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THE LABOR SECTOR AND U.S. FOREIGN ASSISTANCE GOALS

UKRAINE LABOR SECTOR ASSESSMENT EXECUTIVE SUMMARY



DECEMBER 2008

This publication was produced for review by the United States Agency for International Development. It was prepared by ARD, Inc.

Acknowledgements

The successful completion of our labor assessment in Ukraine was assured by the professional logistics direction provided by Ms. Ilona Demchenko, in Kyiv. Our thanks go to her and to all individuals and organizations in Donetsk, Kyiv, Lviv, and Simferopol who graciously shared their time with us. A complete list of contacts made by the team is provided in an annex to this report.

This publication was produced for review by the United States Agency for International Development by ARD, Inc., under the Analytical Services II Indefinite Quantity Contract Core Task Order (USAID Contract No. DFD-I-13-04-00227-00).

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Prepared for:

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U.S. Department of State
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EXECUTIVE SUMMARY

Principal Development Challenges Facing Ukraine

After a decade of wrenching adjustments in the wake of the fall of the Soviet Union and independence, followed by nearly a decade of sustained growth, Ukraine has faced several economic and political challenges in 2009. These set the scene for this labor sector assessment, fieldwork for which was conducted by a multidisciplinary team in December 2008.

First, Ukraine has wrestled with the consequences of an economic growth trajectory that has not been broadly based, but rather has favored the creation of an oligarch class, surrounded by a limited middle class and workers who have become increasingly vulnerable in light of the global economic crisis. Second, it is contending with the effects of severe depopulation on its labor force and on the ability to generate resources to support a rapidly aging generation of pensioners. Third, having committed itself to external economic orientation through the launching in February 2008 of negotiations with the European Union (EU) of an Association Agreement and accession in May 2008 to the World Trade Organization (WTO), Ukraine must establish economic, political, and education and training systems that will enable Ukrainians to take advantage of new trade and investment opportunities and cope with competition from regional and global trade and investors. Finally, as Ukrainians have become increasingly disenchanted with national political stalemates and regional political/economic feuds with negative consequences for Ukrainians, the country must find a way to make the political process more responsive to the needs of a broader cross-section of the population.

Understanding Ukraine's political environment is essential to understanding economic policy, labor policy, and related issues affecting working people in Ukraine. Political cleavages in Ukraine—orange vs. blue, west vs. east, and Party of Regions vs. Bloc of Yulia Tymoshenko (BYuT)—do not break on economic lines. There is neither an identifiably labor-oriented party seeking to expand rights and protections for workers and to increase the state's involvement in the economy, nor a business party seeking to reduce the state's role in the economy and restrict the rights and protections of workers. Issues of wages, workers' rights, and the like have rarely been part of the policy discussion in Ukraine. Indeed, the political context has continued to rapidly evolve since the research for this assessment was carried out, especially with the 2010 election of the Yanukovich government. This assessment is based on the period preceding December 2010.

This is true despite the fact that a relatively large proportion, over 40% according to most estimates, of workers are unionized in Ukraine. However, this number is misleadingly large for two primary reasons. First, unionization in Ukraine occurs passively. Newly-hired workers at several of the major long-established employers are automatically made members of the large, Soviet-era successor, Federation of Trade Unions of Ukraine (FPU). Membership in this union extends to people in management positions, as well as to students and pensioners. The Confederation of Free Trade Unions (KVPU) is the much smaller, newer, and more independent trade union. Across both, union membership in Ukraine is concentrated in only a few industries, primarily state employees, including teachers, and heavy industry, primarily mining, steel, and related fields. Thus, there are huge gaps in union density as the retail, private- and foreign-owned industry, small business, and other less formal sectors have extremely low proportions of unionized workers. There are very few formal, or informal, means for these non-unionized workers to have their concerns addressed by the government.

The relationships between unions and political parties are also a key component to understanding why labor-related issues do not get sufficient attention from policy makers. On the surface, the relationship

between labor unions and political parties seems somewhat simple. The larger FPU, which dates from the Soviet period as the predominant worker organization, is aligned with the Party of Regions, while the much smaller, newer, and more independent KVPU supports BYuT. The FPU supports the Party of Regions, but it is not part of the Party of Regions' governing coalition in any real sense. The Party of Regions is a pro-business party which uses the FPU to communicate and direct workers, but the FPU does not seek to represent the interests of their members to the party. The KVPU has had a relationship with BYuT that goes back at least to the last years of Kuchma's presidency (1994-2005). However, the KVPU is much smaller than the FPU and therefore plays a less significant role in BYuT than the FPU does in the Party of Regions.

Ukraine's development challenges also need to be understood at the sub-national level. One region—the Autonomous Republic of Crimea (ARC)—is of particular consideration, for both economic and geopolitical reasons. Crimea has long held special significance to the Soviet Union and now Russia: already an autonomous republic under the Soviet Union, Crimea was ceded to Ukraine in the 1950s. Crimea's labor market is—in some ways—quite similar to that of the rest of the country. However, because its economy is dependent on two quite seasonal activities, agriculture and tourism, average incomes in Crimea do not exceed national averages. Economic diversification into higher value-added activities within agriculture and services sectors, or into industry, would help to ensure access to more stable livelihoods for Crimeans.

Ukraine's Labor Sector

This section describes the four dimensions—the legal foundation, government institutions, organizations, and markets—that underpin Ukraine's labor sector, as observed during the team's assessment.

While Ukraine's **labor laws**, as written, are very protective of worker rights and generally supportive of union activity, the enforcement of the legal framework has left a pronounced gap between law and practice. There is almost universal agreement that the law is honored more in the breach than in the observance. Work remains to be done to replace the much amended 1971 Labor Code with a more updated version that reflects Ukraine's political evolution in the post-Soviet era. However, a focus on the legal framework that undergirds the labor sector is not in itself likely to yield results without also addressing some of the more fundamental constraints in regards to government institutions and labor organizations. As the country faces strains from both the external global economy and from internal demographics, the regulation of the labor market will become even more important as established social safety nets, such as the pension system, fray.

Ukraine's **government institutions** have been weakened by the chronic, low-level crisis that has been a constant feature of political life in Ukraine since the Orange Revolution. As a result, political leaders over the last several years have focused more attention on politics than on governance. For the most part, government institutions in Ukraine are not deeply concerned or involved with labor issues. The judicial system is universally viewed as lacking credibility and corrupt. Workers rarely use the courts to resolve labor cases (with the exception of dismissals), viewing the courts as biased toward employers and fearing that they could be blacklisted from employment for suing their employer. Instead workers rely on ad hoc solutions to compensate for an unreliable court system and a weak patronage system.

Government institutions treat non-union workers and workers in the informal economy with benign neglect. However, the Ministry of Labor and Social Policy does occupy a critical conjuncture in the modern political economy of Ukraine. Its deteriorating social safety net is called on to provide social protection for those most adversely affected by the global financial crisis. This most likely will exert pressures for the government to establish a new labor paradigm, of which the three-pillar pension system being developed will be a key element. The most pronounced exception to the lackluster performance of government institutions is the State Employment Service within the Ministry of Labor and Social Policy, which uses modern technology and counseling methods to assist those who seek job leads, employment counseling, and business start-up advice.

Ukraine's **labor organizations** landscape is characterized principally by three trade union confederations (there are approximately 25 in all), including 1) the FPU, the successor to the Soviet-era unions, with an estimated membership of eight to ten million workers; 2) the KVPU, the most influential of the independent confederations, with 240-270,000 members; and 3) the All Ukrainian Worker Solidarity (VOST), with an estimated membership of 70-135,000. Despite differences in ideology and outlook, common ground exists among the various unions with regard to the major issues confronting their membership: low wages and wages arrears; ineffective social dialogue; unsafe working conditions; anti-union discrimination; and non-enforcement of labor law. A new concern created by the current financial crisis is the problem of worker lay-offs, and the use of reduced workweeks and unpaid leave as a means of dealing with the layoff problem.

On the employer side, 13 associations exist, the oldest and largest of which is the Federation of Employers of Ukraine. While labor unions have a long history in Ukraine, employer unions are one of the newest actors in the labor sector. Key issues for employer associations include some issues over which employers have differences with workers that need to be negotiated, such as wages. There are also numerous issues in whose resolution both workers and employers have mutual interests, including general agreements, social insurance, a revised labor code, business and competitiveness, public-private partnerships, research on the labor market, and training to improve worker qualifications.

Civil society organizations (CSOs) in Ukraine by all accounts have gained a voice in Ukrainian society. A number of local non-governmental organization (NGOs) address workforce development, gender discrimination, and trafficking issues, yet few, if any, address labor rights issues in Ukraine. Few links exist between various labor unions and other NGOs.

Labor unions in Ukraine share some weaknesses. They appear to have little influence on government policy, as neither union has a real sense of how to engage in political advocacy or the importance of lobbying for labor issues. Secondly, both FPU and KVPU possess a relatively narrow vision of their purpose, limiting their focus to bread and butter issues of their membership. Neither union was concerned, for instance, with problems faced by workers in the informal sector, or by non-union workers, with no appreciation for the responsibility to advocate on behalf of workers in general. This narrowness of vision also results in limited collaboration with other CSOs. In short, despite the fact that the principal labor organizations have strong membership bases, the unions have not yet succeeded in leveraging their strength into effective influence over public policy-making.

Among the notable strengths in Ukraine's **labor market** are the reasonably high levels of education of the Ukrainian workforce, the diversified and rather industrialized economy that offers a panoply of career options to youth, proximity to the Russian and European markets that allows for facile out-migration if demand in the domestic labor market is weak, a rather modern active labor market program run by the Public Employment Service to provide services to the unemployed, and a commitment of authorities to maintain minimum wages at or above subsistence levels. The recent fall in the value of the hryvnia should help to accentuate the competitiveness of Ukraine's labor costs.

However, among the labor market weaknesses we note that growth in the small- and medium-sized enterprises (SME) sector—and thus in employment by SMEs, which is typically a vibrant creator of jobs in more established market economies—is still sluggish due to stalled progress on business environment reforms. However, since the writing of this assessment, there has been a transition of government to one that is determined to end the Orange era of political stalemate and proceed quickly with long overdue reform. This is thus yet another potentially fruitful area for collaboration between business and labor in advocating for reform. The persistence of an “informal formal” employment sector in which formally employed workers are still partially compensated with envelope wages and thus whose rights and wages are not fully protected is troublesome. The lack of communication between the education and training sector, on the one hand, and employers, on the other, whether through workforce councils or the creation of competency frameworks by occupation or other workforce development programs, coupled with the

limited transmission of wage signals to new job seekers, means that youth/students continue to target unrealistic career aspirations and neglect to invest in technical and vocational skills acquisition.

Another weakness is the disconnect between productivity and wage levels. Because of traditionally high unionization and collective bargaining coverage in industry and a centralized approach to wage determination, employers have been forced to increase wages without considering productivity indicators. SMEs, whose interests are usually not taken into account during bargaining processes at the national and sectoral levels, seem to be disproportionately hit by the cost of labor rising ahead of productivity gains.

Perhaps one of the most significant weaknesses of Ukraine's labor market is the growing gap between social security mechanisms, most notably pensions, and the numbers of workers needed to support such entitlement programs. Already, the non-wage labor costs such as the pension system have distorted the wage structure by driving formal remuneration rates downwards. This situation will increase pressures for reform, increasing the potential for labor to increase its ability to advocate through the political process.

The Role of the Labor Sector in Overarching Development Themes

Engaging in labor issues cross-sectorally, i.e. by integrating legal, political, social and economic dimensions, can improve the efficacy of strategic approaches to United States Government (USG) programming. The three largest areas of the USG program in Ukraine cover peace and security, governing justly and democratically, and promoting broad-based economic growth.

Peace and Security: Ukraine is not *prima facie* a first-tier security concern for the US. However, in a less apparent, but not insignificant, way, the future of Ukraine has substantial bearing on broader US security interests. The 2008 war between Russia and Georgia heightened Ukraine's strategic interest to the US, while the increased Russian presence in the ARC following the war with Georgia has raised concerns of further Russian efforts to incorporate it into its sphere of influence.

Labor issues have an indirect impact on peace and security issues in Ukraine. A Ukrainian workforce that is more fairly compensated and represented will likely bring greater stability and prosperity to Ukraine, as well as reduce incentives to out-migrate and vulnerabilities to trafficking. Better representation and protection for workers, not just legally, but in practice as well, will be necessary for greater integration of Ukraine into Euro-Atlantic institutions, which will improve Ukraine's overall security. As the economic crisis worsens it is possible, but far from certain, that there will be greater unrest, including from underpaid, underemployed, and unemployed workers in Ukraine. Creating avenues for these people to raise their concerns and articulate their needs will be important should this unrest intensify.

Governing Justly and Democratically: Programs that help develop issue and advocacy based links between political parties and labor unions, as well as those that help parties develop platforms on labor sector issues and link those platforms to both policymaking in the *Rada* and party development outside of the legislature, can ground democracy and governance work and contribute to the development of a more responsive and issues-oriented political party system. Labor programming can thus be used to both strengthen the representation of labor in the political process in addition to improving the labor enabling environment itself.

Another way that labor sector programming intersects and contributes to the overarching goal of Governing Justly and Democratically is in regards to civil society development. The findings of this assessment indicate significant political space for civil society activism, including by independent trade unions. As with the political process, labor sector programming can also contribute to the enhancement of civil society's ability to advocate on behalf of labor rights. Such potential is particularly pronounced when it comes to pursuing interests that are common to both labor and business associations. Labor programming could also contribute to improved executive and judicial branch operations, as the capacity of unions to advocate for more responsive and balanced service from the Ministry of Labor and the courts is strengthened.

Economic Growth (EG): Labor is the oft-overlooked factor of production within EG programs. Yet lessons drawn from around the globe suggest that failure to incorporate an explicit labor focus into EG programs can jeopardize the accomplishment of EG goals. Myriad examples can be found that indicate ways in which addressing labor sector issues can contribute not only to labor sector goals in their own right, but also make critical contributions to broader EG objectives.

Sometimes the stove-piped nature of development and diplomacy objectives inadvertently pits one priority against another. In some instances, the fact of limited resources encourages an “either/or” mentality: should we design programs that focus on labor rights “or” economic growth, work with civil society organizations “or” trade unions? Sometimes these tensions have real, unintended consequences: unions’ push for higher wages may unintentionally lead to employment reductions or investments in capital- rather than labor-intensive methods of production. On the other hand, sometimes the highlighting of tensions can also help to identify areas of synergy within and among labor-related and political and economic objectives. In other cases, programs may wish to consider not only direct support for labor organizations, but also how to work through labor-related organizations in other Democracy and Governance (DG) and EG areas in a way that indirectly supports (and thus strengthens) them.

An important tension to be noted in Ukraine is the need to balance the fragility of Ukraine’s current political system against the unknown risk associated with strengthening new political variables, such as labor or private sector business. Given the extreme fragility of the Ukrainian political system, the introduction or highlighting of more cleavages, even rational sounding economic ones like labor- and business-related issues, could—instead of giving voice to important issues—simply be the final stress that tears the political system apart.

Strategic Considerations

Identifying strategic considerations for future programming in Ukraine requires an overview of the USG program over the past five years. Approximately 40% of the USG program in Ukraine is spent on peace and security activities, 25% on governing justly and democratically programs, and 20% for economic growth. Most of the remaining budget is allocated to health programs. In addition, the USG’s Millennium Challenge Corporation (MCC) has funded a \$45 million, two-year Threshold program in Ukraine since 2006, focused largely on reducing “corruption through civil society monitoring and advocacy, judicial reform, increased government monitoring and enforcement of ethical and administrative standards, streamlining and enforcing regulations, and higher education testing.”

Integrating Labor Sector Actors Directly into Rule of Law, Political Competition, and Civil Society Programs. More focus on a range of labor sector issues and programming can significantly contribute to achieving USAID’s democracy and governance objectives in Ukraine. Many labor-related policies, whether they are concerned with crafting a new labor law, improving the skill match between workers and employers, ensuring a climate where the freedoms necessary for workers to organize exist, or increasing protections for workers, are closely related to broader goals of democracy and governance. In particular, labor sector programming can improve the rule of law and human rights through the passage of a new labor law, provided it is supported by improved monitoring and enforcement mechanisms. Good governance will be furthered by better enforcement of existing labor codes and through deliberative bodies that are more responsive to labor constituencies. Political competition is an area that could be significantly enhanced by improved labor union lobbying of political parties. Programming in the labor sector also offers immediate and direct benefits to the development of a more vibrant and engaged civil society.

One of the principal goals of democracy assistance is to increase the ways in which ordinary people participate in politics, and increase the impact of that participation. By placing a stronger emphasis on labor sector policies through democracy and participation, policymakers will be encouraged to engage in more open public dialogue on labor issues. By incorporating concrete wage, occupational safety, and

other issues into democracy and governance, labor sector programming, if done well, will demonstrate to ordinary people that democracy is not just a platitude but that it can have an effect on their lives.

A key element of successful democracy and governance work is linking capacity-building projects, whether with CSOs, legislatures, or political parties, to issues of real import to voters, activists, Members of Parliament (MPs), or parties. Labor sector issues can be an important component of this. For example, a legislative strengthening project could organize a series of fora and workshops to discuss proposed drafts of a new labor law. These could include workshops with MPs and labor law experts, union leaders, representatives of employers, and the like, as well as public events where ordinary citizens, and workers, could have some input on the new law.

Similarly there are CSOs which currently focus on various aspects of labor including trafficking, migrant workers, and young workers. However, there are large areas of the labor sector which do not seem to be addressed by major CSOs. Examples of this include organizations that advocate for and seek to represent unorganized workers in the informal sector or older workers who may be past the mandatory retirement age but still be in the workforce, as well as organizations, other than unions, that seek to advocate for workplace safety, living wages, and other labor-related issues.

Efforts to support CSOs addressing these issues would contribute to a depth and vibrancy to Ukrainian civil society that would bolster democracy and governance programs. If CSOs were seen as advocating for critical workplace issues, about which ordinary Ukrainians care a great deal, it would help Ukrainians get a stronger sense of why democracy is important and how it can be effective and help improve the perception of civil society in Ukraine.

Currently, the trade union movement possesses too narrow a view of its role. Negotiating on behalf of members in the workplace is obviously one aspect of a union's role, but not the sole function. Beyond the representational role are the communicative, political, stewardship, protest, collaborative, and economic functions.

Strengthening Labor and Workforce Development Initiatives in Local Economic Development Programs. Local economic competitiveness involves multiple variables, among which are several labor sector issues. A competitive export sector, for instance, needs collaborative, rather than confrontational, labor relations in order to keep the production lines moving. Verifiable and transparent information confirming compliance with core labor standards gives assurances to international buyers that their sourcing partners will not appear in condemning news reports about working conditions. And workers whose labor rights are respected, whose working conditions are decent, and who receive wage incentives commensurate with productivity will work harder than those who work under adverse conditions.

Another labor sector dimension to competitiveness revolves around skills and training. Skills upgrading and preparing the future workforce for tomorrow's jobs are key to advancing Ukraine's economy, coupled with creating jobs, of course. Stories of labor market disequilibria abound in Ukraine: youth who decline to pursue vocational training, students who flood into law and economics rather than pursue science and technology careers, employers who are unable to recruit appropriately trained workers, and the like. Some of these seeming disequilibria are due to the fact that Ukraine is embedded within a regional labor market that, at least until the fourth quarter of 2008, drew labor out of Ukraine into higher paying labor markets in nearby countries.

USAID could strengthen integration of labor sector issues into its competitiveness and local economic development programs, encouraging local level dialogue between local business associations and labor unions to encourage both increased productivity/competitiveness and respect for labor rights. Economic and financial literacy of unions, associations, and their members benefits society broadly – credit, home purchases, profitability of enterprises, etc. In addition, industry-specific employer groups should be supported to signal to education and training institutions, and the youth, students, and mid-career adults

who attend them, what skills they seek, and what levels of compensation they are willing to pay in order to successfully recruit the workforce they need.

Examples of workforce development initiatives that may be successful include:

- Preparation of occupational reference materials, such as competency frameworks that indicate tasks, responsibilities, and skills required at various levels of employment in a firm;
- Collaboration with faculty on degree program and curriculum designs that will produce skilled, recruitable graduates;
- Organization of informational tours, internships, summer employment programs, and career fairs to give youth, students, and mid-career job seekers insights into possible career paths;
- Improve the dissemination of information about the job market. This could involve programs that could use such entry points as the Public Employment Service and media, Internet, and Web 2.0 outlets; and
- Increase education and training opportunities for vulnerable groups at risk of labor migration and labor trafficking.

Programs that integrate more explicit consideration of labor and workforce development issues as part of local economic development can help to ensure that all conditions for growth are being met. In addition, integration of labor and workforce development issues could mitigate increases in trafficking-in-persons, in particular in light of the global economic crisis.

Supporting Pension Reform Strengthens Labor Markets and Growth. In addition to strengthening financial sector stability, continued support for pension reform is important because of the positive repercussions thereof on labor markets and economic growth. When workers believe that their payroll deductions will accrue in pension accounts that will help to support them in the event of unforeseen risks or after they retire from the workforce, they have an incentive to seek employment in the formal sector. This, in turn, augments the income tax base for the country and improves the state's ability to expand its programs.

In addition, pension reform not only aims to allow the elderly to retire with dignity, but in helping workers to manage risks and save for retirement, it frees them somewhat during their working years to invest in other assets, such as housing or education or entrepreneurship, that they might not otherwise be able to afford. This, too, contributes to improved prospects for economic growth.

Final Considerations. Given finite resources and the scope of issues to be tackled, care should be taken to avoid duplication of efforts. Ukraine is currently working toward inclusion in the EU Neighborhood Policy as well as being engaged in negotiations to establish a free trade area with the EU. In determining specific programs to support, it would therefore be advantageous to be cognizant of the work already being done, or planned, by the EU.

USG support for labor programs to date has laid an important groundwork for achieving a well-functioning labor sector in Ukraine. Conditions in Ukraine today are particularly propitious to make further progress and reap the benefits of that groundwork now. With regard to external considerations, Ukraine's interest in negotiating free trade and association agreements with the EU should heighten the country's sensitivity to labor issues, since the EU's commitment to human rights, including core labor standards, is a focus of such negotiations (EU 2001). Within Ukraine, government repression of, and interference with, trade unions has lessened under the Yushchenko administration, compared with the previous administration. The KVPU, with increased membership and institutional stability, is now a more significant social partner. Finally, in the current evolving political landscape, there is an opportunity to

reform the FPU from its organization as a Soviet-legacy trade union to a union that is less dependent on government political control and more responsive to its membership.

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