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Adaptivity of the labour market in Ukraine during the COVID-19 pandemic: Analysis and policy recommendations

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Executive Summary

The COVID-19 pandemic has plunged the Ukrainian economy into crisis. The nationwide quarantine introduced in March especially affected small and medium-sized businesses as convenience stores, entertainment, accommodation, hospitality and transportation services were forced to remain shut for weeks. Other companies were faced with a sudden drop in demand. In consequence, many employers faced the necessity of quickly having to reduce costs in order to stay financially afloat. Adjusting the labour input and reducing labour costs, often the main cost component of companies, was of crucial importance.

We analyse four mechanisms available to companies to make necessary changes to their workforce and reduce labour costs. First, to retain staff, companies could ask employees to take temporary leave, either paid and unpaid, until uncertainty resolves, and workers can safely return to workplace. Second, affected businesses could get an immediate labour cost relief by seeking state assistance: Ukraine, like many other European countries, rolled out a “partial unemployment” programme for employees whose companies remained closed due to restrictions. Another option was to reduce working hours of staff with a proportional wage cut. Finally, an employer could decide to lay off part of the team.

All of these approaches were utilised during the crisis. Putting employees on unpaid leave or reducing their working hours to save costs requires the consent of workers. Although not immediately attractive, acting cooperatively probably was in the interest of workers in order to secure the long-term future of their jobs. Also, informal pressure by employers may have contributed significantly to getting employees’ formal consent to such measures.

Formally, the ability of companies to quickly cut labour costs remains heavily constrained by a very formal and rigid labour law in Ukraine. Layoffs are only permitted on the grounds of “organisational reasons” such as the closure of entire business units and subject to notice periods and severance pay. This does not make firing impossible in times of crisis but requires workarounds that take time and effort as well as objective firing costs due to notice periods and severance pay requirements. While the furlough scheme theoretically bridges this problem by using the state’s coffer to fill the gap and immediately take over responsibility for paying the (reduced) wages of furloughed employees, only few SMEs qualified for the scheme. In consequence, firing employees remained the most widely used mechanism of adaption, despite the high firing costs.

While a final assessment of the adaption to the crisis is not yet possible and will depend on the survival of companies during the crisis and the post-crisis growth of the economy, it appears obvious that labour market adaptivity could be improved in Ukraine. This can be done both through making labour market regulation more flexible (e.g. by permitting layoffs due to economic reasons as a first, short run step) and by extending the coverage of the furlough scheme which permits companies to save labour costs during a crisis while preserving job security of employees, hence reconciling adaption with rigid labour laws. Although the latter approach appears to create fiscal costs, many of those will be compensated as employees are not laid off, leading to savings in the unemployment insurance fund.

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1 Introduction

The COVID-19 pandemic has pushed the Ukrainian economy into a sharp recession. The GDP dropped by 7.8%¹ in the second quarter of 2020 compared to the second quarter of 2019, and the unemployment rate increased immediately from 8.9% to 9.3%². The abruptly imposed nationwide quarantine in mid-March caught many businesses off guard: as non-essential shops, entertainment, accommodation, hospitality, and transportation services were forced to remain shut for weeks, employers faced an unprecedented trade-off: how to keep the core workforce while keeping the business afloat? The Ukrainian government responded to the shock with several anti-crisis measures targeting primarily small and medium businesses: these ranged from the legal regulation of teleworking and the introduction of a “partial unemployment” scheme for idling employees to interest rate cuts of the National Bank of Ukraine and a rollout of affordable loans.

In this policy study, we analyse the developments on the Ukrainian labour market during the COVID crisis. Did the current labour legislation protect Ukrainians from layoffs when the economy abruptly stopped? To answer this question, we explore how business were adapting to new conditions. Specifically, we are interested in the legal margins of adaptivity that allowed the affected businesses to reduce the cost of retaining the workforce during quarantine downtime.

Based on our analysis, we identify four such mechanisms of adaptation. First, to retain staff, companies could ask employees to take temporary leave, either paid and unpaid, until uncertainty resolves, and workers can return safely to workplace. Second, an employer whose business was affected by quarantine restrictions could seek state assistance: Ukraine, like many other European countries, rolled out a “partial unemployment” scheme for idling employees. Another option was to reduce working hours, which would allow a proportional wage cut. Eventually, in compliance with current labour legislation, an employer could decide to lay off part of the team.

The study is structured as follows: In chapter 2, we analyse the severity of the shock that the Ukrainian labour market has experienced. In chapter 3, the four different mechanisms of labour market adaptivity are analysed. For each of these mechanisms, we look at the economic rationale, legal permissibility, statistical data, and qualitative evidence and reports about how businesses were adapting. Conclusions and policy recommendations are drawn in chapter 4.

2 How severe was the shock?

Quarantine measures related to the spread of COVID-19 and the subsequent economic downturn have imposed significant challenges on employers of the affected businesses. Not only they had to organize teleworking options for employees, but also to cope with falling profits and rising operating costs.

Businesses reported much less profits than in 2019.

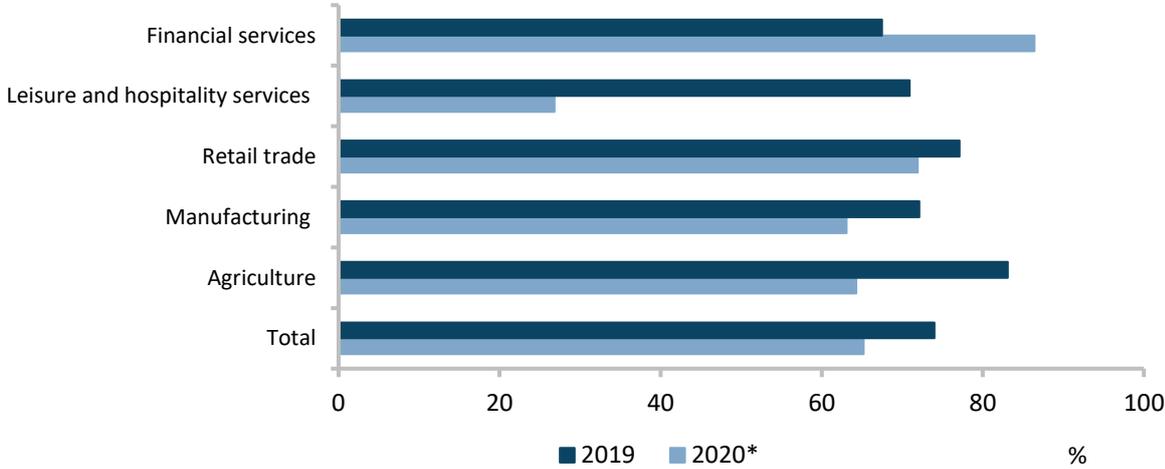
Over the first three quarters of 2020, only 65% of Ukrainian SMEs reported that they were profitable, compared to almost three quarters in 2019. The largest drop was in leisure and hospitality services,

¹ State Statistical Service of Ukraine

² State Statistical Service of Ukraine, ILO methodology

the sector that suffered most from lockdown: from 70% of profitable enterprises in 2019 to a bit more than a quarter in 2020. The only sector where the share of profitable companies grew was financial and insurance services³.

Figure 1: Share of SMEs that reported positive profits

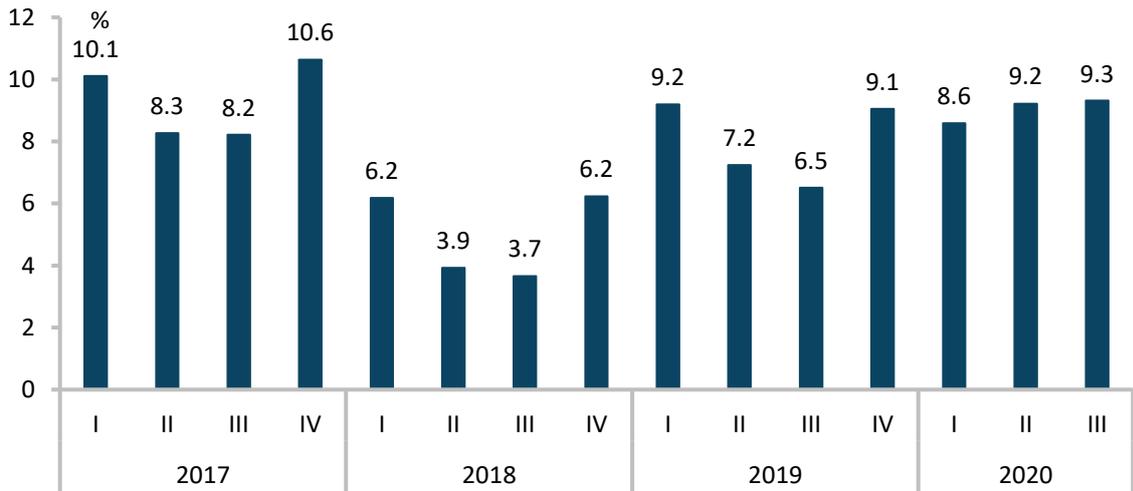


Source: State Statistical Service of Ukraine, *January-September data.

Unemployment rate increased moderately, but not immediately

A snapshot of the Ukrainian labour market up to and including the third quarter of 2020 shows only a slight deterioration. The unemployment rate was already high by the fourth quarter of 2019, standing at 9.1%, which was an expected end-of-the-year trend. Instead of the anticipated spring revival on the labour market, unemployment soared from 8.9% in January-March to 9.2% in April-June and 9.3% in July-September.

Figure 2. Unemployment rate, ILO methodology



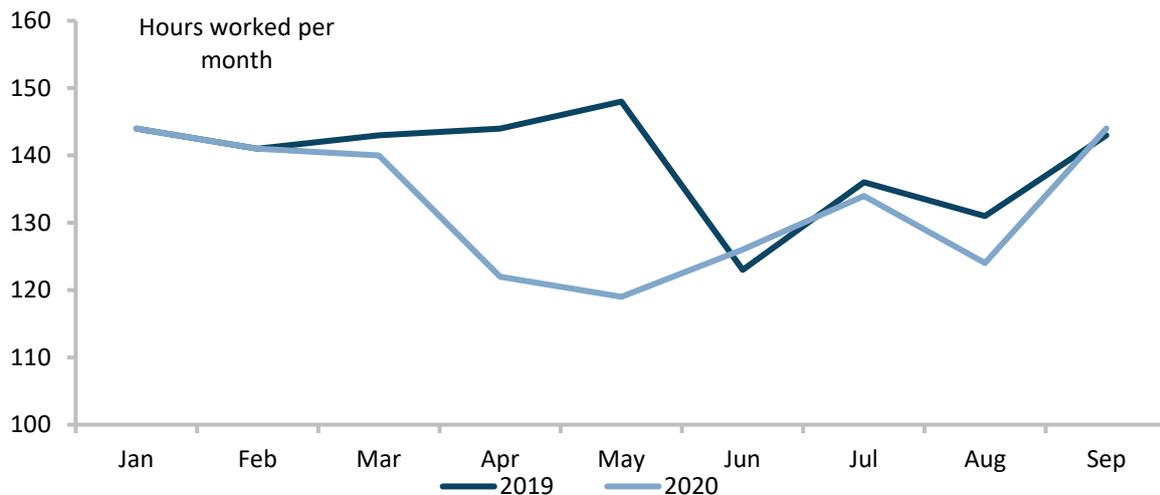
Source: State Statistical Service of Ukraine

³ State Statistical Service of Ukraine

Employees worked less, but total hours worked recovered to pre-quarantine levels once the restrictions had been lifted.

Average hours worked by an employee per month dropped significantly in March-May from an all-economy average of 145 hours to just 122 hours in April and 119 hours in May. The trend quickly reversed once the economy began reopening. By June, average hours worked return to the respective 2019 level, following the usual seasonal trend. The drop was likely driven by two effects: first, many employees stayed at home as their businesses could not operate due to the restrictions. Second, businesses that were able to operate adjusted their working hours to comply with quarantine restrictions on business operations and the weakening demand, with many employees transitioning to part-time.

Figure 3. Average hours worked by an employee per month across all industries



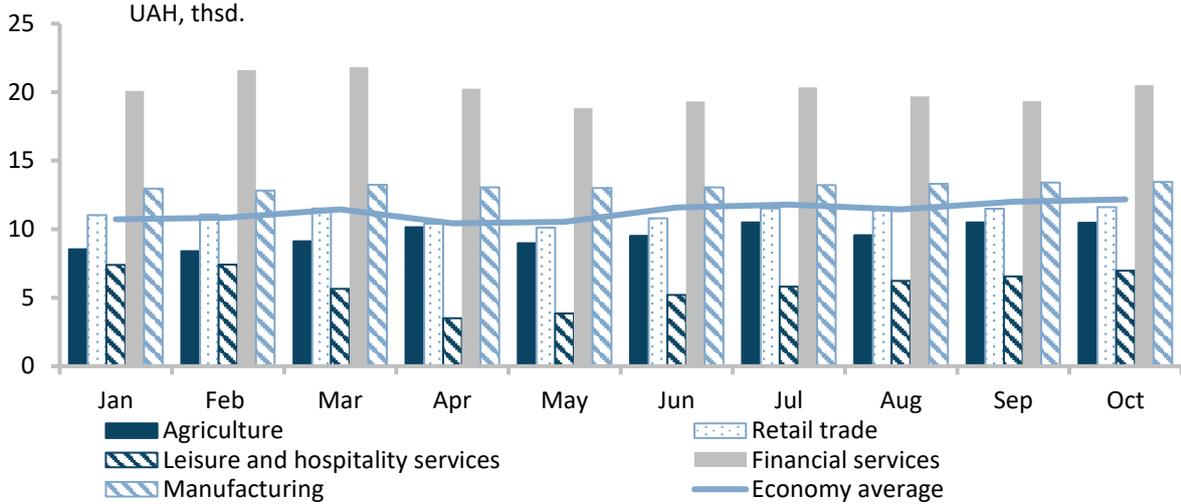
Source: State Statistical Service of Ukraine

Despite rising unemployment, compensation of employees remained relatively stable.

The economy experienced a 9% drop in average monthly compensation of employees over the first two months into quarantine driven primarily by a reduction in working hours. The figures, however, fully recovered by June. An upward trend that started in September was likely associated with an increase in the minimum wage from 4,723 to 5,000 UAH. The effects on salaries differed significantly across industries: average monthly compensation fell by almost 40% in leisure and hospitality services, where most of the staff remained locked out of the workplace for months. As a result, the drop was associated with the proportional fall in average hours worked in the sector. The industry also experienced the quickest recovery during the summer months, as restrictions were eased, and many people spent summer vacations domestically.

Yet the average salary has remained at the level below that in February: obviously, the quarantine loss in hours worked has not been compensated. In contrast, agriculture and manufacturing appeared to be the least affected by the crisis: salaries there remained stable and even increased slightly. The former was likely associated with the start of the planting season in Ukraine and the subsequent increase in the workforce demand, while the latter was driven by the minimal restrictions imposed on operations of enterprises in the sector.

Figure 4. Average salaries across major industries in 2020



Source: State Statistical Service of Ukraine

A slight decline and a rapid recovery of wage rates during the COVID crisis was likely driven by a reduction in working hours. The Ukrainian labour legislation is strict with respect to wage cuts: unexpected reductions are not allowed unless they are substantiated by structural changes in the functioning of the business, such as reorganization or liquidation of a business unit. Therefore, we do not consider compensation cuts as a separate mechanism of adaptation in our analysis, but rather a by-product of another adaptation mechanism: reductions in working hours.

3 Four mechanisms of labour market adaption during the crisis

Labour market adaption is constrained by the regulation of the labour market. The rights of employers and employees to change the contractual relationships between companies and their employees is governed by the Labour Code. In Ukraine, the Labour Code is based on the principle that employees have weaker negotiating power than employers, and thus need protection through labour legislation. The Code hence shields employees from most changes in employment conditions initiated solely by an employer such as unilateral cuts of salaries and working hours cuts and unsubstantiated dismissals. While this strengthens the position of employees, it restricts companies’ ability to quickly reduce labour costs in crisis situations such as the one many companies found themselves in at the beginning of 2020.

In the following, we analyse the four main forms of adaption that companies and their employees used during the crisis. This includes the impact of several amendments to the Labour Code and other measures to improve adaption of the labour market implemented during that time. The bills passed on March 16 and 30, 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 scheme.

3.1 Paid and unpaid leave of employees

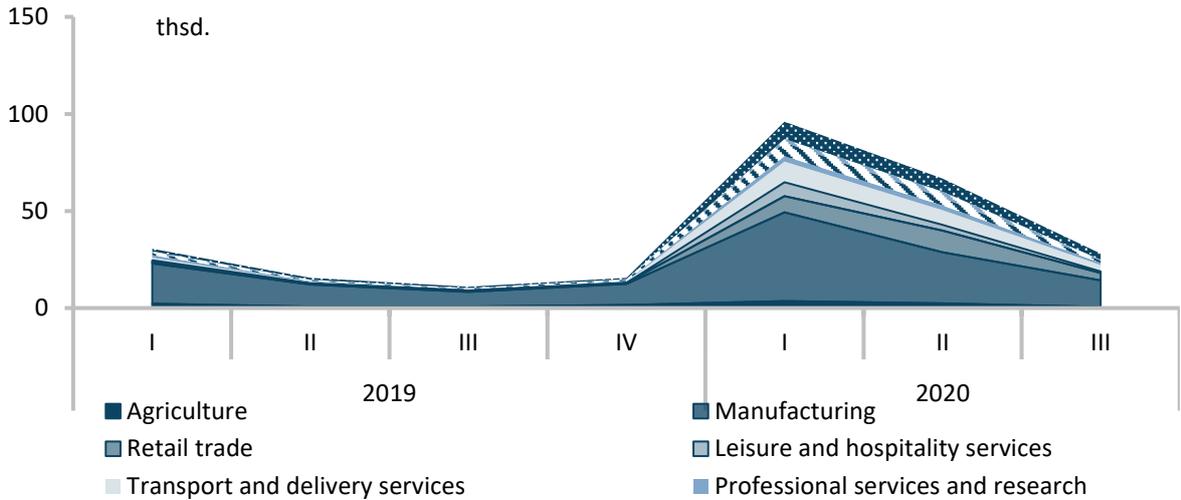
An attractive short-term measure for companies at the beginning of the crisis was to allow an employee to take a temporary leave from work, either paid or unpaid. As it was not yet possible to

foresee the duration of the COVID-crisis in early spring of 2020, this permitted companies to reduce costs (unpaid leave) or conserve the value of their wage payments for later (paid leave) without undertaking substantial measures such as altering employment contracts or even reducing their workforce. By law, state-guaranteed annual paid leave in Ukraine is least 24 calendar days⁴, while unpaid leave used to be limited to only 15 calendar days per year⁵. To facilitate adaptivity, the unpaid leave restriction was relaxed from 15 days per year to an unlimited number during quarantine.

Unpaid leave can be requested solely by an employee, not an employer. Therefore, an employer cannot force their staff into unpaid leave. In reality, many Ukrainian employees were asked to take unpaid leave for the duration of quarantine by their employers. Informal negotiation mechanisms in labour relations are common in Ukraine. Compliance with the labour legislation does not guarantee that an employer will not exercise pressure on an employee. In addition, taking unpaid leave was a good way for employees to retain the job: By law, it is illegal to dismiss a person as long as they are on leave.

It is likely that the Labour Code was amended in March 2020 specifically with this consideration in mind. The new mechanism effectively allowed businesses to keep employees on their workforce for an unlimited period during nationwide quarantine without firing them. Some of the businesses did this at no cost, which was perfectly legal, whereas others kept paying the personnel, in full or partially.

Figure 5. Number of employees on unpaid leave



Source: State Statistical Service of Ukraine

The share of employees on unpaid leave indeed sharply increased during the lockdown. In normal times, not more than 0.2% of all employed in the economy take unpaid leave at the same time, and the fraction increased to around 0.6% in the first quarter of 2020, or around 96 thousand individuals. Interestingly, the figures did not continue climbing in the second quarter: the number of employees on unpaid leave dropped to 67 thousand and stopped at 28 thousand by September 2020.

Significant differences are also observed across major industries. The manufacturing sector, which also in the past accounted for most employees on unpaid leave, was the heaviest user sector of this

⁴ Article 75, Labour Code of Ukraine

⁵ Article 84, Labour Code of Ukraine

instrument during the first quarter of 2020. This was probably due to a combination of lockdown restrictions preventing workers from getting to work and economic reasons, such as the temporary stoppage of car production in Europe. In leisure and hospitality services, the number of employees on unpaid leave soared amid the lockdown, but then slightly decreased in April-May. This suggests that employers in the sector first used unpaid leave to adapt to the new situation and later started reducing headcount when the continuation of the problematic situation during the summer months became foreseeable. An interesting picture emerged for staff in retail trade. The number of employees on unpaid leave kept increasing in the second quarter of 2020, most likely driven by varying quarantine restrictions in the regions (Ukraine transitioned to adaptive quarantine by that time).

Conclusions:

Asking employees to take an unpaid leave was mainly used as a short-term adaptation mechanism during the early phase of the COVID crisis. The manufacturing sector accounted for most of the spike of unpaid leave during the first quarter of 2020. Overall, only a small fraction of employees was on leave during the period of interest, suggesting that this was not a key instrument in adaptation to the crisis.

3.2 “Partial unemployment”: The state furlough scheme

Small and medium enterprises (SMEs) and individual entrepreneurs that had to stop or reduce their business activities due to the quarantine restrictions could apply for the state furlough scheme (also known as the “partial unemployment” scheme)⁶. The programme was a modified version of the usual partial unemployment scheme that has existed since 2013 and was designed mostly for large full-cycle enterprises halting their activities for other reasons, such as seasonal drops in production and structural changes (but not usable during the crisis-related demand slumps).

The scheme allowed companies to reduce payroll costs during the lockdown as the labour legislation would not allow them to immediately lay off people, hence remedying the impact of rigid labour law on companies. The adapted scheme only applies to companies which had to stop work due to government-imposed lockdown requirements. Other than many short-time-work schemes in the EU and elsewhere⁷, it did not apply to companies stopping or scaling down production due to indirect effects of the COVID crisis on demand – such as the stoppage of car production affecting Ukrainian automotive parts suppliers. Workers could then be put on “partial unemployment” by their employer with a reduced salary of up to two thirds of employee’s usual payroll for every hour of underemployment, paid for by the state through the Social Insurance Fund. The maximum benefit amount per month is, however, capped at the minimum wage⁸. Companies using this scheme could still completely cut labour costs of idle employees due to government-required stoppages of work. To be eligible, a firm had to be a social security taxpayer (thus, only the formal sector could participate).

⁶ Article 47-1, Law of Ukraine “About employment”

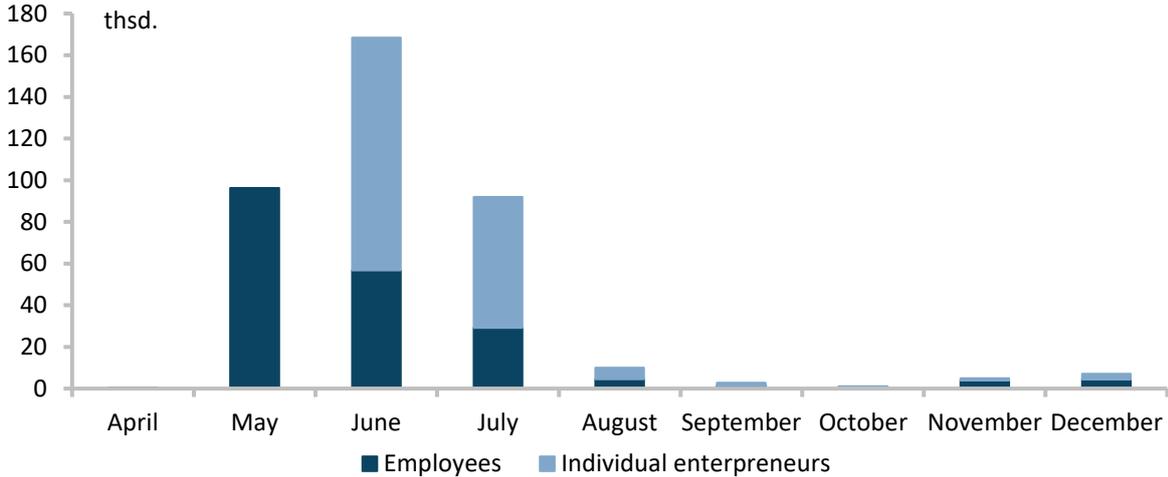
⁷ German Economic Team GET_ALL_PS_01_2021

⁸ Before August 2020, the minimum wage was 4273 UAH; it then increased to 5000 UAH in September 2020 and 6000 UAH in January 2021.

Eligible were insured employees that worked at least 6 months over the past 12 months as well as individual entrepreneurs across all sectors of the economy⁹.

As of January 1, 2021, 197,396 employees and 185,751 individual entrepreneurs (Ukrainian FOPs) received partial unemployment benefits. The programme covered workers in transport services, leisure and hospitality services, light industry, and some other.

Figure 6. Number of employees and individual entrepreneurs on the partial unemployment (furlough) scheme



Source: State Employment Service of Ukraine

Overall, the Ukrainian “partial unemployment” scheme can be described as a limited version of the short-time-work schemes that have been heavily used in the EU and elsewhere during the COVID crisis. Restrictions on eligibility (to SMEs and work stoppages immediately caused by lockdown restrictions) as well as on generosity (support capped at the minimum wage) are clearly reflecting constraints on fiscal and administrative capacities of the Ukrainian state. Nevertheless, for the companies qualifying for this scheme, it was possible to immediately cut the wage cost of employees that could not work (due to lockdown regulations) to zero. As all other methods of adapting to the crisis are either subject to costs and delays (lay-offs) or consent of employees (leave and reductions in working time), this scheme is very important insofar as it provides an immediate, costless relief to companies.

⁹ Another state support measure, which we do not cover here, was introduced by the Ukrainian government in late autumn 2020 (the colloquially so-called “8k UAH law”). The law guaranteed a one-time compensation of up to 8 thousand UAH for employees of small and medium size enterprises as well as individual entrepreneurs that suffered losses due to quarantine restrictions. However, only six NACE groups were eligible for the compensation. Other businesses that suffered direct losses due to restrictions were left aboard. For example, the programme did not cover the beauty services industry, small repair shops.

Conclusions:

Partial unemployment, the Ukrainian state's short-time work or furlough scheme, provided qualifying companies with immediate relief from labour costs for hours not worked due to government lockdown regulations. It hence constituted an important method of adapting to the crisis not subject to the consent requirements or costs and delays of other methods of adaptation. However, the restrictive conditions of the scheme limited take-up.

3.3 Reduction of working hours of employees

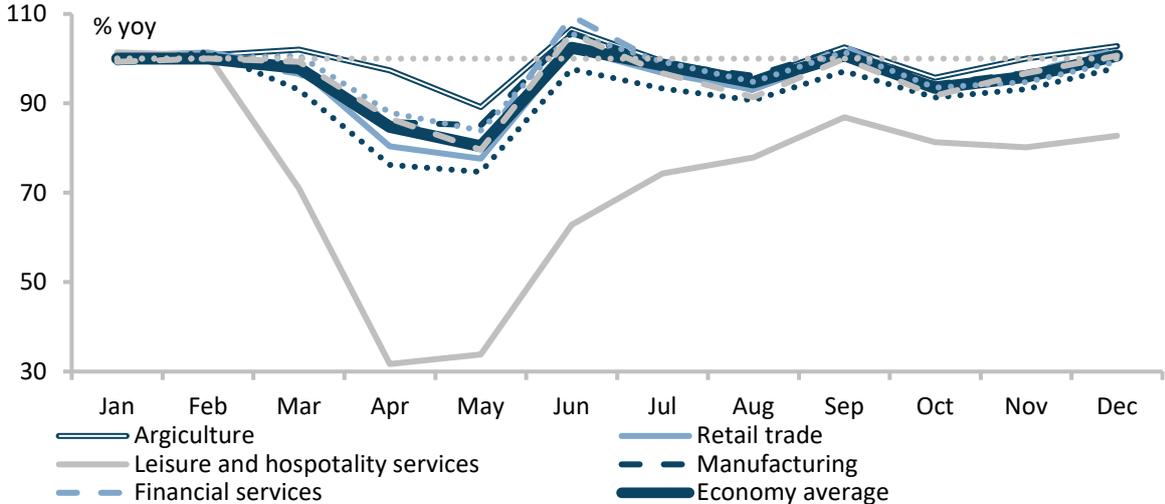
As companies were faced either with lockdown-related restrictions to their operations or with a slump in demand caused by the domestic and global repercussions of the crisis, reducing working hours of employees with corresponding reductions in wage payments was another possibility to reduce wage costs.

However, labour law restricts the ability of employers to change working hours without the consent of employees. The Labour Code's term on significant changes in working conditions applies: "Changes in working conditions can only follow changes in the organization of production and labour. These include liquidation of an enterprise or a certain structural unit, bankruptcy, or reorganization, or reinstatement of the employee that previously performed the job (...)"¹⁰. The labour rule also dictates that any changes to employee's working hours must be communicated to an employee at least two months in advance.

Thus, crisis-related circumstances did not suffice as legal grounds to unilaterally cut working hours for employees. The "partial unemployment" regulations managed to relax this rigidity, but only for a small range of companies. All other companies were effectively facing the normal rigidity of labour law here. Adjustment to changed economic conditions could only take place with two months delay and required structural changes in a company's organisation to be permissible. However, employers could in practice often exert pressure on employees, asking them to transfer to part-time work on their own initiative. This was not uncommon during nationwide lockdown in Ukraine.

¹⁰ Article 32, Labour Code of Ukraine.

Figure 7. Average hours per employee, 2020



Source: State Employment Service of Ukraine

It is non-trivial to identify the pure effect of the adaptivity mechanism in the data, as the data on working hours also include staff on leave (as working zero hours), on the partial unemployment scheme and working less whilst still being paid in full. The first drop in hours occurred already in March – when the quarantine restrictions began – and when statistics about employees on leave also spiked. However, as leave was only used by 0.6% of the workforce, it is unlikely to have been major factor in the reduction of working hours.

Another way to look at the data is to analyse the proportional wage drop. Monthly statistics on salaries count any compensation received by employees, including partial unemployment benefits instead of a proper salary, hence a 9% drop in April-May. While only a limited number of employees were on the state furlough scheme, the larger drop in working hours was likely driven by temporary part-timers. Representative surveys suggest that the share of employees working less than the usual 40 hours a week almost tripled during quarantine: from below 7% in March to 20% in April 2020¹¹. Any reductions in working hours would require cooperation between the two sides unless it is a partial unemployment scheme. Most likely, a good share of employees that started working part-time were asked to do so by their employers. This gave them the legal right to make a proportional wage cut.

Average monthly hours worked dropped in March-April across all major sectors, with few exceptions. On average, working hours were reduced by around 20% in May, the lowest month. Interestingly, the figures quickly recovered once the restrictions had been lifted and even continued following the usual seasonal trend, peaking in the mid-summer: employees who were locked out of their workplace returned to work or transitioned back to full-time as soon as it became feasible, conditional on still being employed. Leisure and hospitality services are somewhat of an exception as working hours in this sector dropped by almost 70% in March 2020 compared to March 2019 and then remained depressed by around 20% for the remainder of the year.

¹¹ <https://sapiens.com.ua/ua/publication-single-page?id=122>

Conclusions:

Although reducing working hours along with a corresponding salary cut during a temporary crisis would be a good way for companies to adapt, it is not without difficulties in practice due to required consent of workers. Although the data is not fully conclusive, it appears that companies did use this channel to the extent possible.

3.4 Laying off employees

Firing employees is to some extent the last resort of companies during a crisis. Especially when the crisis is expected to be short and market circumstances are expected to return to their pre-crisis state, it would be in the interest of companies to keep relations especially with skilled and trained staff. However, when no other methods of reducing labour costs are available or the effects of the crisis are expected to be long-lasting or even permanent, companies will need to lay off staff. However, restrictions on laying off staff are common globally and constitute one of the most important measures of labour market rigidity.

In Ukraine, employers cannot dismiss employees at will. Layoffs are legal only on the grounds of planned redundancies, which must be substantiated by “organisational reasons” such as the closure of an entire business unit and the unavailability of alternative and equivalent jobs for the respective employee¹². If this is the case, an employer must inform an employee about termination of employment relations by issuing an official notice at least two months in advance, and the employee is eligible for a one-month salary as severance pay¹³.

When resignation is initiated by an employee, the decision must be communicated to an employer at least two weeks in advance¹⁴. Employer’s consent in this case is not needed. In cases where the agreement is mutual (employer’s consent is obtained), the two-week term does not apply, and the termination date is determined through negotiations¹⁵. No severance pay is provided.

The strict labour legislation with respect to firing, however, does not protect employees from informal mechanisms of pressure from the employer’s side. This is especially relevant for the people employed in the shadow economy, but formal employees can be asked by an employer to write a letter of resignation of their own accord too, as resignations by employees would allow companies to quickly reduce labour costs. According to anecdotal evidence, an undated letter of resignation occasionally must be signed before signing the actual employment contract.

Before the COVID-crisis, only workers that were dismissed by an employee or by mutual agreement were eligible for immediate unemployment benefits. Those who decided to leave the job at their own

¹² Article 40, Labour Code of Ukraine: Changes in working conditions can only follow changes in the organization of production and labor. These include liquidation of an enterprise or a certain structural unit, bankruptcy, or reorganization, or reinstatement of the employee that previously performed the job such as liquidation, bankruptcy or reorganization of an enterprise, planned redundancy.

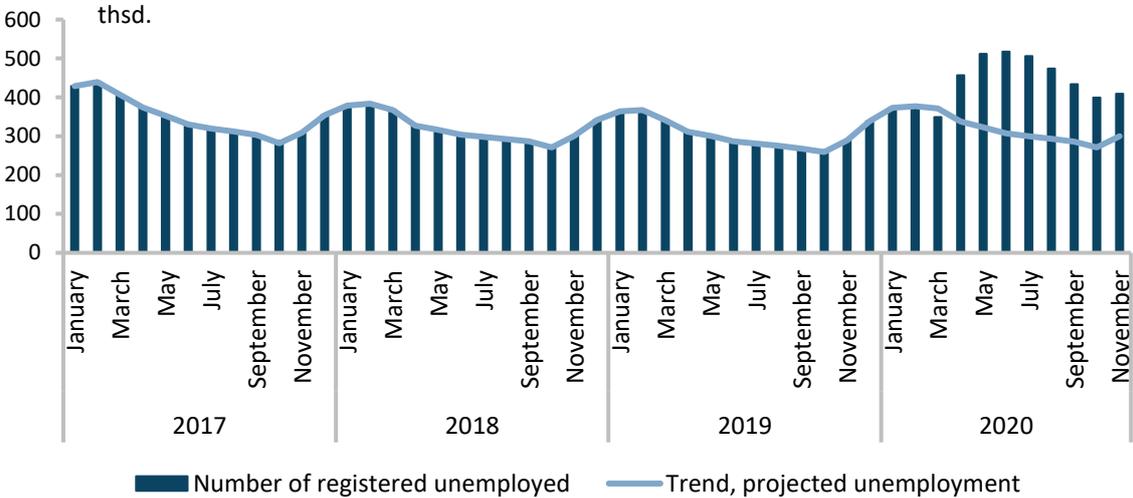
¹³ Article 49, Labour Code of Ukraine

¹⁴ Article 38, Labour Code of Ukraine

¹⁵ Article 38, Labour Code of Ukraine

will had to wait 90 days to become eligible. The labour law amendments in March 2020 accounted for a possibility of informal pressure from employee’s side and made all laid off individuals eligible for immediate unemployment insurance (UI) benefits, regardless of the dismissal reasons.

Figure 8. Unemployment: Actual numbers and comparison with projected trend



Source: National Bank of Ukraine, note: Projected unemployment is calculated as the average number of unemployed individuals registered with the State Employment Service in the respective period over 2017-2019.

Unemployment responded massively to the COVID crisis. The number of unemployed workers increased sharply during the crisis, but not immediately. Comparing to normal seasonality of unemployment, the excess unemployment most probably caused by the crisis started in April (around 120 thousand unemployed above the pre-crisis seasonality trend) and peaked in June-July (approximately 200 thousand registered unemployed above trend). Comparing the first three quarters of 2020 to 2019, the number of laid off employees saw a 50% gain across all sectors. In leisure and hospitality services, one of the worst-hit sectors, almost 13 times more employees have been made redundant in 2020 than in 2019. In sum, this shows that laying off workers was, despite being a “last resort” for companies, a very frequent and heavily used form of adaption by companies to the changed economic conditions.

Also, the timing of the spike in new registrations of unemployed individuals is interesting. The highest monthly numbers of registered unemployed occurred in May-July, two-three months after the lockdown had been announced. This might indicate that the staff were notified about being laid off in March but only became unemployed a few months later, as per Ukrainian law. For employers not using any informal methods, the only legal option to reduce the workforce was to initiate structural changes in their enterprise. An increase in redundancies around May-June, two months after the initial shock, that is observed in the data hence points to employers having done just that. However, it is also possible that part of this increase could be “voluntary” resignations being required at shorter notice (e.g. if companies first wanted to see how the crisis turns out and then decided they needed to reduce their workforce e.g. in April).

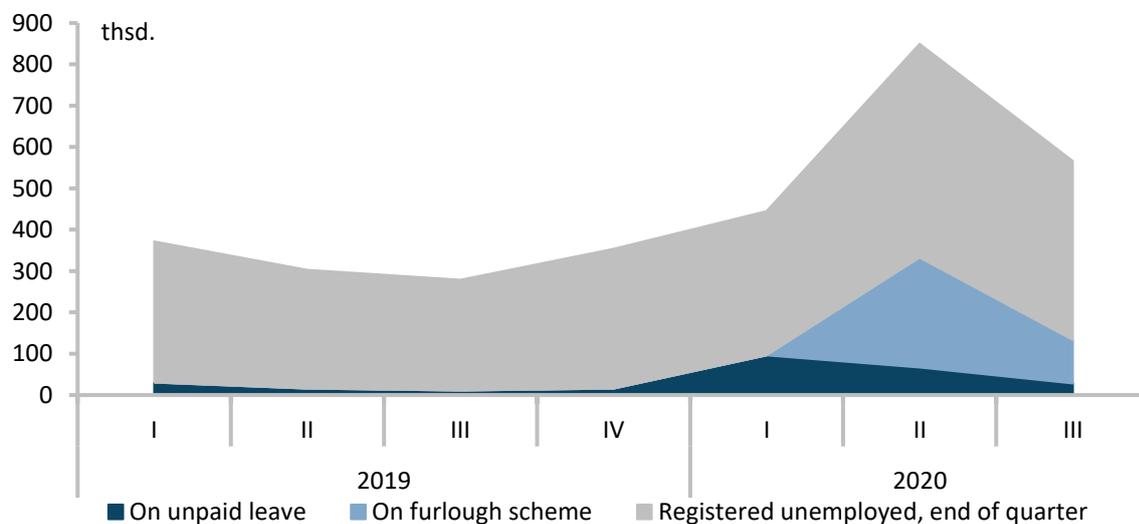
Conclusions:

Despite the rigidity of the Ukrainian Labour Code, laying off staff was a heavily used form of adaption by companies during the crisis. This indicates that either other forms of adaption (such as reducing working hours or furloughing workers) were not readily available to companies or companies expected a more long-term (or even permanent) shock to their business. Another factor could be that, given labour market conditions in Ukraine, some companies may not be concerned about finding suitable new workers after the crisis.

3.5 Consequences

Based on our analysis, we clearly see that the four adaptivity mechanisms were exploited successively. The number of employees on unpaid leave increased, but only in the first months into the lockdown, which was obviously the first adaptivity margin of businesses. Also, at the maximum in March, the numbers were still limited, with 96 thousand employees on unpaid leave. Nevertheless, this was a valid way for companies to react to the crisis initially. The relaxation of the 15-day restriction on unpaid leave contributed to the usefulness of leave as an instrument for companies to react. By still requiring consent of workers, it also required cooperative behaviour of employees. This, however also strengthened job security as employees on leave cannot be fired.

Figure 9. Different forms of unemployment



Source: State Statistical Service of Ukraine, State Employment Service.

The number of individuals on the state furlough scheme increased during the second and third quarter of 2020. The amendments to Article 47 of the Law of Ukraine “About employment” added COVID-related downtime, directly caused by government restrictions, to the list of circumstances that make affected employees eligible for partial payroll compensations. For businesses it was a good way to reduce the personnel costs while keeping contractual relationships with their staff, which permits them to quickly return to higher production levels again after the crisis when staff is recalled.

Nevertheless, total take-up of the scheme remained limited due to strict eligibility criteria. In addition, the cap at the minimum wage made employees often worse off compared to actual unemployment.

Reductions of working hours, although not easy to disentangle from other adaptations in the data, clearly played a role too. Like unpaid leave, this instrument required cooperation between companies and their workforce (or informal pressure from employers). Surveys suggest that up to 20% of all employed in the economy worked less than 40 hours a week in April, as increase from just 7% in March 2020¹⁶.

Layoffs of workers started in April and peaked in June-July. We suggest that this “late start” of the unemployment response was due to two related factors: first, the legally required two-month notice and severance pay implied that this was not a cost-less response for companies and the financial relief would only be effective after some time. Second, businesses of course do not want to needlessly fire skilled and trained employees they might need again in a short time. Hence, businesses probably only resorted to firing workers once it was clear that the crisis was severe and other responses would not bring sufficient cuts in wage costs. But once firing started, it clearly dominated other forms of responding to the crisis.

Conclusions:

Companies used all different mechanisms analysed here to adapt to the crisis situation with regard to their labour input and costs. Whilst mechanisms requiring cooperation between companies and workers (unpaid leave and reductions of working hours) were used successfully, laying off workers still constituted the main response by companies, despite rigidities in labour law and firing costs. Limited take-up of the government’s amended furlough scheme was most likely due to the highly restrictive conditions of the programme.

4 Conclusions and policy recommendations

Overall, different ways of adapting to the crisis with respect to labour costs existed for companies and were used. It is of course too early to draw final conclusions about whether the ability of companies to adapt to the crisis was sufficient. The real consequences of the crisis will be seen later once data on company insolvencies, economic and job growth after the crisis emerge. Nevertheless, some initial conclusions can be drawn here already:

High formal rigidity of labour law leads to the existence of informal methods.

Our analysis has shown that formally, the ability of companies to quickly cut labour costs remains heavily constrained by a very formal and rigid labour law in Ukraine: layoffs are subject to notice periods and severance pay and only few SMEs qualified for the “partial unemployment” furlough scheme that provided immediate labour cost relief. Putting employees on unpaid leave or reducing their working hours to save costs requires the consent of workers. Nevertheless, these measures were successfully used. This points at either the interest of employees in acting cooperatively in order to secure the long-term future of their jobs or at the existence of widespread informal pressure by employees.

¹⁶ <https://sapiens.com.ua/ua/publication-single-page?id=122>

It would be desirable to close the gap between formal and informal methods.

Informal pressure and methods to get consent from workers to “request” unpaid leave, reduced working hours or even resign from their job appear to exist quite widely in Ukraine. Companies develop these methods to some degree because of insufficient flexibility given to them by labour law. While these informal methods provide relief to some companies, others – especially large international companies with stringent governance codes – cannot use such methods. To make Ukraine a more attractive location for such companies (whose by-the-book behaviour is also desirable for the country in other regards, such as taxpaying), it should be considered to modernize labour law towards more flexibility for companies to adjust labour costs more quickly whilst observing legal constraints.

Policy recommendations

Ukraine should use the opportunity to learn from this crisis and improve the adaptivity of the labour market. In effect, it appears sensible to give companies more opportunities to quickly reduce labour costs if confronted with a crisis. This could be done either by making labour law more flexible – and to some degree closing the gap between the formal rigidity and practical flexibility achieved by many companies using informal methods and pressure on employees – or by letting the state step in through a more comprehensive short-time-work instrument. Hence, two policy responses should be considered:

- **Adding “adverse economic circumstances” as grounds for dismissal:** Much of the rigidity of Ukrainian labour law is due to its Soviet roots and the highly formal approach that allows layoffs only on very specific grounds. These “organizational changes” make it difficult for companies to lay off employees in times of economic distress. Hence, it could be contemplated to add “adverse economic circumstances” to the permissible grounds for layoffs.
- **Increasing the coverage and generosity of the “partial unemployment” scheme:** This scheme allows companies to immediately cut labour costs if subject to conditions that allow them to use the scheme. This overcomes the substantial labour market rigidity and the firing costs (notice period and severance pay) whilst also retaining workers that may be needed again shortly after a temporary crisis. At present, the very restrictive conditions limit the take-up of the programme. While the fiscal and administrative reasons for these conditions are understandable, it would nevertheless make sense to consider broadening the use of the scheme to companies experiencing a temporary economic crisis due to adverse market conditions as in many other countries. Fiscal costs of this programme would partially be compensated by savings in the UI, as workers are furloughed instead of being fired.

Of course, a broader strategy of making the labour market highly flexible could also be considered theoretically. Georgia, for example¹⁷, has such labour market regulation that is similar to the flexible labour market of the USA with very short notice periods and no severance pay. However, politically such a reform will be difficult to undertake and indeed the social consequences – economically weak workers shouldering much of the risks of crisis – might be severe such that the more measured

¹⁷ German Economic Team GET_ALL_PS_01_2021

approach to labour market flexibilization along with broadening state instruments to overcome rigidity whilst preserving incomes of workers appear preferable at present.

5 References

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