 computers with World Bank loan in first closed bid competitive tender</p> <p><i>Projected net budget savings for 1998: 2.6 billion Hrn</i></p>
<p align="center"><b>Focus in 1999 on: 1) Complete the Automation of Housing Subsidy Program; 2) Implementation of Reform of Pension System, 3) Setting the Poverty Level, 4) Implementation of Unified Targeted Assistance Program</b></p>		
<p><b>1999</b></p>	<ul style="list-style-type: none"> <li>Implement reforms in delivery of pension benefits:</li> <li>Assist Pension Fund and Ministry to develop legislative strategy for reform of state and non-state pension systems</li> <li>Train staff in Office of the Actuary</li> <li>Complete development of actuarial model of state pension system</li> <li>Design regulatory system for non-state pension funds</li> <li>Assist Pension Fund and Ministry to implement pilot non-state pension programs</li> <li>Restructure nationwide system of offices providing targeted family assistance</li> <li>Develop and install new integrated software for managing all programs of targeted</li> </ul>	<p>Installation of 1,088 computers in housing subsidy offices</p> <p>Train 500 local office housing subsidy staff in use of computers</p> <p>Train 500 Ministry local office staff in use of computers for targeted assistance program</p> <p>Integration of housing subsidy offices and Ministry Offices of Social Assistance into single social assistance system</p> <p>700,000 families enrolled in targeted family assistance program – caseload of housing subsidy program reduced by 10% and costs reduced by 20%</p> <p>Transfer responsibility for calculating pensions from Ministry to Pension Fund</p> <p>Personified reports prepared by 25% of all enterprises in Ukraine by end of year</p> <p>Passage by Supreme Rada of amended laws on State and Non-State Pension Systems</p>

	<p>assistance</p> <ul style="list-style-type: none"><li>• Reform system for establishing poverty level and improve national family income statistics</li><li>• Reduce privileges and entitlement programs</li></ul>	<p>Begin to eliminate workbooks</p> <p><i>Projected Net budget savings for 1999: 1.0 billion Hrn for targeted social assistance programs, 1 billion Hrn from reducing privileges, and 2.0 billion + for pension system reforms</i></p>
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### **3. SUCCESS THROUGH COMPREHENSIVE TECHNICAL ASSISTANCE: THE HOUSING SUBSIDY PROGRAM**

#### **3.1 BACKGROUND**

In 1994, Ukraine faced an acute financial crisis. After independence in August 1991, it had resisted making reforms in its obsolete and increasingly indebted economy. It had run up huge debts continuing to pipe in almost all the oil and gas it used from Russia and Turkmenistan at vastly increased prices. The budget deficit had reached 10 percent of GDP and the policy of printing money rather than cutting spending had caused runaway inflation.

With the winter heating season imminent, Ukraine turned to the International Monetary Fund to borrow enough to keep Russia from turning off the energy supplies. But the IMF demanded reforms as the condition for granting credit. On October 20, 1994, an accord between the IMF and Ukraine was announced. Under the agreement, Ukraine received a standby credit of up to \$1.7 billion, to be paid in four tranches if Ukraine met a series of conditions – known by the IMF neologism as “conditionalities.” For its part, the Government of Ukraine promised price deregulation (including rapid increases in the prices for housing and communal services) as well as accelerated privatization, reduced deficits, monetary discipline, and other changes. The Government scheduled a series of utility price hikes that would lead to monthly housing payments that would cover 80 percent of cost within less than one year. Although the schedule proved overambitious -- 80 percent cost recovery was actually attained reached in August 1996 rather than on the target ate of September 1995 -- Ukraine eventually managed increases faster than most other members of the former Soviet Union did.

The Government and the IMF were notably silent on whether Ukrainian families could afford the scheduled increases and what could be done for those that could not. The IMF's unofficial position was that because there was a lot of hidden income in Ukraine, most families could probably pay. But families without hidden incomes would soon face monthly bills requiring

them to pay 60 percent or more of their income on housing and communal services. Many pensioners, invalids, and single mothers could barely buy enough food, even at subsidized prices. The typical three-member family lucky enough to live in a three-room apartment (about 500 square feet), would have had to pay in excess of \$30 per month – nearly half their average monthly income at the time. Single pensioners in big apartments would have been asked for monthly payments in excess of their monthly state pension just to keep the lights on and the gas stove alight.

The Cabinet of Ministers issued a hasty patchwork of decrees intended to help families cope with higher prices: state enterprises were ordered to give out wage supplements and the state promised pension supplements. But enterprises and national ministries lacked money and administrative structures to honor these promises. Three months later, when the housing subsidy program replaced these measures, no money had been paid under these programs to assist families.

#### **3.2 THE BEGINNING OF THE HOUSING SUBSIDY PROGRAM**

When monthly payments were raised to 20 percent of costs -- retroactively effective to October 1, 1994 -- a cadre of socialist and communist deputies from the Supreme Rada called on the population not to pay the increases. The Cabinet hastily abolished all penalties on paying late. Arrears soared. But the issue of how families could pay for housing became mute by Christmas 1994. Currency emissions issued each fall to pay for the diminishing harvests and to prop up state enterprises had rekindled inflation. The new high prices for housing rapidly shrunk in real terms until households were paying no more than before price reform. The same Cabinet Decree that raised prices for water, heat, and electricity had also freed prices of many foodstuffs. Food prices were free to follow inflation while tariffs for housing and communal services could be adjusted only by Cabinet decree.

Ukraine received the first tranche of its IMF loan and used most of it to pay Russia enough to ensure adequate fuel supplies for the winter. But it was no nearer solving its deepening financial and economic problems. With the IMF making sure its conditionalities were obeyed, First Vice Prime Minister V. M. Pynzenyk asked USAID to help design a way of targeting assistance to low-income families that would allow housing sector price reforms to continue. In January 1995, USAID contracted with PADCO, a private consulting company that had been working in Ukraine for two years on housing and communal service pricing issues, to provide this help. The goal of the new project was to develop a means-tested social assistance program – the first in Ukraine -- for poor families to protect them from the full impacts of rising monthly payments for housing and utilities.

Within a few weeks, on February 4, 1995, a new Cabinet Decree was drafted and issued, creating a housing subsidy program to assist eligible low-income families. Less than three months later -- on May 3 -- 750 offices were opened throughout Ukraine to receive applications from families. The housing subsidy is not a cash benefit to families. It is a discount on monthly payments equal to the difference between 20% of income (then, only 15% of income) and actual payments (within the standardized amount of space for the family size). Housing maintenance organizations and utilities were to be paid directly by the Ministry of Finance to compensate for these subsidies. Families are eligible, whether tenants or homeowners. Rural families facing annual payments for liquid gas and solid fuel for heating (within the standardized amount of space for the family size) in excess of 20% of annual family income can also apply.

The first subsidies were granted within a few days of the offices being opened. Before offices opened, the USAID/PADCO project had designed, printed, and distributed more than a million copies each of the six standard forms needed by local offices. By the end of 1996, one and a half years after subsidy offices first opened their doors, about 4 million of Ukraine's 17.1 million families were receiving assistance monthly to help pay monthly utility payments or to assist in purchasing annual heating fuel supplies.

Since that date, the number of families receiving assistance has slowly declined, as incomes reported by applicants grow (despite the absence of measurable economic recovery). Single

parents and single pensioners make up a disproportionately large share of families participating in the program. By December 1997, the average per family subsidy was about 30 Hrn/month – equivalent to about 26% of the average family income of participating families. For single pensioners, the average housing subsidy was equivalent to an increase of pension benefits of 65%.

### **3.4 THE ACHIEVEMENTS OF THE HOUSING SUBSIDY PROGRAM**

The housing subsidy program has become widely accepted by the public and by elected leaders as an essential part of the Government's social assistance policy. In 1998, the program was in the process of being reshaped from a program providing housing subsidies into the foundation of Ukraine's new, means-tested, social assistance program that will provide both cash and in-kind benefits for poor families.

The program succeeded in supporting Ukraine's ambitious program of increasing the prices for housing and utilities. The Government has been able to increase the share paid by families from 4 percent in late 1994 to nearly 100% today (lack of accounting reform in the housing and communal services sector prevents an accurate assessment of the true rate of cost recovery). As a result, the Government net savings in 1997 from increasing housing and utility payments, even after paying for targeted housing subsidies to low-income families, were 2.4 billion Hrn. (or \$1.3 billion). In two and one half years, net savings to the budget has totaled more than \$2 billion. The projected savings for 1998 are for a further savings of over \$1 billion.

## 4. PARTIAL TECHNICAL ASSISTANCE: THE CASE OF PENSION REFORM

### 4.1 BACKGROUND

The state pension system collapsed during 1993 and 1994, when hyperinflation reduced the real value of pension benefits by 70 percent. Overnight, invalids and the elderly became the new poor. Their financial hardship was sadly exacerbated because inflation had also wiped out most of the value of the savings accounts held by many pensioners as insurance against economic adversity in old age.<sup>3</sup>

At the same time, as more and more enterprises encountered financial difficulties, they became less and less regular in paying contributions to the Pension Fund. In 1996, the Government increased pensions for the first time in nearly two years. Predictably, pension arrears mounted. By mid-1998, arrears exceeded 2.5 billion Hrn – between 3 and 4 months of pensions. Arrears were not spread evenly throughout the country. Areas where tax revenues were equal to or above projections -- such as the City of Kyiv, the City of Donetsk, and Dnipropetrovsk -- were able to pay pensions on time. Other areas fell chronically behind. This very disparity in payment discipline was a symptom of the fragmented nature of the State Pension system and its imperfect operations.

### 4.2 TALKS, TALKS, AND MORE TALKS

Because of the size and urgency of the pension crisis, international donors were quick to offer advice. Beginning in 1994, USAID, the International Labor Organization, the United Nations Development Program, TACIS, the Government of Germany, among others, began sending advisors to help the GOU develop a strategy for pension reform. These advisors worked with counterparts in the State Pension Fund, the Ministry of Labor and Social Policy, and the Ministry of Finance, and with trade

unions. They organized round tables, seminars, and conferences to educate officials about how pension systems operated in other countries and attempted to agree on fiscally and politically feasible reforms. Donors wanted to reach a consensus on the shape of pension reforms before committing large-scale assistance. Discussions, for the most part, ranged over general issues -- raising the pension age, improving the rate of collection of contributions, and relating benefits more closely to work experience and past earnings.

Unfortunately, no concrete agreement was reached. But the reasons for this failure offer important lessons for the design of technical assistance strategies. In the first place, most Ukrainian counterparts understand neither the size nor the causes of the problem. Denial was inevitable because long-time administrators had built their careers in a system that they did not want to abandon. They wanted the problems to be a short-term “aberration” -- to be resolved when the economic situation stabilized, allowing them to return to their prior *modus vivendi*. The lack of understanding could not be remedied because few of the participants trusted the information distributed at meetings by foreign advisors. The Pension Fund of Ukraine had never built its own actuarial model to make projections. Each year, forecasts were hastily made based on vague and undocumented assumptions. With no agreement on the facts, there could be no agreement about what to do.

In early 1997, TACIS, the World Bank, and the Harvard Institute for International Development all tried to build agreement around their own models. This failed because the models were built with little or no participation by staff from the Pension Fund, the Ministry, or even Cabinet of Ministers. They were largely indecipherable to the untrained Ukrainian counterparts -- often not even translated into Ukrainian (or Russian). Counterparts were expected to “trust” the models on the basis of the foreign advisors’ superior expertise. One attempt to train counterparts in actuarial skills by TACIS (using a simple EXCEL model of Ukraine’s state pension system) failed because the Ukrainian participants lacked basic mathematical and modeling skills. After TACIS

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<sup>3</sup> In 1994, the Government promised to compensate all those who had been holding savings with the state banks where they had lost their savings. However, the first repayments were not made until 1998, when compensation was paid only to the estates of those who had since died.

experts left, Ukrainian staff were still unable use the model to analyze options for pension reform. As a result, none of the draft pension reform laws submitted to the Supreme Rada in 1998 had been rigorously analyzed.

A second reason for the failure to reach agreement was the unwillingness of Ukrainian counterparts to consider reforms that would rearrange responsibilities among different agencies. The desire to defend turf can blind even the best-qualified bureaucrat to the merits of proposed reforms. Foreign experts had already made it clear that they favored consolidating revenue collection responsibilities within the State Tax Administration (which would collect both taxes and contributions to social insurance funds). This would deny the State Pension Fund its only real administrative responsibility. At the same time, other proposals were circulating to move the responsibility for calculating and distributing pensions from the Ministry of Labor and Social Policy to the Pension Fund – a logical step since the Pension Fund was responsible for balancing receipts and expenditures each year. Patronage and power issues providing a subtext to all discussion of pension policy. Ukrainian officials proved willing to agree to almost anything at discussions involving foreign experts -- in the hope of participating in observational tours or receiving computers in their offices. But, once foreign advisors had left the room, they refused to give any ground to their colleagues.

Third, even if Ukrainian officials were willing to agree to a reform proposal, they lacked the knowledge and resources to design and implement them. Foreign advice about pension policy was, necessarily, offered at a fairly high level of abstraction. Foreign advisors had only a vague understanding of how the state pensions system operated in practice. But translating general advice into specific implementation plans proved difficult for inexperienced counterparts. Departments responsible for administering different aspects of the pension system are, by western standards, tiny. There are only 120 staff in the Ministry of Labor and Social Policy head office in Kyiv managing all social protection programs – from childcare and housing subsidies to systems for calculating and distributing pensions and overseeing dozens of orphanages, old people's homes, and sanatoria.<sup>4</sup>

Ministry departments could rarely afford either the time or the money to prepare and print materials, hold training seminars, and pay for the hundreds of other tasks to make reform happen. They needed all types of help. But foreign donors were unable, or unwilling, to enter into the details of pension reform. They were willing to comment on various draft laws, but not to assist counterparts in developing a workplan for implementation. Since counterparts rarely knew whether their new foreign friends would help pay at least part of the costs of implementation, they were rarely willing to commit their own overextended staff and budgets to beginning to work on the details themselves.

The slow development of pension reform, therefore, was due to the fact that, while many donors offered general advice, no one had offered a comprehensive program of technical assistance. Neither donors nor counterparts had a clear vision of what steps were needed to implement pension reform.

### 4.3 ENTER THE WORLD BANK

The situation changed in early 1997. The extent of the deterioration of the State Pension system became less easy to deny and the March 1998 elections for the Supreme Rada loomed. The Harvard Institute for International Development had assisted Vice Prime Minister Victor Pynzenyk to prepare a series of draft reform bills addressing bankruptcy law, pension reform, tax reform, the elimination of privileges, and proposals to accelerate privatization of state-owned assets. This broad reform package was divided into bite-sized portions by the Supreme Rada, and picked apart, bill by bill. The reform program contained no implementation plans for the numerous recommendations offered. It attempted to do too much too quickly.

From the wreckage of the reform program, the Cabinet of Ministers created a Pension Reform Task Force in February. Its goal was to develop a pension reform package extensive enough to justify applying for a credit from the World Bank for between \$200 million and \$400 million. The money would be used to pay off pension arrears and finance systemic reforms in the State Pension system. The Task Force began intensive meetings in April 1997. At the end of June, however,

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<sup>4</sup> A department in the Ministry with a staff of only 8 people (including two secretaries), for example, manages the entire housing subsidy program. The Department of Health and Human Services, in

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Washington DC, would have at least 300 staff, backed up by modern computer and communications systems, to run a comparable program.

discussions were suspended. The GOU rejected two “deal breaking” conditions set by World Bank experts: 1) to begin immediately raising the age at which people would be eligible to receive pensions; and 2) begin funding a portion of the state pension by diverting a part of current contributions into notional individual accounts. Throughout the Task Force’s deliberations, there had been little concrete discussion about how the massive -- and growing -- deficit in the State Pension system would be covered.

The Harvard Institute for International Development had recommended a more radical solution -- the immediate replacement of the State Pension system with a fully privatized system modeled on the Chilean system. But papers distributed by HIID were silent about how to cover the deficit in the present state system and how to deal with administrative details such as ensuring the integrity of private individual accounts or how to distribute social pensions.

#### 4.4 A MORE PRAGMATIC APPROACH

Following the suspension of talks concerning the credit from the World Bank, and the rejection by the Task Force of a fully privatized pension system, Ukraine and USAID-contractor PADCO initiated a more pragmatic approach. Whatever changes were finally made in the state and in private pension systems, Ukraine needed to find ways to pay adequate pensions on time and to begin building the information infrastructure as the foundation for future pension reforms. In the summer of 1997, PADCO successfully developed and implemented a prototype software program in collaboration with the Pension Fund of Ukraine and the Ministry of Labor and Social Policy. The program allowed enterprises to prepare for the Pension Fund quarterly reports showing for each employee (identified by TIN number) how much salary had been paid and how much contribution was due for each individual to the Pension Fund. This project is referred to as “personification of the pension reporting system.”

Under a new contract with USAID, beginning on February 1, 1998, PADCO brought in a new actuarial expert who began developing an actuarial model of the Ukrainian pension system in collaboration with the Ministry of Finance, the Ministry of Labor and Social Policy, and the Pension Fund of Ukraine. By August 1998, this model was being refined based on detailed comments from technical staff from each of the collaborating agencies. In addition, the Ministry of Finance had agreed to create, within

the Pension Fund of Ukraine, an Office of the Actuary, that would be staffed by individuals with mathematical and computer background and would be tasked with the responsibility of manipulating the actuarial model. This would create a permanent capacity in Ukraine to operate models that could actually project revenues and expenditures of the state system under alternative scenarios for reform. This capacity is needed for the Cabinet of Ministers to proceed through the complex and politically tense process of implementing pension reform.

At the same time, the Pension Fund asked for further help implementing the personification project -- refining the software, developing a system for building personified databases within the pension fund, and training enterprises and Pension Fund staff in the use of the new system. The President and the Cabinet of Ministers enacted decrees permitting an expanded pilot-testing of the personified reporting systems in Moskovska Raion in Kyiv and in L’viv Oblast. Personified reporting is the first necessary step toward building a central database for the pension system in which contributions paid on behalf of, or by, all working Ukrainians are recorded and maintained. This database -- similar to that maintained by the U.S. Social Security Administration -- will allow closer monitoring of delinquent payers as well as the core administrative mechanism calculating and distributing pension benefits. This personified database will also be necessary for effective regulation of any system of private pension accounts.

Ukrainian counterparts have agreed on the necessity of these two steps toward pension reform -- breaking the deadlock in earlier discussions of pension reform options. At last, projections of the fiscal consequences of alternative proposals could be agreed to by all participants.

Before any pension database analogous to the database maintained by the Social Security Administration in the USA can be created in Ukraine, the State Pension Fund must invest in modern efficient computers. The State Tax Administration has already done this. The USAID/PADCO project developed a proposal under which a World Bank credit of up to \$40 million. The credit would pay for computer equipment and software development to build a database analogous to that maintained by the US Social Security Administration. This database would move Ukraine closer to being able to manage the calculation and distribution of pension

benefits and to eliminate the inefficient and corruption-prone system under which all records of working Ukrainians are maintained through workbooks.

Of course, these important steps toward pension reform do not solve the problems that prevented agreement on the World Bank credit in 1997 – raising pension ages and beginning to fund the state system. But by working through these steps, more and more Ukrainian decisionmakers are beginning to understand the breadth and depth of needed reforms. The President and the Cabinet of Ministers have both indicated, informally, that the GOU is preparing to consolidate responsibility for tax collecting under the State Tax Administration and to give full responsibility for

calculating and distributing pensions to the Pension Fund. The final decrees implementing these changes had not been issued by August 1998. A pilot program, however, to transfer the responsibility for calculating benefits to the Pension Fund had been approved. The Cabinet of Ministers has submitted a pension reform bill to the Supreme Rada that would begin funding a portion of the state pension system – albeit not in a form that yet appears fiscally feasible. And a growing cadre of officials admit – at least in private – that the pension age will have to be raised – and there are draft decrees that will provide financial incentives for people choosing to delay receipt of their pensions.

## 5. MEASURING SUCCESS OF USAID TECHNICAL ASSISTANCE FOR SOCIAL SECTOR REFORM

The previous sections have described two different programs intended to bring about systemic reform in Ukraine's social sector – one, successful almost immediately, the second beginning to succeed after four years and only after changing its approach. The implication is that technical assistance for systemic reform must be comprehensive and must, from its inception, support implementation as well as general policy guidance.

How can the chances for success be strengthened in future USAID-supported technical assistance for social sector reform? This section describes ways in which USAID can design technical assistance programs to improve the chances of success. Four criteria should be applied to measuring the success of USAID technical assistance programs.<sup>5</sup>

1. Did the project meet its objectives;
2. Did the project lead to systemic changes;
3. Was the project conducted in a cost-effective manner; and
4. Did the project meet the needs of the host country?

Measured against each of these objectives, as is shown below, the social sector reform program has been successful.

### 5.2 MEETING PROJECT OBJECTIVES

The USAID Mission in Kyiv has defined nine strategic objectives for its technical assistance programs in Ukraine. Four of these objectives have been applied directly to the social sector reform program in past and present contracts. These objectives are:

- Increased soundness of fiscal policies and fiscal management practices. Social protection programs account for nearly two-thirds of the Consolidated State Budget – therefore, any improvement in the efficiency and effectiveness of spending of social protection programs will have a potentially large impact on the overall fiscal soundness of the Budget.
- More effective, responsible, and accountable local governments. Two thirds of all spending for social protection programs is made by local governments – from the local portion of the Consolidated State Budget. Improving the efficiency and effectiveness of social protection programs and holding them strictly accountable for results will improve local government practices.
- Improved sustainability of social benefits and services. Sustainability depends on the creation of accurate fiscal forecasting models of the annual costs of social protection programs. The actuarial model of the pension system and the monthly reporting system developed for the housing subsidy program

<sup>5</sup> See Raymond J. Struyk, *Making AID Work: Lessons from Successful Technical Cooperation in the Former Soviet Bloc*, The Urban Institute Press, Washington DC, 1997, Chapter 3.

allow accurate forecasting of program costs. These techniques will be applied to other social protection programs in the future.

- Reduced human suffering and mitigating the impacts of economic and social crises. Targeted social assistance programs and social insurance programs have the greatest effect on reducing human suffering during the period of economic transition.

Each of these strategic goals has been embodied in the goals and objectives established for the social sector reform program.

#### *Systemic Changes Resulting from Social Sector Reform Program*

In the development of targeted social assistance programs and in the new pension reform initiatives, widespread systemic changes have been achieved. These changes apply not only to the design of social assistance and social insurance programs, but also to the process of policymaking for social sector programs and in the day-to-day administration of programs.

#### *Cost-Effectiveness of Social Sector Reform Project*

No full-scale analysis of the cost effectiveness of the social sector reform program has been performed. Nevertheless, when measured against other USAID initiatives (in Ukraine and elsewhere) and against programs by other donors in the social protection area, the program has achieved widespread success despite annual expenditures that have averaged less than \$2 million per year for four years.

#### *Meeting Host Country Needs*

One way of measuring the extent to which the social sector reform program has met the needs of the Government of Ukraine is the extent to which the fiscally strapped GOU has committed its own resources to implementing the reforms supported by USAID. The following lists the major commitments by the GOU in the past three and one-half years:

- The GOU created 756 Housing Subsidy Offices and approved and paid for the 7,000 full time staff for those offices;
- Oblast and local administrations purchased more than 600 computers and related equipment (printers, UPSs) from local resources to equip housing subsidy offices to match the 400 computers provided by USAID;

- The GOU created a department in the Ministry of Labor and Social Policy with a staff of 8 to manage the housing subsidy program;
- The Ministry of Labor and Social Policy has created an e-mail system using government lines to all oblasts and is now extending this system to all local offices in 609 raions and 145 oblast subordinated cities and towns, using the Ministry of Internal Security system;
- The Ministry of Finance has approved and financed the creation of an Office of the Actuary within the Pension Fund with 5 staff to support the development of the actuarial model of the pension system;
- The GOU has enacted over 50 Presidential and Cabinet decrees needed to implement recommendations of the USAID/PADCO social sector reform project;
- The GOU has implemented and financed large scale pilot projects to develop new systems – including a nationwide audit of over 100,000 applicants for housing subsidies, the development of new reporting systems for the Pension Fund, and the linking of pension offices with housing subsidy offices; and
- The Ministry of Labor and Social Policy has created a permanent monthly training program in Ministry facilities, which every month trains 25 local social protection staff in the use of new computer software.

### **S.5 RECOMMENDATIONS FOR USAID TECHNICAL ASSISTANCE ON SOCIAL SECTOR REFORM**

There are four reasons why USAID's support is vital today:

- Build on Success. During the past three years, the social sector reform project has achieved widespread, systemic success in reforming social assistance programs. This has allowed large savings for the State Budget (estimated at more than \$1 billion in 1997) as well as providing additional assistance to families most harmed by the process of economic and social transition;
- Opportunities for Reform. The social sector reform team from PADCO has built close connections and trust among GOU counterparts in the Ministry of Labor and Social Policy, the Pension Fund of Ukraine, the Ministry of Economy, the Ministry of Finance, and the State committee for Statistics and is making significant progress toward further reforms in social insurance and social protection systems (described below) that

promise even greater budget savings and even greater targeted benefits for at risk families and individuals;

- Deteriorating Conditions for Poor People. The financial collapse in Russia during the summer of 1998 threatens renewed inflation and reduced benefits to pensioners, invalids, and other needy families in Ukraine; and
- Preserve Political Stability. Expanded support for the poorest families in Ukraine during the period of economic transition is essential to encourage political stability and reduce political opposition to further economic reforms, and to ease the State Budget deficit.

There are five areas where USAID support should be continued and/or expanded. These are discussed, in turn, the following subsections. In the subheadings, it is indicated what work will be possible within the existing social sector reform task order, and what activities should be considered for supplementary USAID assistance.

#### *S.5.1 Completion of System of Targeted Social Assistance (Part of Existing Task Order)*

The success of the housing subsidy program has provided financial relief for many poor families. Among the approximately 4 million households receiving housing subsidies, about 600,000 suffer severe economic privation – with per capita household income below 37 Hrn per month. The GOU is creating, with the assistance of the USAID social sector reform program, a guaranteed minimum income program to assist these “poorest of the poor.” This program will allow the elimination of many poorly targeted social assistance programs as well as laying the foundation for the elimination of privileges – which cost the State Budget an estimated 5 billion Hrn (larger than the current budget deficit projected for 1998).

The social sector reform program is assisting the Ministry of Labor and Social policy in drafting the necessary normative documents, preparing administrative software, training material and public education programs. This assistance is modeled on the very successful program that allowed the smooth introduction of the housing subsidy program. The difference is that this time, the Ministry is able to shoulder a larger share of the responsibility for designing and implementing the tasks.

#### *S.5.2 Automation of Social Assistance Programs (Requires supplementary USAID assistance)*

With a credit of \$2.6 million, the GOU is beginning the process of automating all social assistance programs with the purchase of over 1,000 computers. Because of USAID-supported computerization, the administrative costs of the housing subsidy program have been kept below 1.5% of benefits distributed, and it has been possible to automate procedures for income verification and auditing. Other targeted social assistance programs need to develop similar capabilities. When the World Bank credit was granted, USAID undertook to provide the GOU with \$300,000 in technical assistance to ensure the efficient and effective use of the computers and related equipment. The terms of this assistance are now being negotiated between the Ministry and USAID. Since computers will begin to be delivered in mid-November (under the terms of the contract signed as a result of the competitive tender managed by the Ministry), completion of these negotiations must be a top priority.

#### *S.5.3 Procedures for Defining the Poverty Level (Partially covered under existing Task Order)*

The Constitution of Ukraine guarantees all citizens a “minimum consumption level”. But this term has never been defined and procedures for setting this level have never been implemented. The result is that there are no accurate data concerning the number of poor people and the level of assistance with which they should be provided. The result is that the GOU is often attacked by the Supreme Rada on the grounds that it is not meeting the nation’s social protection needs at laws are passed requiring expensive increases in poorly targeted benefits.

The State Committee for Statistics has asked the social sector reform team for help in improving the quarterly survey of income and expenditures and in developing a new methodology for setting the poverty level. These reforms are urgently needed in order to assess the breadth and the depth of poverty among households in Ukraine. In addition, the State Committee has asked for assistance in improving the quarterly survey of household income and expenditures – including measures to improve the sample, automating data entry, and redesigning the report (including detailed tables and figures). Since these data provide the single most important

picture of the economic and social status of Ukrainian households, this task will be important for achieving political consensus concerning the problem of poverty as well as for providing a timely measure of the needs of the population for social assistance.

#### *S.5.4 Pension Reform (Requires supplementary assistance from USAID)*

The failing state pension system poses the greatest threat to the fiscal threat to the State Budget. Although the state pension system is “off-budget,” supplementary funds must be sought from the budget to meet the growing needs for “social pensions” and to pay the growing arrears that exceed 2.5 billion Hrn today. The solvency of the pension system, therefore, adversely affects Ukraine's overall fiscal position. With 14 million pensioners supported by about the same number of tax-paying workers, little can be done to improve the position of pensioners without major reforms.

It is estimated that a completed program of pension reform, by the year 2002, could save the GOU up to 4 billion Hrn per year which would allow the timely payment of pensions, reductions in payroll taxes, and increases in benefits.

The major problems with the present system that reform must address include:

- Very low benefits paid to pensioners and invalids-- barely  $\frac{3}{4}$  of the poverty level – and arrears of two or three months in paying pensions;
- The lack of correlation between contributions paid and benefits received; and
- The high rate of payroll taxes – 32.5% -- to support the state pension system.

The reasons for these problems are:

- The low rate of collection of payroll taxes -- a non-payment rate of about 30% for registered companies in 1996, and complete evasion by unregistered companies and evasion through non-declaration of full income;
- The lack of personified records to assure benefit payment accuracy and compliance in making payments;
- The lack of proper financial analysis and projections for the Pension Fund;
- The low age at which people may receive pensions -- 55 for women and 60 for men for regular old age pensions, and much younger for many privileged classes of workers;
- The lack of a proper legal, regulatory and administrative structure for non-state pension funds; and

- The high administrative costs of the system – about 8% of the value of pensions distributed

In 1997, a multi-faceted plan by international donors to support pension reform failed. Since that time, however, the USAID/PADCO social sector reform team has made significant progress. It has completed a small pilot project to develop a personified reporting system through which enterprises may submit annual payments to the pension fund; and it has developed an actuarial model of the state pension system. Because of the success of the latter, the GOU has approved and funded the creation of an office of the actuary within the pension fund. In addition, it has provided the GOU with support in the design and development of the legal framework for pension reform.

Within the current Task Order, the following initiatives can be completed:

- Implementation of oblast-wide pilot project to test the personified reporting system;
- Continued support for the improvement of the legislative framework;
- Completion of the development of the actuarial model; and
- Assistance in creating and training staff for the new office of the actuary.

Additional support is needed for the following activities:

- The creation of a national database of all pensioners to allow automated pension calculations, auditing of pension expenditures, and reduced administrative costs;
- The creation of a nationwide database of all working Ukrainians (modeled on the SSA database in the USA) to improve collection of payroll contributions, eliminate workbooks, improve labor mobility, and allow auditing of all social protection programs. This will require the acquisition of large-scale computers and a long-term program of software development. This should be financed through a credit from the World Bank or EBRD.
- Consolidation of revenue collection in State Tax Administration (to avoid double set of tax collectors which the present system suffers from) and providing the Pension Fund with full responsibility for calculating and distributing pensions (these latter functions are now performed by Ministry of Labor and Social Policy).

*S.5.5 Restructuring the Housing and Communal Services Sector (Requires new program of USAID support)*

Despite tariff increases from 4% of cost recovery to nearly 100% of cost recovery, vital communal services to Ukrainian families have not improved. Unless the housing and communal services sector is restructured – with reforms in accounting, tariff-setting procedures, management and finance -- services will continue to deteriorate, payments from households will decline, and, in the not-too-distant future, the system is likely to collapse completely.

USAID support should support the following types of technical assistance:

- National regulations and local pilot programs to implement Generally Accepted Accounting Standards for communal service enterprises in Ukraine.
- National guidelines and local pilot programs for tariff setting by oblast and local administrations;
- Reform of national regulations affecting communal services enterprises; and
- Pilot programs to demonstrate better management and technical procedures for providing services.

The following tables show expected timelines for the completion of restructuring the social assistance and pension systems in Ukraine.

**S.1.A. OVERVIEW OF USAID TECHNICAL SUPPORT FOR SOCIAL SECTOR REFORM: 1995-1996****FOCUS: DEVELOPMENT OF TARGETED HOUSING SUBSIDY PROGRAM**

Year	USAID Project Activities	Tangible Outcomes
<b>1995</b>	<ul style="list-style-type: none"> <li>• Created legal and administrative basis for Housing Subsidy Program -- drafting 7 normative acts adopted by Cabinet</li> <li>• Supported implementation of utility pricing reform – beginning the process of raising payments from 4% to 80% of costs</li> <li>• Office procedures manual provided for all local housing subsidy offices</li> <li>• Trained 7,000 local office staff and established office operating procedures for housing subsidy program</li> <li>• Educated public on need for targeted assistance and utility rate increases through TV and radio advertisements and press coverage</li> <li>• USAID installs 40 computers in pilot housing subsidy offices</li> <li>• Developed first version of caseload management software and trained 400 staff in its use</li> </ul>	<p><b>February:</b> Cabinet Decree No. 89 issued, creating the housing subsidy program. Housing and utility payments raised to 20% of costs</p> <p><b>March:</b> Cabinet of Ministers sets up department to manage housing subsidy program</p> <p><b>April:</b> Cabinet dismissed by Supreme Rada for failing to protect population from impacts of price reforms</p> <p><b>May 3:</b> 750 housing subsidy offices are opened nationwide and begin receiving applications</p> <p><b>June:</b> Housing and utility payments raised to 30% of costs</p> <p><b>August:</b> Program extended to cover rural families' purchases of liquid gas and heating fuel</p> <p><b>Sept:</b> Housing and utility payments raised to 40% of costs</p> <p><b>October:</b> One millionth family receives housing subsidy</p> <p style="text-align: center;"><i>Net budget savings for 1995: 100 million Hrn</i></p>
<b>1996</b>	<ul style="list-style-type: none"> <li>• Seven normative acts drafted</li> <li>• Automated the Housing Subsidy Program: <ul style="list-style-type: none"> <li>◆ Installed 355 USAID-purchased computers</li> <li>◆ Designed/installed NASH DIM caseload management and reporting software in 400 Offices</li> <li>◆ Fully automated applicant processing and report preparation</li> <li>◆ Trained staff in use of computers and software</li> </ul> </li> <li>• Linked social protection offices and housing subsidy offices to allow automatic enrollment in program of pensioners and invalids</li> <li>• Designed and tested auditing system of applicants for means-tested assistance</li> </ul>	<p><b>January:</b> Housing and utility payments raised to 60% of costs</p> <p><b>February:</b> Two millionth family receives housing subsidy</p> <p><b>August:</b> Housing and utility payments raised to 80% of costs</p> <p><b>July:</b> Ministry of Labor and Social policy introduces monthly training sessions for housing subsidy local office staff</p> <p><b>October:</b> Three millionth family receives housing subsidy</p> <p><b>November:</b> Nationwide pilot audit of housing subsidy program applicants and offices conducted</p> <p style="text-align: center;"><i>USAID/PADCO caseload software used in 300 local offices Local governments purchase 300 computers</i></p> <p style="text-align: center;"><i>Net budget savings for 1996: 900 million Hrn</i></p>

## S.2 OVERVIEW OF USAID TECHNICAL SUPPORT FOR SOCIAL SECTOR REFORM: 1997-1998

**FOCUS ON: 1) REFINEMENT OF TARGETED HOUSING SUBSIDY PROGRAM, 2) CREATION OF AUDIT SYSTEM FOR SOCIAL PROTECTION PROGRAMS, 3) REFORM OF PENSION SYSTEM, 4) MEASUREMENT OF POVERTY, 5) CREATION OF GUARANTEED MINIMUM INCOME PROGRAM**

Year	USAID/PADCO Project Activities	Tangible Outcomes
1997	<ul style="list-style-type: none"> <li>• Eleven major normative acts drafted</li> <li>• Installed Local Area networks in 130 oblast and local housing subsidy offices</li> <li>• Designed and implemented monitoring system of caseload and financial flows</li> <li>• Designed and tested individualized pension reporting system</li> <li>• Created Electronic Library, e-mail Links to all oblasts with Ministry</li> <li>• Created utility indebtedness reporting system for State Committee for Statistics</li> <li>• Developed automated system for linking housing subsidy offices, local social protection offices, and State Tax Administration</li> <li>• Developed plan for poverty monitoring system</li> <li>• Designed first stage of Targeted Family Assistance Program</li> <li>• Designed software for nationwide auditing</li> </ul>	<p><b>March:</b> Automated system of monthly reporting created from 32 pilot housing subsidy offices to show financial accounts and caseloads</p> <p><b>October:</b> Nationwide program to audit incomes of applicants begun</p> <p><b>October:</b> Supreme Rada approves World Bank loan of \$2.6 million to computerize all housing subsidy offices</p> <p><b>November:</b> State Committee for Statistics introduces new monthly reporting system on housing subsidies and utility indebtedness</p> <p><b>December:</b> Completion of pilot program to create personified pension reporting system</p> <p style="text-align: center;"><i>Local governments purchased 500 computers</i></p> <p style="text-align: center;"><i>Net budget savings for 1997: 2.4 billion Hrn</i></p>
1998	<p><i>Completed:</i></p> <ul style="list-style-type: none"> <li>• Drafted new law on family assistance (in collaboration with MLSP an TACIS)</li> <li>• Designed and installed caseload management software for childcare assistance program</li> <li>• Designed and installed monthly reporting system for Ministry of labor and Social policy for social protection programs</li> <li>• Designed software and training program for oblast and local office management information systems</li> <li>• Developed actuarial model for state pension system</li> <li>• Analysis of poverty assessment methodologies with recommendations for reform</li> </ul> <p><i>Projected by end of 1998</i></p> <ul style="list-style-type: none"> <li>• Begin assistance to Pension Fund to create nationwide personified reporting system</li> <li>• Begin assistance to MLSP to install and utilize 1,000 computers purchased with World bank credit</li> <li>• Develop software for caseload management of targeted family assistance program</li> <li>• Seminars on pension reform issues</li> </ul>	<p><b>February:</b> Ministry conducts first-ever competitive tender for purchase of 1,000 computers for housing subsidy offices</p> <p><b>March:</b> Mikolaiv Oblast transfers childcare assistance program to local social protection offices from enterprises</p> <p><b>July:</b> Ministry of Labor and Social Policy submitted draft law on Targeted Family Assistance to Cabinet of Ministers</p> <p><b>August:</b> Housing and utility payments raised to cover 100%</p> <p><b>August:</b> Family share of monthly utility payments for housing subsidies raised from 15% to 20%</p> <p><b>September:</b> Seminar conducted on No-State Pension Systems</p> <p><i>Anticipated</i></p> <p><i>Pension Fund begins Office of the Actuary</i></p> <p><i>Pilot personified reporting pilot programs begun in two oblasts</i></p> <p><i>Local governments purchased 300 computers and Ministry will purchase 1,000 computers with World Bank loan</i></p> <p><i>Projected Net budget savings for 1998: 2.0 billion Hrn</i></p>

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	<ul style="list-style-type: none"><li>• Begin implementation of new poverty measurement system</li></ul>	
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### S.3 OVERVIEW OF PROPOSED USAID TECHNICAL SUPPORT FOR SOCIAL SECTOR REFORM: 1999

#### FOCUS ON: 1) IMPLEMENTATION OF REFORM OF PENSION SYSTEM, 2) MEASUREMENT OF POVERTY, 3) IMPLEMENTATION OF GUARANTEED MINIMUM INCOME PROGRAM

**1999**

*Planned Activities and Projected Tangible Outcomes*

- Implement reforms in delivery of pension benefits:  
*Estimated savings to Pension Fund: 1 billion Hrn.*
- Assist Pension Fund and Ministry to develop legislative strategy for reform of state and non-state pension systems
- Assist Pension Fund and Ministry to implement pilot non-state pension programs
- Restructure nationwide system of offices providing targeted family assistance
- Reform system for establishing poverty level and improve national family income statistics
- Reduce privileges and entitlement programs:  
*Estimated budget savings 1 billion Hrn.*
- Begin to eliminate workbooks

*Projected Net budget savings for 1999: 1.0 billion Hrn for targeted social assistance programs, 1 billion Hrn from reducing privileges, and 2.0 billion + for pension system reforms*





# **1. WHY ECONOMIC TRANSITION REQUIRES REFORMS OF SOCIAL PROTECTION SYSTEMS**

## **1.1 MARKET ECONOMIES REQUIRE NEW SOCIAL PROTECTION SYSTEMS**

### *1.1.1 The Collapse of the Economy and of Social Protection Systems Has Created the "New Poor"*

Market economies create social protection systems with different philosophical and financial foundations than those used in economies characterized by government ownership and control. The latter provide basic goods and services to the entire population at heavily subsidized rates – paid for through the payment of very low wages to employed people. The former offer workers much higher wages and provide social protection only to those that need the assistance or to those that have paid the full cost of social insurance premiums.

During economic transition, the state loses control of most means of production and, therefore, of most of the financial resources previously used to pay for entitlement programs. The state can no longer afford to pay for the type of social protection system with which the public and the state government are familiar. To allow economic reforms to continue, therefore, countries moving from socialist systems toward market economies must rebuild existing social insurance systems and create, *de novo*, targeted social assistance programs that help families and individuals unable to provide for themselves under new economic systems.

Although western experts had anticipated that the transition from a socialist economy to a market economy would rapidly produce economic benefits for the majority of the population as well as fiscal benefits for the government, these hopes have not been supported by experience. Because of corruption, the slow pace and bad design of reforms, the difficulty of implementing reforms, and the enormous inflexibility of an economic system used to centralized control, economic transition has impoverished a large part of the population. Only a few, well-connected and often unscrupulous people have enjoyed large gains in wealth and income.

In Ukraine, as elsewhere in the former Soviet Union, the “new poor” have emerged as a result of four characteristics of the transition process. First, the “price reforms” necessary to eliminate the enormously expensive and inefficient system of subsidies that characterized the pricing of all basic goods and services consumed by the population led to large increases in the real prices of food, housing, and utilities. The government could not afford to provide compensatory increases in pension and invalid benefits, childcare assistance, and take-home pay. In Ukraine, prices for these basic commodities and services grew at more than twice the overall rate of inflation between 1994 and 1998. People who could not supplement low wages by working in the gray economy found themselves unable to afford basic necessities. According to official statistics, for example, meat consumption per capita declined by 50 percent since Ukrainian independence in 1991 and 1998.

Second, inflation has wiped out a large part of the savings of families, which could otherwise have been used to cushion the impact of falling real wages and real benefits. Between January 1, 1993 and December 31, 1995, Ukraine’s consumer price index rose by more than 30,000%. The interest rate paid on savings accounts in state banks – the location of savings of the vast majority of the population – was far too low to compensate. Most Ukrainian families lost more than 95% of their savings. The Government, despite an immediate verbal and legal commitment to repay lost

savings, did not begin the process until 1997, and then providing partial compensation only for the accounts of deceased people.

Third, hidden unemployment and wage arrears have become widespread. The collapse of the economy – especially the manufacturing sector – has left many people without jobs, on involuntary part-time employment, on unpaid leave, or, worse, without pay for work performed. Measured manufacturing output in Ukraine fell by more than 70% between 1991 and 1998. Although the official unemployment rate remains low – 4% by mid 1998 -- as many as 25% of the workforce are on unpaid leave. The gray economy provides well-paid (and untaxed) income for an unknown number of people - but opportunities are not distributed evenly to all those that have lost their regular sources of income.

Fourth, government benefits fell precipitously in real terms. The acute fiscal problems of the government result from continued expenditures on subsidies to large sectors within the economy, corruption, and the inability to collect taxes from the burgeoning gray economy. They have forced drastic cuts in pensions and other benefits that have left many of those people least able to take advantage of opportunities in the gray economy with pitifully low incomes. A single, unemployed mother receives only about \$4 per month to look after a child; a pensioner receives a monthly benefit that is only two-thirds of the poverty level.

The combined impact of these four forces was catastrophic for many individuals and families. Yet government statistics were inadequate to identifying the problem. They had never before needed to identify problems of poverty. Acute poverty did not exist under socialism, which ensured everyone a minimum standard of subsistence. Statistics, therefore, were ill suited to measuring either the seriousness or the incidence of poverty.

For many of the “new poor”, poverty will prove a transitional problem. It will disappear as the private sector emerges from the debris left by the collapse of state enterprises to provide new, better-paid jobs. For some, however -- those least able to find well paid work in a competitive labor market and those dependent on government benefits as their primary source of income – poverty will be an enduring problem. For both the “transitionally” poor and the emerging “underclass,” the new society and its political institutions must create systems of government assistance.

### *1.1.2 The Challenge to Rebuild Social Insurance Programs*

Social insurance programs – providing old-age and invalid pensions, death benefits, temporary benefits for the jobless, and to compensate those injured at work -- were funded directly by the state under socialism. Contributions were transferred from the budgets of state enterprises into insurance funds. State enterprises passed onto employees and consumers the burden of paying for these expensive benefits through lower wages and higher prices. State enterprises and employees assume most of the responsibility for record keeping. But Ukraine’s economic transition has caused the collapse in the value of output of state enterprises as defense expenditures were slashed following independence, government subsidies reduced, and competing goods become available from internal and overseas competitors. Emerging businesses exist, for the most part, outside the formal economy – exiled by high tax rates, burdensome regulation, and rampant corruption. The result is social insurance benefits far below those paid under the former regime.

The challenge to transition governments in social insurance reform, therefore, is to restructure the tax and contribution system to capture revenues generated by emerging private enterprises. This requires rebuilding the system for collecting insurance contributions and also creating new, modern systems to manage revenues and to distribute benefits. It also means encouraging behavior on the

part of citizens that would supplement the costs of these programs. Citizens need to be encouraged to save for their own old age, benefits, and family needs. Means need to be devised so that the Ukrainian population, with or without direct orders from the government, directly assist the transition to a market economy by saving, investing and providing for their own needs through their own abilities. This cannot be achieved easily. It requires the enactment and broad popular acceptance of a legal foundation for social insurance, as well as reform of tax systems, the widespread privatization of economic activity, the creation of a financial sector, and a long list of reforms with which Ukraine has been struggling for several years. In the absence of these changes, new economic activity will remain in the gray sector and social insurance funds starved of revenues.

### *1.1.3 The Challenge of Creating New Social Assistance Programs*

Social assistance programs -- those designed to assist the “new poor” -- must be created from whole cloth. As a member of the former Soviet Union, Ukraine had no programs to help the poor because it didn't need them. The government provided basic services -- food, housing, utilities, health, and education -- either at no price to consumers or at token charges. State enterprises were given the responsibility for the distribution of general entitlement benefits such as child care assistance, sick pay, and even for providing many services such as kindergartens, health care, and sanatoria. As market reforms were introduced, sharp income inequalities become evident. Many people lost the ability to pay for basic services.

By comparison with families in market economies, almost everyone was poor in Ukraine under socialism. They lacked the discretionary income and the choice of consumer goods and services that almost all those living under market systems take for granted. But the poor were hidden; they were not a separate class requiring special assistance. Today, they are.

To assist them, Ukraine needs to create an entirely new system of targeted assistance – providing cash and in-kind help to individuals and families that can demonstrate their legitimate needs for it. Yet, with no history of “means-testing” benefits, creating such a system is difficult.

## **1.2 NEW SOCIAL PROTECTION SYSTEMS NEED ECONOMIC REFORMS**

Rebuilding social protection systems is only possible with the fiscal dividends of economic renewal. Ukraine is, however, still several years away from receiving such fiscal dividends. Old jobs have disappeared before new ones are created. The existing tax system cannot collect revenues from new firms thriving in the gray economy. Ukraine lacks data systems and enforcement mechanisms to “find” new businesses and new businessmen and to collect taxes from them. The result is yawning government deficits that desperate bureaucrats try to contain by holding pensions and other government benefits at absurdly low levels.

The average pensioner today receives benefits that are worth less than one tenth of the value of pensions ten years ago. Pensions bring the elderly barely two-thirds of the way to Ukraine's very modest poverty level. Parents of invalid children in Ukraine receive less than ten dollars per month to pay for their child's care. In Russia and in Ukraine, the vast majority of the population feel themselves far worse off today than they were ten years ago. These suddenly impoverished people are ready recruits for the army mustered to oppose further economic changes. With so many people suffering so visibly as a result of economic and social changes, it is politically less and less easy to sustain further momentum toward economic reform.

The reality of transitional poverty creates a widening gulf between international organizations and Ukraine's elected leaders. International donors recommend radical reforms in pension systems, for

example. But government officials cannot easily appreciate why such reforms are needed or how to explain the reforms to the public. The Government faces immediate and seemingly insoluble problems of keeping its promises to the people – how, for example, to pay off today’s mounting arrears out of shrinking revenues. International advisors, by contrast, argue for reforms to ensure the solvency of the Fund in the year 2020.

### **1.3 RESTRUCTURING SOCIAL PROTECTION NEEDS MORE THAN MONEY**

Meeting Ukraine’s needs for social protection, however, is not just a question of money. Social protection programs require large information systems. State pension funds, for example, must be able to track the work experience and wage history of all members of the workforce. Means-tested programs rely on the ability to access information concerning the incomes and assets of families and individuals applying for assistance to reduce fraudulent claims by non-needy people. Social protection systems only work if many related systems and institutions operate effectively – auditing, financial infrastructure, accounting systems, etc. The expertise to create these systems, and to identify and develop the computer hardware and software systems is largely missing in Ukraine, where the government cannot afford either the salaries or the consulting contracts to fill the gaps.

It may seem both obvious and simple to an international expert to recommend that a transition country adopt a means-tested program to protect the poor. But how can it be implemented? The vast majority of social benefits -- child care payments, kindergartens, health care centers, vacation sanatoria, for examples -- were provided not by government agencies or even by a charitably-minded non-profit sector. They were provided by state enterprises based on the calculation of budget norms and other procedures. Many of these enterprises are now unable to afford these services and the government must take over - despite chronic lack of budget resources.

In western countries, systems that support social protection programs have evolved over long periods. Eligibility has been slowly extended to cover more and more people; procedures for political balancing of fiscal prudence with political expediency have grown slowly – with many false starts and painful changes in direction; and the necessary public administration systems have developed in response to new technologies and the growing scale and complexity of programs. But transition economies lack this luxury of time. The poor have emerged suddenly and social protection systems have collapsed precipitously.

The values that must be embodied in the new social insurance and social assistance systems for transition economies differ markedly from the values embodied in the systems as they operate today. The Constitution of Ukraine, for example, states that all citizens are guaranteed a minimum standard of living and those falling short will receive social assistance. Although “minimum standard of living” has yet to be defined in terms of money or services, and the relationship between the minimum standard of living and the poverty level has not been clarified, these obligations must be met under any system of social protection in Ukraine.

Today’s policymakers may genuinely believe that providing equal benefits for all is an important legacy of socialism with which they are reluctant to part -- until they properly understand the advantages of the new system. Their international advisors, however, are much more intimately aware of the enormous wealth-producing power of market-based economies and argue for immediate privatization and for the importance of individual accountability. Most programs of technical assistance have spent relatively little time helping design and develop programs that offer a politically acceptable level of social protection. They have been predicated on the belief that economic growth will make both individuals and the government rich enough to pay for social

protection. But this mantra is not persuasive when demanding that “former” communist officials surrender the only system they understand.

Social protection reforms must, therefore, be an inseparable part of economic transition: social protection systems cannot serve the population unless other parts of the economy are working. But those other parts of the economy cannot be made to work unless social protection systems are in working. New social insurance and social assistance programs are needed to underwrite further economic reforms and to cut bloated state budgets. But it is unrealistic to expect government officials to implement such complex new systems either because they want to or just because they have been required to as a condition for foreign aid. Foreign experts must show – not simply tell -- how to build new systems. Showing how requires more than the presentation of papers describing how things work elsewhere. It requires collaboration with government officials in all stages of the realization of new systems.

This is not easy. But it is not impossible. The following chapters of this report show how technical assistance from international donors can help bridge this painful gap.