

Challenges in 2009: Getting the Timing Right

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2009 will be a unique year: the severe recession crystallizes both short-term and long-term concerns about pensions. In the short term, Ukraine retirees need to be protected against the expected high rate of inflation. In a recessionary economy jobs will be few and even fewer will be available to retirees. More than ever their pensions need to be safe from inflation.

Thinking longer-term, if workers are going to receive dependable pensions that can really help them during retirement, two things need to happen as soon as possible. First, Pillar I pensions –pensions under the solidarity scheme – need to be predictable both for retirees and the government. Workers need to be able to anticipate how much they are likely to receive and, once retired, they must know that the value of their pension will not disappear because of inflation. The government also needs this certainty. It needs to be able to predict pension costs and plan. Second, and this will be difficult, the cost of pensions under Pillar I need to be cut. Ukrainian workers and their employers just cannot continue paying ever higher contribution rates. There are only a few options for cutting solidarity pension costs. Raising the retirement age is number one. If workers want better pensions when they retire, they have to work longer. No one likes this, but it's a fact. Concessions also need to be made by those with specials pensions. Pensions for workers in hazardous occupations have to be pre-paid, that is they must be funded through individual accumulation accounts. We will talk more about that in a later column.

An important part of reducing Pillar I costs and raising pension levels at the same time is advance financing. Workers need better pensions and they deserve them. Saving in advance is probably the only way to get them. That's why the government must move now to set the stage for pillar II. Under this part of the pension system, each worker would be given an individual accumulation account. A part

of his or her contributions would be diverted to this account, the money invested and the entire account balance used to support the worker's retirement benefits. Maybe it's time to consider giving all workers better benefits through greater gender equality. This a strong international trend and it would be good for the women of Ukraine to join in. Increasing their retirement age to the age for men would level the playing field and give women more. Under Pillar II the longer you work and the more you save, the more you will have when you retire.

It would not be good to implement Pillar II during a serious recession. If companies are not investing because there is decreasing demand for their products, dumping money – in this case pillar II individual account contributions - into capital markets would not lead to more economic development. To the contrary, it would only artificially inflate security prices. Then why the urgency? Because it will take up to 3 years to implement Pillar II and the best time is when the economy is recovering. When the economy again begins to grow, and it will begin to grow, a fresh supply of money to invest will be welcome and where better than to have it come from Ukrainians themselves? The flight of foreign capital has worsened Ukraine's current situation and less reliance on such capital in the future would be a good thing.

If the government acts now, Ukraine would be better prepared with the potential capital to support greater economic growth during the recovery and the new system to increase the pensions of every hard working man and women in the country. ///

*The views expressed here are those of the author and do not necessarily reflect the views of USAID or CMP.