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V17

Reforming the revenue side of the compulsory social insurance system: Assessing the potential for lower payroll taxes in Ukraine

Executive summary

Ukraine's expensive compulsory social insurance system is financed through high payroll taxes. High taxes induce tax evasion. Reforms of the social insurance system should aim at lowering taxation (contribution) rates and reduce complexity and susceptibility for corruption and evasion. One step in this direction could be the unification of revenue collection.

We estimate the potential gains of unifying the collection of social insurance contributions in Ukraine and the potential scope for lowering the contribution rates. We find, that unifying revenue collection per se will not lead to a significant reduction of the social insurance contribution rate, even when improved information sharing and better coordination by social insurance funds would increase the revenue collection levels.

But, the introduction of a unified collection system should be used to increase the tax base through including into the standard social security system those individuals that are subject to simplified taxation and fixed agricultural tax. The most significant reduction of the social insurance contribution rate on the revenue side would be achieved through the combination of reforms, including the unification of collection, improved information sharing and broadening the tax base and canceling the compulsory state insurance in case of working accidents. This combination of revenue side reforms would allow a reduction of social payroll taxes by 7.31-20.27 percentage points to currently 33.83%.

Content:

1. Introduction
2. The revenue side of the present social insurance system in Ukraine
3. The Russian Unified Social Tax Reform
4. Reforming the revenue side of the social insurance system in Ukraine
5. Conclusions

1. Introduction

Ukraine's present compulsory social insurance system is suffering from serious design faults on both the revenues side and the expenditure side. On the revenue side (contributions) of the compulsory social insurance system tax payers[1] are treated differently and some privileged groups are contributing at significantly lower rates than others. But on the expenditure side (benefits) the participation of all groups is rather equal. Consequently, the relationship between contributions and benefits is rather weak. Even worse, the current system's benefits are negatively related to longer and higher contributions, eroding the systems long term stability[2].

As a result, the social tax burden for the not privileged groups is very high, while at the same time the performance of the social insurance system is perceived as rather poor. Under such circumstances strong incentives exist to evade taxes, underreport income and move economic activity into the shadow, i.e. avoid contributions to the social insurance system.[3] Hence, achieving a fair and sustainable compulsory social insurance system needs reforms on the contribution (revenue) side[4].

Empirical studies of transition countries conclude that the tax rate (i.e. both personal income taxes and social insurance contributions) is the most important factor stimulating tax evasion. However, tax evasion is further induced by high income inequalities, a high poverty risk, corruption and the complexity of the tax system[5]. With the exception of the flat personal income tax rate of 13% most of these factors are also present in Ukraine, and in the Ukrainian social insurance system in particular. Consequently, reforms should be directed at lowering the taxation (contribution) rate, reduce complexity and susceptibility for corruption and evasion.

One reform option addressing this issue is the improvement of revenue collection through administrative unification of the payments collection. Several transition countries integrated collection activities, i.e. Croatia, Estonia, Hungary, Latvia, Russia, Serbia, and Slovenia and reforms are currently in progress in Albania, Bulgaria, Romania, and Montenegro[6].

Russia's 2001 reform package implemented the sharpest reduction of payroll taxes. The reform aimed at providing strong incentives for de-shadowing wage income. Lower under-reporting and less tax evasion should in the long run refinance the lower payroll taxes.

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1 From an economic point of view the compulsory social insurance contributions are earmarked taxes.

2 See IER policy paper V9: the pension system derailed: Proposals how to get back on the reform track.

3 According to the IER Quarterly Enterprise Survey, the reduction of social contributions is the most expected and desires by business reform.

4 Of course, the benefit side should be reformed as well in order to balance the social insurance system. Some proposals are provided in IER policy paper V9.

5 See for example: Edward Christie and Mario Holzner (2006): What explains tax evasion? An empirical assessment based on European data. WIIW working paper Nr. 40.

6 Peter Barrand, Stanford Ross, and Graham Harrison (2004): Integrating a Unified Revenue Administration for Tax and Social Contribution Collections: Experiences of Central and Eastern European Countries. IMF working paper 04/237.

Ukraine implemented in 2004 successfully a 13% flat personal income tax (PIT), but left the compulsory social insurance system so far unchanged. Today Ukrainian policy makers are debating the implementation of a unified social contribution (i.e. tax), in order to improve the revenue side of the system by reducing administrative costs and ensuring stricter contribution compliance.

This paper discusses first the drawbacks of Ukraine's present social insurance system. Second, we assess the social insurance reforms in Russia. Third, we estimate potential gains on the revenue side by unifying revenue collection in Ukraine. Then we estimate the impact of other revenue side reform measures. The paper concludes with policy recommendations for reductions of the social tax burden in Ukraine.

2. The revenue side of the present social insurance system in Ukraine

In 2001 Ukraine introduced a compulsory social insurance system, which until now comprises four types of insurances:

1. Pension insurance,
2. Social insurance in case of temporary working disability and expenses associated with birth and funeral (further: sickness insurance),
3. Social insurance in case of unemployment (further: unemployment insurance),
4. Social insurance in case of working accident and occupational illness (further: work accident insurance).

The contribution rates of the four compulsory insurances are paid from gross wages and salaries by both, employer and employees directly to each insurance fund separately. In 2006 the social tax rates for the sickness, unemployment and pension insurance do not vary and amount to 38.8% for employers and employees. Employees with wages below the subsistence minimum contribute at reduced rates to the sickness and pension insurance funds.[7]

The contribution rates for the work accident insurance vary according to a classification of occupational risk between 0.84 – 13.8% of the gross wage.[8] So in 2006 the four social taxes sum up to 37.84%-52.6%.

From the perspective of an individual with a regular social insurance employment contract the Ukrainian state taxes away between 50.84% and up to 65.6% (including PIT plus compulsory social insurances) of the gross wage. Such high direct taxes induce evasion, underreporting and shadow economic activities. Table 1 reports the development of wages and contributions paid to the funds indexed to the year 2002.

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7 For wages below the subsistence minimum the cumulative contribution rate is 37.0%.

8 The Fund of insurance in case of working accidents suffers from perverse redistribution effects, as the majority of payments (55% in January 2004) are directed at one occupational group – the miners. Furthermore, while miners are charged the highest contribution rates (13.8% of the gross employer wage), other sectors with high accident rates such as agriculture contribute only 0.2%, i.e. even less than sectors in the 1st category.

The indexed changes reveal that the despite the same tax base (wages) the contributions to each compulsory social insurance fund developed rather different, indicating underreporting and evasion.[9]. The contributions to the sickness and the pension fund increased much sharper than wages, while the contributions to work accident and unemployment insurance stayed behind.

Table 1: Contribution revenues of social insurance funds

	2002	2003	2004	2005
Contributions, index 2002 =100%				
Pension insurance fund	100.00	119.55	165.09	190.23
Unemployment insurance fund	100.00	106.00	124.84	134.35
Sickness insurance fund	100.00	113.39	146.08	200.85
Working accident insurance fund	100.00	113.69	136.08	155.21
Average wage, index 2002 =100 %	100.00	116.94	136.92	164.68

Source: Statistical Bulletins of the Ministry of Labor and Social policy

The Pension Fund seems to be the most trusted and regarded institution of the social insurance system. Against the benchmark of contributions to the Pension Fund we estimated the potential underreporting to the other funds for the year 2005.[10] We calculated an effective average contribution wage of UAH 940.85 for the whole year of 2005. We assumed the same contribution base for all types of insurances and calculated the potential revenues according to the official contribution rate. Because of lacking data we do not consider in our estimation the work accident insurance. Table 2 reports our findings.

Table 2: Revenues of social insurance funds in 2005
(average contribution wage UAH 940.85)

	Number of individuals (m)	Contribution rate, % (effective in 2005)	Average monthly contribution per individual (UAH)	Potential revenues (UAH bn)	Actual revenues UAH bn (%)	Foregone revenues (UAH bn)
Pension insurance fund	12.50	34.30	322.71	48.41	48.41 (100)	0.00
Unemployment insurance fund	12.50	2.10	19.82	2.97	2.54 (85.5%)	0.43
Sickness insurance fund	12.50	3.90	36.80	5.52	4.62 (83.7%)	0.90
Subtotal	12,50	40.30		56,9	55.57	**1.33**
Work accident insurance fund	12.50	(0,86-13,8)	36.80	N/a	2.02	

Source: the Bulletin of the Ministry of Labor and Social Policy, Derzhkomstat, own calculations

We find that the revenue levels are at 85.5% for the unemployment insurance and at 83.7% for the sickness insurance, that is substantially below the revenue collection level of the Pension fund.

Besides tax evasion and underreporting some individuals rely on a legal loophole to avoid high social taxation rates: they choose taxation schemes under the so called

9 The contribution rates for some types of insurance were changed several times over the years, but they cannot really explain all difference in patterns of revenues development.

10 For all estimations we use numbers of 2005, as data for 2006 are not yet available in full. But we assume, that the impact of reforms as well as scope of potential gains would be rather similar.

simplified taxation and the fixed agricultural tax. Of the total working population of 18.6 m individuals around one third or 6.1 m work under such social tax saving schemes and contributes less than 3% of revenues to the social insurance system. Table 3 reports the contribution rates of the different groups to the pension system.

Table 3: Contributions to the PAYG Pension fund revenues by groups in 2005

	number of individuals (m)	Share in economic active labour force (%)	Contribution (UAH bn)	Contribution (%)	average monthly contribution per individual (UAH)
Standard compulsory contributions (33.8%)	12.5	61.27	39.6	96.59	264.00
Contributions under FAT	4.1	20.10	0.8	1.95	16.26
Contributions under Simplified taxation	2	9.80	0.4	0.98	16.67
Transfer from the Unemployment fund	1.5	7.35	0.1	0.24	5.56
Transfer from Work accident fund	0.3	1.47	0.1	0.24	27.78
Total	**20.4**	**100.00**	**41.0**	**100.00**	**167.48**

Source: Derzhkomstat, own calculations

In short, on the revenue side of Ukraine's present compulsory social insurance system we found the following problems:

- Uneven contributions towards different funds. The calculations show, that despite the same wage base contribution levels differ across the different compulsory social insurance funds. A rather cautious estimation detects forgone revenues for the unemployment and sickness funds of at least UAH 1.3 bn due to either underreporting and/ or bad administration.
- Uneven contribution by different social tax status groups (e.g. those who selected simplified schemes of taxation), while even participation in benefits (free riding).
- Consequently, benefits paid are not related to contributions, what reduces incentives of individuals to pay contributions.

This results in very high payroll taxes, causing tax evasion, shadow payments of wages, and hampering overall economic development. Therefore, social insurance reforms should be aimed at reducing the social tax rate as well as reforming revenues side of the social insurance funds.

3. The Russian Unified Social Tax Reform

Russia changed in 2001 radically the taxation of individuals, simultaneously replacing the progressive personal income tax (PIT) with a flat rate of 13%, and unifying the various compulsory social insurance contributions into one regressive unified social tax (UST). The reform replaced the direct compulsory contributions to the Pension Fund, the Social Insurance Fund and the Health Insurance Fund with a single earmarked UST payment by the employers. Direct relationships between the social insurance funds and companies were cut and all UST payments are channeled through the state tax administration. Further administrative simplification was achieved by canceling any social insurance contributions paid by employees.

The contributions by employers to the State Employment Fund were replaced with earmarked individual deductions from PIT payments.

The consolidation of payments was considered to improve the efficiency of the state social insurance system by means of a unified tax and also to contribute to de-shadowing of wage payments.

However, the privileges for agricultural employees and entrepreneurs remained and after all they are eligible for paying lower contribution rates.

The basis for calculating the UST payments to be transferred by employers[11] are the individual annual income statements of each employee. Such a sequence of procedure allows for more cross checking by the state tax administration and introduces uncertainty for both employers and employees, providing stronger incentives to declare open wage payments.

A regressive scale of UST taxation was implemented for further stimulation of "honest" wage payments. While the income of the first RUR 100,000 (USD 3,428 in 2001) was UST taxed at a rate of 35.6%, the next RUR 200,000 were taxed at 20% and the next RUR 300,000 at 10%. All income above RUR 600,001 should pay 2% of UST.

Table 4: Russia: UST rates for general groups

Before 2005		Since 2005	
The annual employee's salary, roubles	Tax rate for the employer, %	The annual employee's salary, roubles	Tax rate for the employer, %
Below 100,000	35.6	Below 280,000	26.0
100,001-300,000	20.0	280,001-600,000	10.0
300,001-600,000	10.0	Above 600,000	2.0
Above 600,001	2.0		

Source: The Tax Code of Russia, Section 24.

In 2005 the UST rates for the first two income groups were merged and a combined UST rate of 26% was introduced. This change altered also the distribution of funds, which initially allocated half of UST revenues to the Pension fund and the rest was split between social and medical insurance. Now the different income related contribution levels are connected to the distributions of the earmarked funds (table 5).

Right from the beginning of the Russian UST reform in 2001 the combined UST rate of 35.6% for the first RUR 100.000 of wage income was set substantially lower than the cumulative previous taxes to three insurance funds, which amounted to around 46% of the total gross wage. The subsequent losses in revenue collection were to be compensated by the Federal budget. In 2005 the Russian Ministry of Finance estimated the forgone revenues due to the further lowering of the UST rates a RUR

[11] Tax base for employers is defined as remuneration of employees with some deductibles. However, the tax base is then narrowed by different deductibles. Tax-deductible remunerations include state allowances (e.g. sick leave and unemployment payments, maternity leave payments, etc.), some forms of compensations (e.g. indemnity for injuries at work, severance payments, business trip expenses, etc.), some types of financial aid and insurance premiums. Besides, there are privileges while taxing the remuneration paid to disabled individuals.

189 to RUR 220 bn and pension payments were secured by using the resources of the emergency Stabilization Fund.

Table 5: The distribution of the UST in Russia

The annual employee's salary	Federal budget/pension fund	Social Insurance Fund	Compulsory Health Insurance Funds		Total UST rate
			Federal Compulsory Health Insurance Fund	Territorial Compulsory Health Insurance Funds	
Below 280,000 roubles	20%	3.2%	0.8%	2.0%	26.0
280,001-600,000 roubles	7.9%	1.1%	0.5%	0.5%	10.0
Above 600,000 roubles	2.0%				2.0

Source: The Tax Code of Russia, Section 24.

However, it is still too early to assess the success of the reform, i.e. when the reforms will start financing themselves through de-shadowing and higher participation in the system. While the total collection rate of UST from 2001 to 2004 increased by more than 80% in US-Dollar terms, as share in GDP UST declined slightly (table 6). UST collection grew at the similar rates as real GDP. UST collection increased more than wages.

Table 6: Russia - UST and PIT collection

	2001	2002	2003	2004
GDP, index 2001=100	100.00	104.68	112.37	120.35
Wages, index 2001=100	100.00	116.91	131.63	144.44
UST index, 2001=100	100.00	107.58	112.83	123.79
PIT index, 2001=100	100.00	121.43	138.23	156.02
UST, including pension payments, USD bn	20.64	23.78	28.54	37.25
PIT, USD bn	8.76	11.39	14.84	19.92
Share in GDP, %				
- UST	6.7	6.8	6.6	6.4
- PIT	2.8	3.3	3.4	3.4

Source: Kuznetsov A., Goncharnko L. Welfare State and Taxation in Russia: the Contradictions of the Unified Social Tax, Intereconomics, July/August 2006; own estimations.

In comparison, the PIT reform introduced at the same time showed much stronger increases in US-Dollar terms and PIT remained stable measured as share in GDP. The difference between the developments of PIT and UST is most likely the result of stronger growth of non wage income and the regressive scale of the UST, what could explain the weak relationship to wage growth.

In a nutshell the Russian UST reform was bold in lowering the contribution rate, but still requires substantial transfers to the social insurance system from the federal budget and the Stabilization Fund in order to compensate forgone revenues.

The de-shadowing effect seems to be smaller for UST than for PIT reforms, despite the unification of tax collection within the state tax administration. The Russian case indicates that isolated reforms in an overall difficult business environment with persistent high corruption levels do not change abruptly the expectations and behavior of economic agents.

In conclusion, the Russian case provides valuable insights but not a blueprint for reforms aimed at reducing social taxes in Ukraine.

4. Reforming the revenue side of the social insurance system in Ukraine

The Ukrainian government should pursue reforms of the compulsory social insurance system with the aim of reducing both the social tax burden and the complexity of the system. First of all, the government should clarify, what types on insurances should be compulsory.

The present Ukrainian compulsory social insurance system financed through wage related contributions comprises (1) pension, (2) sickness, (3) unemployment, and (4) work accident insurance. Furthermore, social policy makers continuously demand the introduction of a compulsory wage related (social) health insurance.

In our view, **healthcare in Ukraine should remain tax financed**. Health care is demanded by all citizens, not only by employees. Health care costs tend to be higher for children and elderly than for working age individuals. When considering the demographic developments and ageing of the Ukrainian society, tax finance would be a more sustainable source of finance. However, instead of searching for more health care funds the government should introduce first reforms to improve the efficiency and performance of the health care system by switching to fee-for-service payments and granting the management of health care providers more independence and commercial incentives. Barriers to competition between private and public suppliers of health care should be removed[12]. Keeping health care tax financed will not increase the payroll tax. In addition the government should stimulate the development of a complementary private health insurance market[13].

The compulsory work accident insurance in its present form should be abolished (see Table 7, reformstep 1)**.** Current work accident insurance contributions deducted depend on the overall "danger" classification of an industry. The "danger classifications" are administratively determined. The classification does not take into account really occurring work accidents of an industry, as for example employees in agriculture – this sector records among the highest work accident rates – pay lower work accident contributions than "white collar" office employees, who face one of the lowest work accident risks. Furthermore, risk profiles of the different companies within a branch can differ considerably and it is highly inefficient to make all companies pay the same insurance premiums regardless of their past safety records. In that sense the present work accident insurance is a brake on structural change.

Instead, a mandatory private work accident insurance should be introduced at the company level. Treating work safety as a normal input for production would require

[12] For details see IER policy paper U8 "First Steps of Reforming Public Health Care: Improve Efficiency and Get the Private Sector Involved".

[13] For details see IER policy paper U11: "Promoting private health insurance in Ukraine".

companies to invest into safer work conditions. Only by doing so they could lower their work accident risk in a private insurance system and hence decrease insurance premiums. Extremely hazardous plants and mines unable to obtain a private work accident insurance would be closed. Besides, the government should stimulating safer working conditions through proper incentives and the introduction of standards. Professional organizations should be created to supervise adherence to these standards.

The proposed system would lead to a reduction in the extremely high number of work-related accidents in Ukraine.

Replacing the present expensive, inefficient and ineffective work accident insurance and detaching it from wages would be a starting point for reducing payroll taxes.

In our view the Ukrainian compulsory social insurance system financed through wage related contributions should include (1) **pension** insurance, (2) **sickness** insurance and (3) **unemployment** insurance, as they cover employee's essential risks of losing wage income.

In the following part we will consider only these three social insurances, when discussing reform measures[14].

The unification of revenue collection at one point and forwarding of contributions to the three insurance funds for administration and execution of benefits would achieve after some implementation period a reduction of administrative costs. Currently governmental plans foresee to entrust the Pension fund with the revenue collection. The World Bank estimates the potential savings from such a measure at 0.1% of GDP.[15] In 2005 this would have amounted to UAH 420 m. In table 7 we list this option as scenario 2.a.

In another scenario (2.b) we assume that unification of collecting contributions, reporting and accounting will allow reducing costs by 50% (i.e. UAH 650 m in 2005). The sharper reduction of the administrative costs will be achieved by a parallel collection of the personal income tax (PIT) and the unified social contribution (in our view similar to an earmarked PIT) by the same collection agency. Currently the PIT is administered by the State Tax Administration (STA). We think that the STA should also administer the unified social contribution, which is to be paid to the State Treasury, which then distributes the revenues as assigned by the laws. The STA would have the administrative capacity for monitoring and controlling the unified social contributions paid, as it already has a complete register of tax payers, including PIT and payers of the simplified taxes. The STA conducts already inspections of legal entities concerning wages and PIT paid, so adding checks on payments of the social contributions would be less costly than handing it to a different institution, say the Pension fund. By doing so the total number of investigations could be kept low, thus, influencing positively the regulatory climate in Ukraine.

Because all compulsory social insurance contribution are calculated on the same wage base, better information sharing and cross checking between the three funds

[14] For some pension insurance expenditure side reform measures see IER Policy Paper V9 "The pension system derailed: Proposals how to get back on the reform track".

[15] Statistical Bulletin of the Ministry of Labor and Social Policy "Compulsory state social insurance and pension provision in numbers and facts in 2005".

would improve the current rather poor revenue collection level of the unemployment and sickness funds to at least the level of the Pension fund. This would result in higher revenues, we estimate the potential for 2005 was in the range of UAH 1.3 bn (scenario 3 in Table 7). Such reform step would require development of the unified register of compulsory insured individuals, which could be used by all state social insurance funds.

In addition to the rather administrative improvements we consider further the broadening of the contribution base by including individuals under simplified taxation (SIT) (scenario 4 in table 7) and fixed agricultural tax (FAT) (scenario 5 in table 7) into the compulsory social insurance system revenue side. With such reform measures the government would make the compulsory social insurance also compulsory on the revenue side. We propose to include the payments from SIT and FAT at the contribution level of the minimum wage. These measures would reduce the redistributions towards both groups and limit their free riding.

For the proposed reform measures (1-4) we estimate the potential on the revenue side for lowering the contribution rates and reducing the complexity of taxation.

For our estimations we rely on 2005 data for the number of individual contributors to the insurance funds, the amounts of collected revenues and contribution rates.

Our assessment is made on following assumptions:

- the contributors (insured) to all three insurance funds are identical;
- the contribution base is identical;
- we are approximating the contribution base using the effecting contribution wage of the pension system;
- changes in the structure of contributions on the revenue side will not lead to "changes in benefits paid", i.e. keeping status-quo of present benefits system were all benefit in a similar way;
- the total amount of revenues necessary to finance benefits is fixed;
- the gains of each reform step will be 100% used to lower the contribution rate;
- the collection of earmarked contributions will be unified within a single institution, but collected revenues will be passed on to the respective insurance funds, which will administer revenues and pay benefits.

Potential improvements of the business climate and possible de-shadowing effect are not assessed. Such assumption is explained by several factors. First, based on the Russian experience we are rather cautious concerning immediate possible de-shadowing effects. Under the given business climate in Ukraine, business will wait some time before de-shadowing wage payments. At the same time, the unification of collection, reporting and accounting will simplify the activity of the business, thus positively influencing business climate.

For each possible reform option we estimate separately the financial impact and the potential for reducing social insurance contributions. The results of our assessment of gains are presented in the Table 7.

In scenario 1 we assume that the government liquidates the compulsory state insurance in case of working accidents. The impact from such reduction will depend on the class of occupational risk of the legal entity. Therefore, the reduction of the payroll tax would have amounted to 0.84-13.8 p.p. in 2005.

In scenario 2.a the introduction of unified social revenue collection through the Pension fund would lead to savings of administrative costs of revenue collection at the unemployment and the sickness funds, allowing a payroll tax reduction of 0,3 p.p.

Increasing the revenue collection levels of the unemployment and sickness funds to the level of the Pension fund through information sharing and better administration would allow according to scenario 3 a reduction of contribution rates by almost a whole percentage point.

Including small entrepreneurs currently working under the scheme of simplified taxation would generate according to scenario 4 additional revenues of UAH 2.3 bn and permit a reduction of payroll taxes by almost 1.7 p.p.

In scenario 5 we estimate the impact of including employees currently paying the fixed agricultural tax (FAT) fully into the revenue side. For FAT we distinguish two different scenarios: The first with "preserving the current level of central fiscal transfers" for FAT (scenario 5.a) would generate more than UAH 5.8 bn in revenues allowing for a reduction of social contributions for all insured of around 4.2 p.p. Under the second scenario (5.b.) the cross subsidies for FAT are cancelled. But still, revenues would increase by more than UAH 4.6 bn and opening maneuvering space for a payroll tax reduction of more than 3.3 p.p. In other words, bringing agriculture into financing the social insurance system would be the most revenue deriving measure.

Part III of the Table 7 presents the outcomes of combinations of different reforms. All the reforms described can be implemented separately as well as simultaneously. However, the government could achieve the most by implementing all suggested reform steps aimed at improving administration as well as broadening of the tax base. So, according to scenario 10 the combination of 5 proposed revenue side reforms would reduce the redistribution among the various groups and lead to higher revenues of about UAH 11 bn. This combination of revenue side measures would allow an overall reduction of payroll taxes by 7.3-20.3 p.p. to a general level of 33%

Table 7: Contribution revenues of social insurance funds (base year 2005)

Scenario	Volume, UAH bn	Reduction of total contribution rate (p.p.)	Social insurance contribution rate	
			With the lowest rate for WAI**	With the highest rate for WAI**
I. No reforms				
Total contribution, including working accidents insurance (WAI)			41.14	54.1
II. Estimation of separate reform measures				
1. Liquidation of compulsory state insurance in case of working accidents	2.03	0.84-13.8	40.3	40.3
2. Unification of collection				
2.a. 0.1% of GDP (estimation by World Bank)	0.42	0.3	40.84	53.8
2.b. 50% reduction	0.65	0.47	40.67	53.63
3. Information sharing (improved management)	1.33	0.97	40.17	53.13
4. Incorporated contributions of entrepreneurs under simplified taxation scheme	2.32	1.68	39.46	52.42
5. Incorporated contributions of payers of FAT				
*5.a. Present level of central fiscal transfer for FAT **	5.82	4.22	36.92	49.88
*5.b. Canceling of present level of central fiscal transfer for FAT **	4.62	3.35	37.79	50.75
III. Combination of reforms				
6. Reforms 2.b + 3	1.98	1.44	39.70	52.66
7. Reforms 2.b +3 +4	4.3	3.12	38.02	50.98
8. Reforms 2.b + 3 + 5.b	6.6	4.79	36.35	49.31
9. Reforms 2.b + 3 + 4 + 5.b	8.92	6.47	34.67	47.63
10. Reforms 1 + 2b + 3 + 4 + 5.b	10.95	7.31-20.27	33.83	33.83

*in 2005 the Pension Fund received central fiscal transfer for the compensation of losses acquired by lower contribution paid by the payers of fixed agricultural tax. Therefore, this transfer should be cancelled if payers of FAT are incorporated into standard social security system.

** Work accident insurance

5. Conclusions

We estimate that the unification of revenue collection per se will not lead to a significant reduction of the social insurance contribution rate. Improved information sharing and better coordination by social insurance funds would increase the revenue collection levels of both unemployment and sickness funds. However, this could be also achieved without the unification of revenue collection.

The introduction of a unified collection system should be used to increase the tax base through including into the standard social security system those individuals that are subject to simplified taxation and fixed agricultural tax. The most significant reduction of the social insurance contribution rate on the revenue side would be achieved through the combination of reforms, including the unification of collection, improved information sharing and broadening the tax base and canceling the compulsory state insurance in case of working accidents. This combination of revenue side reforms would allow a reduction of social payroll taxes by 7.31-20.27 percentage points to currently 33.83%.

For the further reductions of payroll taxes without transfers for foregone revenues the improvements of the relationship between contributions and benefits need to be implemented on the expenditure side of the budgets of insurance funds.

The unification of the collection and accounting will improve business climate as simplifies regulatory climate. At the same time, de-shadowing effects will not be observable immediately after lowering social insurance contributions. But with increasing credibility of the government and business expectations about the sustainability of lower social contributions the effect will materialize substantially more.

Besides, unifying social insurance contributions similar to an earmarked PIT and entrusting the state tax administration with control responsibilities would reduce further the bureaucratic burden of enterprises and improve the business climate.

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