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German Economic Team

NEWSLETTER

UKRAINE

The Ukrainian labour market during the COVID-19 crisis

The COVID-19 pandemic hit companies in Ukraine hard. Immediate steps taken by the government since spring 2020, such as providing regulation for work from home, relief payments to companies and adapting an existing short-term work scheme, helped companies to adapt to the unforeseen circumstances. Yet, quickly adapting their workforce to reduce labour costs still remained essential for many companies to survive. However, their ability to do so was constrained by labour law, which needs to strike a balance between the interests of workers and companies.

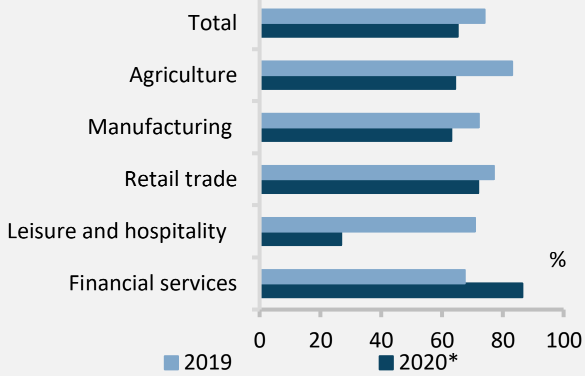
Companies used several ways of adapting their labour force to the new circumstances and to cut labour costs. Unpaid leave or working time reductions required the consent of workers and were used in relatively small magnitudes. The adapted short-time work only covered relatively few companies. In consequence, the main form of labour market adaption was still to dismiss employees, even though this cannot be done quickly nor cheaply and many companies would have rather retained contractual links with their workers during the temporary crisis. To improve the ability of the labour market to reflect both the needs of companies and workers in crisis, extending the existing short-term work scheme in the spirit of short-time work schemes employed by EU countries should be considered.

Drastic decline of company revenues

The COVID-19 pandemic pushed the Ukrainian economy into a sharp recession. The nationwide quarantine in mid-March 2020 during the first wave caught many businesses off guard: non-essential shops, entertainment, accommodation, hospitality, and transportation services were forced to remain shut for weeks. Other companies could not operate normally as employees could not get to work. Yet others faced sudden and drastic declines of demand for their products - such as automotive suppliers affected by the temporary suspension of car production in Europe.

In consequence, the Ukrainian GDP dropped by 7.8% in the second quarter of 2020 compared to the second quarter of 2019. Companies were suffering the brunt of the economic impact as revenues declined, but operating costs often could not be scaled back in proportion and quickly. Over the first three quarters of 2020, only 65% of Ukrainian SMEs reported profits, compared to 74% in 2019. The largest drop was in leisure and hospitality services, the sector that suffered most from lockdown, where just 27% of companies remained profitable.

Share of SMEs reporting positive profits



*Source: Ukrstat, *January-September data*

Government undertook measures to help companies

As companies were under pressure to quickly reduce operational costs to maintain financial viability, labour costs, usually one of the largest cost items, were of particular importance. The government of Ukraine, itself subject to tight financial constraints, took immediate action to help companies: Amendments of the Labour Code since March 2020 relaxed restrictions on unpaid leave of employees, introduced remote work and flexible working hours as legal forms of employment, and adapted a state furlough (or short-time work) scheme. In addition, employees of companies temporarily suspended due to the lockdown were eligible to receive a one-time payment of UAH 8000, distributed via the employers. Now, a one-time payment is renewed for employees and businesses in the “red zone”.

Options to reduce labour costs

The ability of companies to react is limited by labour law. Ukrainian labour law is considered to be relatively rigid. It generally seeks to strengthen the rights of employees against companies. While it is generally accepted that a certain strength is necessary to compensate for the otherwise weaker bargaining power of workers, rigidities restricting companies’ ability to scale down their labour force and labour costs can cause harm to companies in a crisis. During 2020, these rigidities required companies to choose among different options, each with advantages and disadvantages, while trying to reduce labour costs. In the short run, unpaid leave of employees could save costs quickly while retaining the link with the employees – but required the cooperation of employees who needed to request such leave. Similarly, reductions of working hours with corresponding pay cuts needed to be agreed to by workers, who themselves thus faced a tradeoff between temporarily accepting a lower pay or receiving unemployment benefits, but losing their job. Layoffs, on the other hand, could not be done immediately as a two months notice period must be observed and employees are entitled to mandatory severance payments of usually one month's pay. Hence, firing workers does not really save companies labour costs in the short run, but only after three months. Furthermore, firing qualified and trained workers is often not desirable for companies that will need these workers again once conditions return to normal.

Limited short-time work scheme

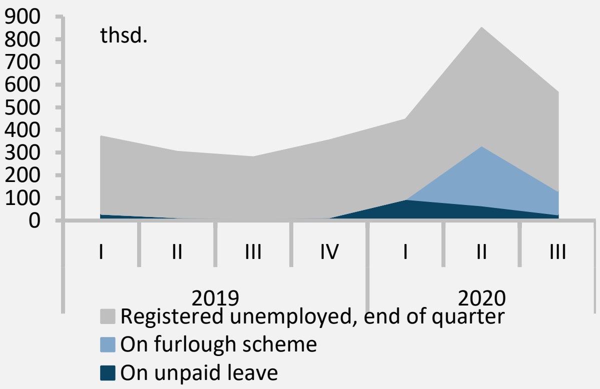
Unlike many other countries in the region, Ukraine also applied an instrument of similar to a short-time work or furlough scheme – a type of instrument applied by many advanced economies. Called "partial unemployment", this scheme originally was designed to assist large manufacturing companies in structural distress, but was adapted to support SMEs and their employees during the crisis.

In such a scheme, the state covers a replacement salary to workers currently working less than normal, or not at all due to an economic crisis. Companies thus are immediately relieved of labour costs and retain contractual links with their employes, while workers are compensated for their lost income. In Ukraine, this scheme is limited to SMEs and, among them, only to those closed down by government measures. In this case, workers could be put on the scheme by their employer with a reduced salary of up to two thirds of employee's usual pay for every hour of underemployment. In other countries such as Germany, such a scheme is normally open to all companies in temporary economic distress. Also, due to funding issues of the scheme, payments of assistance to eligible companies often were subject to substantial delays.

Layoffs the dominant response by companies

Statistical data shows that Ukrainian companies apparently used all these forms of adjustment, but firing employees was the dominant form of adjustment.

Different forms of adaption to the crisis



Source: Ukrstat, State Employment Service

Numbers of registered unemployed increased by around 300,000 workers in the second quarter of 2020, but not all fired workers would have registered for unemployment benefits. The adapted short-time work scheme was also used by slightly less than 200,000 workers since the second quarter of 2020. Unpaid leave was used to a smaller extent. Data on working time reductions is difficult to interpret and suggests less use of this form of adaption. Also, there will have been widespread layoffs and other forms of reduction of the labour force in the large informal economy, where labour law rigidities are not observed and workers are entirely unprotected.

Assessment and policy recommendations

Whether companies had sufficient room for manoeuver can only be fully assessed later, when it becomes clear how many companies did not survive the crisis. However, the data indicate that companies may have been quite severely restricted: Layoffs were the only real option for many companies, but did not provide quick relief of labour costs and hamper scaling up operations after the crisis, when skilled employees are required again.

Extending the existing short-time work scheme in the direction of the schemes successfully employed by many EU countries appears to be worth exploring more closely for Ukraine. Although such a scheme creates fiscal costs for the government, most of these are offset as workers who are eventually dismissed will receive unemployment benefits. Also, plenty of options to mitigate fiscal costs and abuse risks exist for such schemes.

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