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## REFORMS OF SOCIAL SECURITY CONTRIBUTIONS IN SELECTED EU MEMBER STATES AND UKRAINE: PECULIARITIES OF IMPLEMENTATION AND CONSEQUENCES

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**Introduction.** *The need to improve the situation in labor markets and to intensify the entrepreneurial activity prompts to reduce tax burden on labor by revising the rates of social security contributions in most EU countries. In Ukraine, the main goal of the corresponding reform in 2016 was to reduce informal employment and income.*

**Problem Statement.** *Neoliberal strategies for reforming social security contributions and transforming social security systems have been spreading over some EU countries and Ukraine, which may result in deteriorating economic growth and increasing inequality and poverty.*

**Purpose.** *The purpose of this research is to substantiate possible social and economic risks of introducing radical proposals on the single social contribution reform and to define the expediency of their realization in Ukraine.*

**Materials and Methods.** *The European Commission methodology for calculation of the implicit rate of labor taxes in Ukraine, methods of the comparative analysis of social security contributions reform in Ukraine and the EU countries; theoretical generalization of the reasons for the spread of neoliberal strategies; factual and statistical analysis have been used in the research.*

**Results.** *The peculiarities and common features of reforming social security contributions in Ukraine and post-socialist EU countries with the largest scale of their reduction have been defined. It has been proven that the critical perception of the SSC reform in 2016 in Ukraine is largely related to the establishment of a contribution exclusively for employers. The fiscal, economic, and social aspects of the reform processes and possible risks of implementation of proposals on the abolition of SSC in Ukraine have been substantiated.*

**Conclusions.** *The most obvious consequences of the abolition of SSC in Ukraine may be a decrease in the welfare of workers and retirees and aggravation of inequality and poverty. It is not implausible that the expected results might be contradictory or uncertain. Although the short-term forecast is likely to increase the rates of economic growth, in the long run, there is a significant threat of degradation of its quality.*

*Keywords:* tax burden on labor, the labor taxes incidence, reforms of the social security contributions, sources of financing social expenditure, and neoliberal strategies.

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In 2010–2020, the reforms aiming at reducing the tax burden on labor by revising social security contribution rates were carried out not only in Ukraine but also in most EU countries, because of a high tax burden on labor in these countries (19.6% of GDP, in 2018 [1]), which was considered one of the world highest and negatively affecting the labor market and economic growth. However, the scale of their reduction was different, which has confirmed the idea of the dependence of the level of labor taxation on national preferences and the size of social security system, and hence, the lack of optimal tax burden on labor [2]. While in the EU-11 social security rates decreased by an average of 2.7 percentage points, in Romania, it fell by 8.5 p.p., in Hungary, it dropped by 9.5 p.p., and in Lithuania, it went down by 18.7 p.p. [3], which indicates the implementation of neoliberal strategies for reforming social security contributions in some post-socialist EU countries, as well as in Ukraine.

Given the above, there are several questions that we try to answer in this research. What is the difference between the reforms of social security contributions in Ukraine and in the post-socialist EU countries with the largest scale of reduction and what do they have in common? What are the consequences of these reforms? What is the reason for the spread of neoliberal strategies for social security contributions reform in some post-socialist EU countries and in Ukraine? What may be the social and economic effects of the implementation of the most radical proposals for the reform of the single social contribution (hereinafter, SSC) in Ukraine in the case of its abolition? The purpose of this research is to substantiate the possible social and economic risks of implementing radical proposals for reforming the SSC in Ukraine and to determine the feasibility of their implementation.

The foreign researchers have analyzed the following main aspects of social security contributions: 1) their essence and social purpose; 2) the economic effects, in particular, the impact of social security contributions on labor supply and demand and thus on the unemployment rate in the country;

3) the problem of choosing between the funding social expenditure at the expense of social security contributions and its financing from general tax revenues.

While disclosing the essence of social security contributions, the authors have drawn attention to the fact that, to some extent, they are similar to labor income tax however, but have some specific features. Among these specific features, there are such specific functions as life-cycle income smoothing, poverty protection, and social risk insurance [4], a non-income tax base that includes only labor income instead of broad-based income that includes labor and capital, as well as its limitation by the ceiling income, which creates a regression effect; legislative distribution of contributions between employers and employees; the relationship between the amount of contributions paid and the amount of payouts (insurance proceeds or retirement benefits) [5]. The closeness of this relationship is a decisive factor in determining the nature of social security contributions. If it is strong, social security contributions become signs of deferred wages or prices for future benefits, if it is weak, they become identical to the payroll tax [6].

Given the official distribution of social security contributions between employers and employees, their size may affect both the demand and supply of labor, and hence, the unemployment rate. It is just high mandatory payments on labor income that is often cited as one of the reasons for relatively high unemployment rates in Europe [5]. Theoretically, an increase in the rate of social security contributions for employees may reduce real wages and labor incentives and consequently decrease its supply, while for employers it may mean an increase in labor costs and reduced labor demand. However, the real economic consequences of taxation may be different. In particular, for employers, an increase in social security contributions may lead to: a) a decrease in the firm's profits, i.e. the tax burden may fall fully or partially on the shoulders of employers; b) a reduction in real wages, which means the transfer of the bur-

den to employees; c) an increase in the prices for the company's products, i.e. to the shift of the burden to consumers. Thus, the economic consequences of taxation depend on whom the burden of labor tax in general and social security contributions in particular is transferred to, which (the direction of transfer) is determined by the behavioral responses of economic agents in terms of elasticity. The higher elasticity (of supply or demand) causes a greater response to changes in taxes, with the relatively less elastic party bearing a higher tax burden [7].

The analysis of empirical research has shown a lack of consensus on who ultimately bears the burden of labor taxes. According to A. Á. Melguizo and J. M. González-Páramo, this is explained by the fact that the distribution of the tax burden depends on a large number of political and socio-economic factors, including: economic institutions, in particular, the degree of centralization of labor markets and the role of trade unions in them<sup>1</sup>, binding minimum wage<sup>2</sup>, as well as the ef-

<sup>1</sup>The characteristic of labor markets A. Alesina and R. Perotti focus on is their degree of centralization defined as the inverse of the number of unions in the economy: in more centralized labor markets, workers are represented by fewer unions, each encompassing more sectors. The degree of centralization is an important determinant of the effects of fiscal policy because large unions can better internalize the negative employment effects of their wage demands, but they also have more monopoly power. Thus, how much wages increase in response to an increase in labor taxation depends on the degree of centralization of labor markets. So, in the presence of strong unions the burden of labor taxation (social contributions) will be borne in part by employers, at least, in the short run. However, the increased wage pressure is reflected in higher output prices and therefore entails a loss of competitiveness, which will induce the unions to moderate their wage claims. Thus, as the degree of centralization increases, the distortionary effects of fiscal policy first increase, then decrease [8].

<sup>2</sup>According to the final report of the European Commission, the labor market outcome is affected by minimum wage. In case they are binding the incidence result is clear, with the incidence fully falling on the employers [7]. In this case, the binding minimum wage means the minimum rate for all employees as established by law or as agreed in negotiations (general agreements at the national level, sectoral tariff agreements, etc.).

iciency of the public sector; the type of pension system and, more importantly, the perception by payers of the correlation between social security contributions and social benefits; taxes included in the tax wedge<sup>3</sup>, in particular, not only labor taxes (personal income tax and social security contributions for employers and employees), but also indirect taxes that determine the gap between producer and consumer prices, forming a «price wedge»; time horizon, as the tax effect on wage may differ in the short and long term.

The meta-regression analysis (A. Á. Melguizo and J. M. González-Páramo) suggests that, on average, in the Anglo-Saxon and the Continental-Mediterranean economies, workers bear 70% of taxes. In the Nordic economies the degree of shifting is about 88%, so all tax changes are almost entirely offset by a wage variation. The degree of shifting is much lower in the short run: workers bear less than half of the tax burden [6].

In addition to the direction of tax burden shifting, the economic consequences of social security contributions also depend on their nature. If there are sufficient grounds to consider them deferred wages rather than taxes, the effect of such contributions on the labor market, in particular, on reducing labor supply, shifting the tax burden to employers, and increasing labor costs is less distorting than the tax effect [9]. This means that the transition to raising funds for state pensions through general tax revenues to the state budget increases distortions.

The conclusion that workers pay a larger share of labor taxes is consistent with the estimates of long-term elasticity of taxable income at the marginal tax rate, which have been made based on the data of tax returns (E. Saez, etc.); these estimates range from 0.12 to 0.40 [10].

The debatable issue of public finances, which has been discussed regarding the proposals to reduce social security contributions, is the question of whether social benefits should be financed from

<sup>3</sup>The tax wedge refers to taxes that create a wedge between labor costs and net wage and adversely affect labor supply, structural employment, and hours worked [6].

general budget revenues or from a separate source that is social security contributions. The general idea underlying the approach to distinguishing between the two sources of funding for social benefits — taxes and contributions, is a logical consequence of their structure that has the two components: the payouts under social insurance programs and the payouts under social assistance programs. If the former should be financed from social security contributions, the payment of which is a condition for receiving certain social benefits, the latter shall be paid at the expense of taxes. However, the insurance nature of contributions is more pronounced in the non-state insurance systems and, to a lesser extent, in the state ones where the connection between the payouts and the contributions paid in the past is not always obvious. This makes the difference between national social security contributions and taxes insignificant [5] and is the theoretical framework for the partial financing of state pension programs from the general state budget revenues.

Regarding the pragmatic aspect of this problem, its origins are the lack of funds to finance social benefits, especially pensions, because of the need to reduce the tax burden on labor. This is the reason for a decrease in the share of social expenditure financed from social security contributions and an increase in their funding at the expense of taxes. However, such structural changes in the social expenditure financing sources do not in themselves solve the problem of compensation for a reduction in social security contributions, which is a consequence of social security contributions reform. Many publications have dealt with the analysis of such sources and the problem of their choice, which should be addressed individually by each country that reduces social security contributions (see, for example, [2, 11, 12]). Their consideration has shown that there is a consensus on a few EU member states that have the necessary fiscal space to reduce the tax burden on labor without the need to compensate for the loss of state budget revenues. In 2016, only Germany, Latvia, Lithuania, and Austria in

the Euro area had a sufficient fiscal margin to raise the issue of non-compensatory reductions in labor taxes [12]. Most countries should look for sources of such compensation. Among them there are as follows:

- ◆ expanding the scope of social insurance by covering the employees who are engaged in the informal economy, through specific strategies [11];
- ◆ shifting the burden to taxes that are less harmful to economic growth, in particular, consumption taxes, recurrent taxes on immovable property, and environment taxes [11];
- ◆ reducing public expenditure and increasing its efficiency, one of the ways of which is to limit the use of tax expenditure (tax reliefs). Unless government spending is reduced at the expense of education, infrastructure, innovation, and tax incentives for R&D, its revision may have beneficial long-term effects on economic growth and jobs. However, in the short run, spending cuts may have significant implications that are more pronounced than the expansive effects of tax cuts, especially if spending cuts affect government consumption and investment [12];
- ◆ introducing harmonized tax instruments that aim at reducing aggressive tax planning and tax evasion, improving the administration of taxes and fees, and ensuring compliance with tax legislation.

The problem of a high tax burden on labor in Ukraine, which in 2015 was estimated by us as 34.64% (implicit labor tax rate), i.e. was higher than its average level in the EU-11 (33.45%), necessitated the SSC reform of 2016, which was accompanied by a reduction in its rate from 36.76–49.7% (depending on the class of occupational risk) to 22%; an increase in the maximum base of SSC from 17 to 25 subsistence minimum for able-bodied persons, and from January 1, 2018, up to 15 minimum wages; a twofold increase in the minimum wage in 2017 and an automatic increase in the SSC base as a result; introduction of mandatory SSC for individual entrepreneurs (except for those who have chosen the simplified tax system) and persons engaged in independent professional

activities, in the amount that shall not be less than the amount of the minimum insurance fee.

Reducing the burden on the wage fund by reduction of the SSC rate was complemented by the reform of personal income tax (hereinafter, PIT): from January 1, 2016, a low-progressive scale with rates of 15% and 20% was replaced by a single rate of 18%. According to these changes, the personal income tax rate for persons whose wage did not exceed 10 minimum wages, which in 2015 was 15%, increased by 3 p.p., which, in fact, compensated for the budget losses associated with the abolition SSC for employees.

As a result of the reform, the SSC rate in Ukraine was set at a lower level than in any EU member state, except for Denmark (8.00%), Cyprus (16.60%), Ireland (15.05%), Malta (20.0%), and Lithuania (21.27%) since 2019 [3]. The implicit labor tax rate that fell down to 28.6% in 2016 is now the lowest one as compared with all EU-11 member states, except for Bulgaria. In addition to the large reduction in the SSC rate, its reform in Ukraine is notable for a one-step way of reduction, which is not typical of EU member states that prefer gradual transformations. Such a reduction in the contribution rate was made for a significant legalization of employment and income. However, the real scale of change has turned to be much smaller than expected. According to the State Statistics Service of Ukraine, in 2019, the share of the informally employed population in the total number of employed aged 15–70 was 20.9% as compared with 26.2%, in 2015, when its level was the highest and with a decrease by only 2 percentage points, in 2010 [13]. The share of unofficial wage remained significant 45%, in 2018 [14].

This result has a logical explanation. It is that the level of burden of taxes and social security contributions is only one of many factors influencing the system of economic relations that exist outside the legal institutions of the state. The other factors include: the quality of institutions, the intensity of regulation, the level of public services, tax ethics, the effectiveness of measures to prevent non-compliance with tax laws, the state of the

formal economy, the scale of self-employment [15], corruption [16, 17], business conditions, income inequality, and GDP per capita [16]. Therefore, by changing the parameters of only one factor, it is impossible to achieve significant success in the legalization of the labor market and income.

The empirical studies of the actual consequences of reducing the tax burden in the context of its effect on the level of shadow economic relations have shown ambiguous effects of tax burden reduction in different countries. Thus, F. Schneider and D.H. Enste [18] have confirmed the favorable effects of reducing the tax burden on economic entities in Denmark, Norway, Sweden, Austria, and Germany. Other researchers have pointed to the lack of a link between the tax burden and the size of the shadow economy, or that this link is not strong enough [19]. According to F. Schneider, even large-scale tax reforms that provide for a significant reduction in tax rates may not lead to a significant reduction in the shadow economy; such reforms may only stabilize its size and thereby prevent further growth. This fact complicates the reforms aiming at a sharp reduction in tax rates, as their effectiveness, at the end, may not be high [20, 1083].

Another, and in our opinion, the main feature of the SSC reform in Ukraine was the elimination of the contribution for employees<sup>4</sup>, the necessity and expediency of which have not met officially explained. Ukrainian researchers have not paid much attention to it either. One of the reasons for this may be the idea prevailing in the public consciousness that regardless of the official distribution of contributions between the employer and the employee, all their burden falls on the employer who, paying wage, is forced to include in it both SSC and PIT. In fact, this idea is a conse-

<sup>4</sup> In all EU countries, employees pay social security contributions. At the same time, in most countries, contribution rates for employers are higher than those for employees. However, there are several countries (Netherlands, Germany, Slovenia, Romania, Croatia, Great Britain, and Lithuania) with a higher burden of social security contributions on the latter and two EU countries (Cyprus and Malta) with its proportional distribution.

quence of insufficient attention to the processes of tax shifting and the peculiarities of wage formation in different markets for both highly skilled and unskilled labor. Another reason for this may be the debatable, in our opinion, thesis that “in the economic context, a pension benefit is part of wage/salary, the payment of which is deferred until the loss of ability to work”, and therefore the payment of contributions for its financing (it does not matter, by employee himself or on his behalf) and the payment of the pension are the employer responsibility [21, 104].

Meanwhile, the establishment of SSC exclusively for employers has led to: first, a distortion of social security relations that should be based on the principle of “solidarity in financing,” instead, in this case, the employer provides funding while the employee gets benefits; secondly, a transformation of the single social contribution into a tax as a result of destruction of the relationship between the contributions paid by the beneficiary and his right to social benefits; third, an increasing non-transparency of the process of SSC shifting and contradiction between the economic content and the legal form of the contribution.

Theoretically, lowering single social contribution rate enabled businesses to use the resulting resources to increase wage for officially registered employees or to reduce the part that had been paid unofficially or to abandon such payments at all. This would lead to an increase in the SSC base and would partially compensate for (reduce) the loss of contribution revenues due to a reduction in its rate. In fact, as one can see from Figure, the wage fund for the economy as a whole in 2016 increased by 22.5%, including by 32.3% in the public sector, while in the business sector it grew only by 18.9%<sup>5</sup>.

<sup>5</sup> Indicators of the wage fund and SSC revenues in Ukraine for the business sector were estimated with the use of the methodological approach used by D. Serebrianskyi and A. Vdovychenko [22], as the difference between the indicator for the economy as a whole (according to summary data on single contributions to mandatory state social insurance [23]) and for the budget sector, i.e. the total number of employees who receive wage from the state and local budgets (according to the annual report on the state budget expenditure according to economic classification [24]).

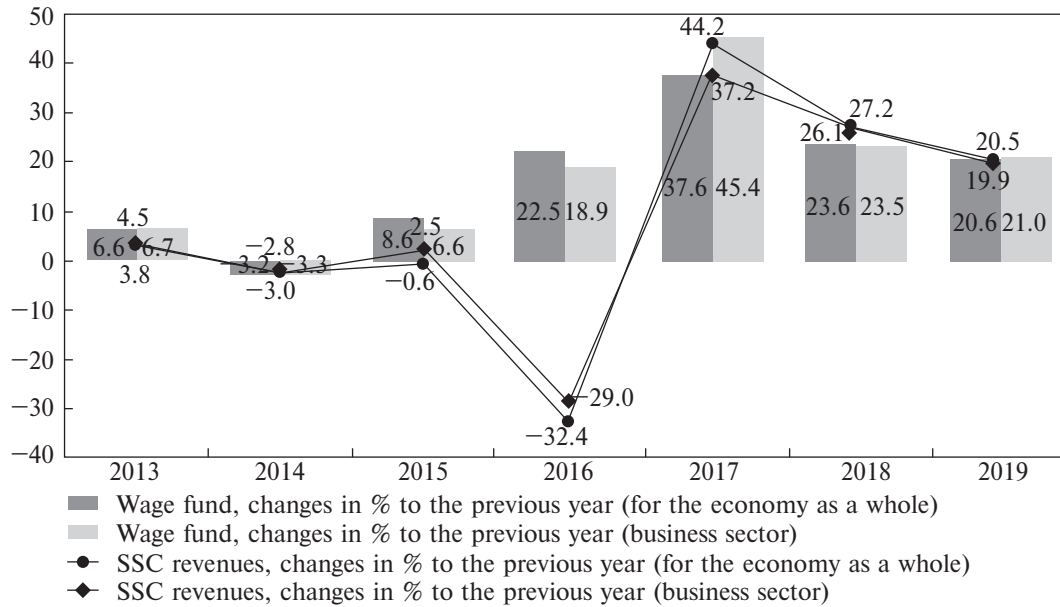
Thus, the growth of the wage fund in the economy as a whole was mainly due to the public sector. Instead, the largest increase in wage in business structures was reported in 2017. However, its main reasons are not related to raising minimum wage, competition for skilled labor with foreign employers and continuing positive dynamics of the economic development rather than to the SSC reform [25, 8].

As for the contribution revenues, in 2016, they fell by UAH 53.9 billion or by 29% in the economy as a whole and by UAH 45.1 billion or 32.4% in the private sector (see Figure). This could not but caused problems related to the financing of the domestic social insurance system, first of all, an increase in the Pension Fund deficit and the growth of transfers from the state budget. In 2016, they exceeded the revenues to the Pension Fund and accounted for 55.6% of the total revenues (6.0% of GDP), as compared with 35.8% (4.8% of GDP), in 2015. Only in 2019, as a result of the broadening of the SSC base, it was possible to reduce the budget support to the Pension Fund almost to the pre-reform level (4.9% of GDP).

Ukraine was no exception and introduced significant changes in SSC, in 2016. In 2010–2020, reforms aiming at reducing social security contributions rates were implemented in 15 EU member states (9 EU-15 and 6 EU-13 countries). At the same time, in 6 EU countries SSC rates increased; in 6 more countries they remained unchanged.

Let us consider in more detail the experience of countries with the largest decrease in social security contribution rates: Romania, Lithuania, Hungary, Belgium, and Bulgaria<sup>6</sup>. It should be noted that despite the reforms, in all these countries, in contrast to Ukraine, these rates remained high as of 2020: 37.25%, in Romania; 39.50% and 40.57%, in Hungary, and Belgium, respectively; the only exception is Lithuania with a rate of 21.27% [3]. The social security contributions reforms in all these countries are notable for the fact that their main

<sup>6</sup> Bulgaria's experience in lowering the social security contribution rates, which has been described in the best way in the existing literature, is not a new one, but it remains interesting given the similar consequences of the reforms.



**Figure.** Dynamics of changes in the wage fund and SSC revenues in Ukraine in the economy as a whole and in the business sector.

Source: estimated based on [25, 26].

beneficiaries are employers. In particular, during the largest reform of social security contributions system in Bulgaria, in 2005–2010, the total SSC rate was gradually reduced from 35.5 to 20.5%, mainly as a result of a significant decrease for employers, from 24.85 to 11.6%, while for employees the adjustment was insignificant, from 10.65 to 8.9% [28].

The reform of social security contributions in Romania, like in Bulgaria, provided for a gradual reduction of their burden on the wage fund in 2010–2020, from 45.70 to 37.25%. However, in 2010–2017, its reduction was ensured by decreasing the rate for employers, with that for employees remaining unchanged, whereas the main feature of the 2018 reform was the redistribution of burden between employers and employees. In particular, if for employers the SSC rate decreased from 23.45 to 2.25%, for employees it increased from 16.50 to 35.00%. This was done by shifting medical and pension contributions that previously were distributed between the employer and the employee entirely to the employee. The remaining contributions (unemployment insurance, sickness insurance, occupational risk insurance, etc.)

were combined into a single insurance contribution for the employer. By a separate resolution, the government made changes in the redistribution of social contributions between the pension system tiers, reducing the share of that assigned to the second tier from 5.1 to 3.75% of gross wage, since January 2018 [29, 2].

In 2019, a similar transfer of the burden of social security contributions to employees was also introduced in Lithuania, where the total social security contributions rate decreased significantly from 40.18 to 21.27% as a result of a reduction in its rate for employers, from 31.18 to 1.77% and an increase in its rate for employees, from 9 to 19.50%, as well as the introduction of a maximum ceiling income imposable with social security contributions: 120 average wages per year, in 2019; 84 average wages (EUR 104,227.60) per year, in 2020; 60 average wages per year, in 2021 [30, 31]. These measures have been designed by the government for making social insurance more understandable and attractive, reducing the tax burden on labor and making taxation framework the most competitive in the Baltic States. In addition, the

reform aimed at reducing a relatively high tax burden on low-paid employees and combating a high informal employment and wages [30].

In fact, at the same time, SSC reforms that were in general similar in terms of the changes implemented were launched in Belgium and Hungary. In Belgium, the total rate of social security contributions (from 48.07 to 40.57%) in 2017–2018 was reduced solely due to its reduction for employers, from 35.00 to 27.50%, while the rate for employees (13.07%) remained unchanged [3]. In Hungary, the total rate of social security contributions decreased (from 47.00 to 35.50%) over a longer period, namely, in 2017–2020, but also as a result of its reduction only for employers, from 28.50 to 17.00%, while the rate for employees remained fixed (18.50%) [3, 32].

Thus, in the all EU member states where the reforms aiming at a significant reduction in social security contributions rates have been implemented, the rates have decreased only for employers (Romania, Lithuania, Hungary, and Belgium), and in the two countries – Lithuania and Romania – also through the shift of the burden of social security contributions to employees.

What determines the expediency of such a reform vector and what is its economic meaning? Theoretically, shifting the tax burden from employers to employees should help increase labor demand and reduce unemployment, as well as increase business activity in general. This, according to E. Saez and others, is the political justification for these changes. However, in practice, such a reaction from employers is not guaranteed. Instead, business owners may appropriate the additional income from tax cuts as windfall profit [33]. After all, in imperfect labor markets, the effect of changes in the distribution of social security contributions between employers and employees on the outputs of the labor market depends on the interaction of supply and demand in the market. On the other hand, given that many researchers believe that most of the burden of social security contributions formally paid by employers is ultimately borne by employees, it may be assumed that the

legally established distribution between these categories of payers should be close to the real economic distribution, i.e. that the legislative transfer of the burden of social security contributions to employees makes the process of its economic distribution transparent, without changing its essence. However, to what extent these processes are identical is a question for further research. However, the legislative transfer of the tax burden to employees may establish a clearer relationship between the contributions paid and the right to receive social benefits. In this case, according to K. Goudswaard and K. Caminada, the social security contributions paid by employees start to be perceived as a price (rather than a tax), which could potentially reduce distortions in terms of labor supply, wage costs, and private savings [5].

All this allows us to agree with the conclusion that there is no convincing evidence to support the benefits associated with the transfer of the burden of paying social security contributions from employers to employees, as well as there is a lack of consensus on whether a formal, legally established distribution of the burden between the employer and the employees for the economic allocation of such burdens [31]. Not surprisingly, that changes to the system of social security contributions in Romania since 2018, especially in terms of shifting them to employees, have been perhaps the most controversial and criticized by both employers and trade unions. In particular, the latter noted that the above-mentioned shifting eliminated the principle of solidarity and social responsibility in relations between employers and employees, on which the social insurance system in the European space should be based. All amounts withheld from wage were transferred to the state accounts by the employers, although the obligation to pay the majority of the contributions became the responsibility of the employees. At the same time, the motivation of this measure was not entirely clear to employers, and its consequences were difficult to predict [29].

In several countries under study, the social security contributions reforms have been comple-



mented by PIT reforms that have been implemented in the context of a general course to reduce the tax burden on labor. In 2008, Bulgaria introduced the lowest proportional tax among EU member states at a rate of 10%. In Romania, the increase in the burden of social security contributions on employees was partially offset by a reduction in the PIT rate from 16 to 10%, since January 2018, and a significant increase in the minimum wage (up to RON 1,900 or about EUR 413 per month). In addition, the authorities called on the social partners to review wage in the private sector so that net wage of employees did not decrease as a result of the increase in social security contributions [29].

Instead, in Lithuania, simultaneously with the reform of social security contributions, there was a return to progression in personal income taxation as its rates were 20 and 27%, in 2019, and 20 and 32%, in 2020. This tax was introduced instead of the proportional personal income tax that existed in 2009–2018 and was levied at a rate of 15%.

The increase in social security contributions for employees and the introduction of progressive PIT in Lithuania were accompanied by a requirement to revise the amount of gross wage from January 1, 2019, with the use of coefficient 1.289 to prevent the adverse effect of changes in the tax legislation on net wage. In this case, despite this revision, the gross wage costs of the employer (the total cost of employment) remained almost unchanged [31]. Recent statistics have shown an increase in the gross wage by more than 30% with a stable employment rate. This is due to the fact that because of the tension in the labor market, Lithuanian corporations are willing to pay their employees higher wages than those required by law [30].

In addition, the minimum wage was raised from EUR 400, in 2018, to EUR 555, in 2019, the non-taxable minimum increased from EUR 3,600, in 2019, to EUR 6,000, in 2021, and PIT benefits for children were established. The labor tax reform was preceded by a pension reform (2018) aiming at abolishing transfers from the State Social Insurance Fund to private pension funds, thus trying

to encourage taxpayers to transfer their own free money to these funds.

Thus, although most EU member states have not had a radical reduction in the social security contributions rates because of the importance of meeting high social standards, in some countries these changes have been quite noticeable, which allows us to compare them with the reduction of the SSC rate in Ukraine. However, in contrast to our country, in the five EU member states with the largest reduction in SSC, the changes took place mainly stepwise, in order to mitigate negative fiscal consequences, and aimed primarily at reducing the tax burden on employers. Given that four of the five countries belong to the new EU members, this vector of their reforms may be explained by the desire to increase the competitiveness of their tax systems. The change in the proportion of the tax burden between employers and employees towards increasing the share of the latter in the two countries (Romania and Lithuania) was accompanied by measures to prevent a reduction in employee incomes, which prevented the negative social consequences of reforms.

The assessment of reforms in the countries that were the subject of our analysis, in the context of their effect on the changes in sources of funding for social benefits has shown that in Bulgaria, the reduction of social security contributions rates led to a decrease in social security fund revenues the scarcity of which were compensated for at the expense of rapidly growing transfers from the national budget. In fact, in 2005–2010, the share of social security contributions in the financing of the social protection system decreased from 61 to 47%, while the transfers from the national budget increased from 36.1 to 51.2% reaching a historic maximum in 2010. This year, almost two thirds of old-age pensions were funded from the budget through transfers [26, 14].

This has led to a change in the policy towards a gradual increase in the tax burden on labor. In particular, in 2011–2019, the total rate of social security contributions increased from 20.5 to 24.3%, in particular, from 11.6 to 13.72% for employers

and from 8.9 to 10.58% for employees. As a result, although the share of financing social expenditure through social security contributions gradually increased (from 47 to 58%, in 2011–2018), it has never reached the level of 2005 (61.0%) [27]. Today, Bulgaria is the country with the highest level of public funding for social spending as compared with any other EU-11 member state.

As emphasized in the scholarly research literature, this ratio of sources for social insurance funding in Bulgaria does not provide the best distribution effect. Given the growing role of budget funding for social security, and in particular, pension and health care systems, finding additional sources to fund rising social spending is very important. Further increase in the indirect taxes, the most important source of budget revenues, is problematic as they are already high. The direct taxes have been reduced as a result of several liberal reforms. Meanwhile, the problem of poverty is aggravating and income differentiation is high, as noted in the annual reports of the European Commission on Bulgaria.

Under these conditions, there increasingly emerge proposals that focus on a return to progressive personal income taxation and a revision of the design of social security contributions towards differentiation of their rates depending on the level of income received or, at least, a significant increase in the threshold for levying the contributions or its abolition in general [26, 22–23]. These initiatives, according to estimates, should not significantly affect the level of shadowing of the Bulgarian economy, which remains high (as it grew from 36.0 to 37.8%, in 2008–2016 [28, 25–26]), especially given that there are virtually no alternatives to such proposals.

In other countries, it is not yet possible to disclose the fiscal consequences of reforms of system of social security contributions because of the lack of necessary statistics, the last of which dates back to 2017 (this year social security contributions reforms started in Belgium and Hungary; in other countries, they started later). The available information for 2008–2017 has shown that in the

studied countries the financing of social benefits at the expense of social security contributions prevailed, with their share increasing, while the share of transfers from the national budget in financing decreased. In Belgium, there is a different situation: there, the share of social security contributions in the financing of social benefits, although is still dominant, continues declining gradually, while budget funding is growing significantly.

Regarding the expected macroeconomic effects of reforming social security contributions, having studied them in Lithuania – the country with the largest reduction in their rates – a group of researchers concluded that the reform could worsen the government balance by almost 1.5% of GDP. Declining government revenues, in turn, may have a negative impact on addressing income inequality and combatting poverty in the future. At the same time, the labor tax reform will have a slight stimulating effect on the economy because of the reduction of the tax burden. The GDP was expected to grow by 0.4% in the first year and to remain about 0.3% above baseline over the next four years. The simulation results have also indicated an increase in employment and wages, which should have contributed to growing private consumption by 1% [30]. However, the COVID-19 pandemic could not but make its adjustments to the macroeconomic consequences of the SSC reform in Lithuania, as it caused a fall in GDP by 0.9%, according to the European economic forecast [34, 42].

The comparative analysis of the reduction in social security contributions rates in Ukraine and the five EU countries has allowed us to highlight not only the differences in approaches to the reform and its consequences, but also common features. Among them, there are a decrease in contributions and an increase in the share of financing social expenditure from total budget revenues. However, if in Bulgaria, such consequences have led to reverse measures, in Ukraine, they have given the impetus for proposals aiming at either further significant reduction of SSC (up to 10%) [35] or its abolition (combination of several manda-

tory payments: SSC, personal income tax, and military tax in one tax is equivalent to the abolition of the contribution) [36–38].

Characterizing these proposals, it should be noted that their authors provide for the financing of payments to retirees (within the subsistence level) from the state budget, but do not answer the question from which sources unemployment benefits should be paid in case of temporary disability, occupational disease, loss of breadwinner, etc. Meanwhile, SSC alternative in terms of sources for such payments may be funded either from the state budget or from private insurance funds.

It should be noted that the financing of social expenditure from the general state budget is a common practice of any EU member state; the only difference is its amount and hence the ratio of different sources of funding. In the process of its selection, the pros and cons of different options for financing social expenditure are taken into account. In particular, Wagner's study focuses on the benefits of financing through social security contributions because in the short or medium term, the social systems based on them are more resilient during a crisis (recession) than the systems based on taxes [39]. Instead, one of the latest OECD reports [40, 26] contains recommendations for increasing the amount of state funding for social insurance, given that its funding through social security contributions that increase the burden on labor has a negative impact on employment and economic growth. However, most researchers have emphasized the feasibility of diversifying sources of funding for social spending [41].

As for the choice between public (government) and private insurance, according to R.S. Avi-Yonah, the private market may be an inadequate substitute for many social insurance programs, for a variety of reasons. First, the risk can be too uncertain for private insurance companies to predict actuarially. Second, risks can co-vary in ways that threaten all policyholders at once. If the risk is not adequately diversifiable, private insurance may become impossible to obtain. Third, adverse selection may occur if the potential insured know the risks much better than the insurers, resulting

in overrepresentation of high risks in the insurance pool and possibly leading to premiums so high that they price all low and moderate risks out of the market. Finally, there may be cases of extreme moral hazard when the insured changes her behavior to increase the risk. Government insurance can alleviate these problems, at least theoretically, with a combination of taxation and regulation [42].

In practice, given the above, public insurance is combined with private insurance, i.e. it has nothing in common with complete replacement of the former by the latter or, on the contrary, with full budgetary financing of social expenditure, including the standard list of insurance risks, or especially with sudden transition to it<sup>7</sup>. There is no such practice among EU member states. If in some countries, the state financing of social expenditure increases, this process is gradual. According to the latest data (2017), there are a few member states with more than 50% budget funding: Denmark, Malta, Ireland, Sweden, and the United Kingdom, as well as Norway. Even in Denmark that remains the undisputed leader among EU countries in terms of public funding of social expenditure, it accounts for 77.8% of the total expenditure, while the shares of social security contributions and other revenues are 18.9% and 3.3%, respectively [27].

The number of countries where more than 50% of funding is provided by social security contributions is much larger: 20 EU member states, as well as Switzerland. That is, today, social security contributions dominate in the structure of sources for financing social expenditure of the vast majority of EU countries. Shifting the burden of financing many social risks to the budget, so far as it is associated with the search for additional sources to fill it (primarily, to increase tax revenues), remains less common.

It is important to answer the question how some EU countries with a low rate of social security contributions and, consequently, a high share of budget funding for social spending manage to en-

<sup>7</sup>Such a transition has been proposed for Ukraine and implemented in Georgia.

sure their funding at a high level. This is because of the proper level of tax rates with a broad base, which provide significant revenues to the state budget, as well as the level of development of private pension systems.

Denmark has the lowest total social security contributions rate; there, social spending is financed by high taxes, mainly personal income tax. In particular, the country has not only the highest maximum rate of this tax (55.9% as of 2020) [1], but also the highest gross average salary (EUR 5179 per month) among the EU member states [43]. Other countries with a large share of budget financing of social expenditure also have high maximum rates of personal income tax: 52.3%, in Sweden; 45%, in Great Britain; 40%, in Ireland; and 35%, in Malta.

The social security system in Denmark is generally based on government funding, but there are also private retirement benefit schemes (plans). It should be noted that the latter is most common in the financing of such costs as the payment of old-age retirement benefits [44, 14]. The development of the private retirement benefit system in Denmark is evidenced by the fact that it is the leader among OECD countries in terms of assets in saving and private pension funds (198.6% of GDP); it is followed by the Netherlands (173.3%) and Great Britain (104.5%) [45, 72]. It should be pointed out that in Denmark, like in all EU member states, the retirement age is quite high (65 years for both men and women), and there is a significant share of the employed population aged 54–65 years [46].

Thus, the condition for further reducing the SSC rate rather than abolishing it in Ukraine may only be a significant increase in tax revenues to the state budget and a decrease in its unproductive expenditure<sup>8</sup>, as well as a developed system of pri-

vate pension insurance. Otherwise, the abolition of SSC will result in the collapse of the state social security system. As the government will not be able to provide adequate financing of social spending from the state budget, most of it will be transferred to employees, which will increase the vulnerability of hired labor to the growing risks posed by causes beyond the control of employees and lead to aggravating social inequality and poverty. In turn, the reaction of employees to increasing their insecurity may be an increase in their commitment to the left and populist parties, social resistance, and a growth in migration to countries with effective social security systems. Given the possible adverse consequences of reforming the way of social security financing, the OECD Report to the G-20 Finance Ministers and Central Bank Governors emphasizes that such a reform should not lead to a reduction in social transfers that are important for reducing inequality [40].

Proponents of this idea justify the abolition of SSC by the expected increase in economic growth as a result of a reduction in the tax burden on labor. However, this reduction in itself does not guarantee high rates of economic growth, it may only create the preconditions for increasing employment and become one of the factors (in the presence of other favorable conditions) of increasing investment in the economy. In addition, the study of the scholarly research literature that deals with the causal links between the amount of government funding and economic growth in both advanced economies and developing countries has led to the conclusion that such a link is far from unambiguous, as evidenced by S. Nyasha and N.M. Odhiambo [47].

Meanwhile, the abolition of SSC in the long run, in addition to the possible adverse social consequences, may lead to a deterioration in the quality of economic growth (because of the degradation of human capital). Moreover, since the implementation of liberal innovations requires significant changes in the system of public spending, given the preservation of oligarchic capitalism in Ukraine and the current level of corruption, the most likely scenario is a large-scale reduction in its so-

<sup>8</sup> The possibility of finding adequate compensators for the loss of SSC revenues (in 2019, 6.88% of GDP), in case of its abolition, is not considered in this research, as it requires special analysis. We can only note that the compensators offered in the literature, in our opinion, are either insufficient (in terms of tax revenues) or such that have adverse social consequences (in terms of government spending).

cial component that, in 2016–2019, decreased from 10.8 to 8.1% of GDP. One should not hope for a radical solution to the problems of tax evasion and shadow economy, because in a weak state that is unable to effectively combat tax minimization and evasion, taxpayers will not stop using this opportunity.

Radical changes in the social security contributions systems in some post-socialist EU countries have manifested themselves in a significant reduction in their rates, shifting the tax burden from employers to employees, while in Ukraine, they have resulted in proposals to abolish SSC in general. These are manifestations of neoliberal strategy in tax policy. For the most part, they are combined with neoliberal social policy, which is quite logical, given the lack of funds for the implementation of social security programs because of a significant reduction in social security contributions. What are the reasons for the spread of neoliberal strategies?

The answer to this question is multifaceted.

1. Proponents of neoliberal reforms in Ukraine, as in many post-socialist EU countries, overestimate their impact on economic growth and underestimate their redistributive effects that result in increased inequality, which adversely affects economic growth and sustainability.

2. Ukraine, like some post-socialist EU countries, is trying to strengthen its position in the competition for foreign direct investment using tax as the most available tool, which has led to the proposals to “liberalize the economy” and to “reduce taxation for business” for Ukraine to become “a paradise for international investors, corporations, and businesses from around the world.”

However, the economic model of the so-called “tax heaven” in the current context of intensifying international efforts to prevent the outflow of capital into tax heavens does not guarantee attracting a projected level of investment and a high economic growth. One can cite the example of Georgia, where the abolition of social security contributions in 2008 did not entail positive changes in the dynamics of foreign direct investment. In

2007–2019, on the contrary, they decreased from USD 1 764.7 to 1 310.8 million; their dynamics remained extremely unstable during this period [48]. In addition, it should be taken into account that the European Union is pursuing an offensive policy against offshore, which may complicate the development of Ukraine’s economic integration with the EU.

3. There is neither effective political opposition in Ukraine nor strong trade unions capable of offering a socially acceptable alternative to neoliberal reforms. When such reforms are proposed in developed EU member states, the trade unions play a leading role in mobilizing the opposition thereby forcing governments to negotiate and to make significant concessions through real social transformations.

4. Because of the socio-economic model that has formed in Ukraine, oligarchic capital has a decisive influence on its budget and tax policy through controlled mass media, think tanks, and paid experts, which form the priorities of such a policy that ensures the achievement of its goals. The results of sociological research have shown that neoliberal ideas correspond to its interests and do not correspond to the interests of the majority of the population. In particular, according to the poll *Reforms in Ukraine: Public Opinion 2019* made by the *Democratic Initiatives Foundation* and *KIIS*, the majority of respondents (71%) believes that the government should provide services (education, medicine, retirement benefits) for free, even if to this end it needs to increase taxes; on the other hand, only 22% support the opposite position that the role of the state should be minimized by reducing taxes for people who are able to pay themselves for education, medicine, and accumulate pensions [50].

Therefore, we consider unacceptable the idea of abolishing SSC in Ukraine, as well as the proposals for further significant reduction of its rate, as they are antisocial, bear the risk of worsening the welfare of both employees and retirees and leaving them vulnerable to current challenges and threats; demoralize SSC payers depriving

them of the confidence that by paying contributions today they will receive social transfers in the future. The economic consequences of such a measure are not obvious. Although in the short term there may be an increase in economic growth, but in the long run there is a significant risk of degrading its quality, exacerbating inequality and poverty, and preventing the implementation of such a model of economic development in which growth rate ceases to be an end in itself and is subordinated to smart sustainable and inclusive development.

Given the negative consequences of the establishment of SSC only for employers in Ukraine, in 2016, in the process of its further reform it is advisable to consider reducing the contribution rate for these economic entities and its resumption (and

increase) for employees (the latter should occur in parallel with the introduction of funded pension system). In the process of implementing these transformations, the experience of Lithuania may be used through increasing gross wages by such an amount as to maintain the pre-reform level of net wages and at the same time keeping fixed (or increasing slightly) the gross labor costs of employers. At the same time, it is not necessary to follow those countries that have shifted most of the burden of social security contributions to employees. As for the possibility of reducing the aggregate SSC rate in the future, in our opinion, it should not be radical. In addition, it should not be made unless it is possible to fully compensate for its decrease by an increase in other taxes, such as environment and rent payments, as well as by a pension reform.

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## РЕФОРМИ СОЦІАЛЬНИХ ВНЕСКІВ В ОКРЕМИХ КРАЇНАХ ЄС ТА УКРАЇНИ: ОСОБЛИВОСТІ РЕАЛІЗАЦІЇ ТА НАСЛІДКИ

**Вступ.** Необхідність покращення ситуації на ринках праці та активізації підприємницької діяльності спонукає до зниження в більшості країн ЄС податкового навантаження на працю шляхом перегляду ставок соціальних внесків. В Україні основною метою відповідної реформи 2016 р. було зменшення масштабів неофіційної зайнятості й доходів.

**Проблематика.** В окремих країнах ЄС та Україні набувають поширення неоліберальні стратегії реформування соціальних внесків, а також трансформації систем соціального забезпечення, наслідком реалізації яких може бути погіршення якості економічного зростання та збільшення нерівності й бідності.

**Мета.** Обґрунтувати можливі соціальні та економічні ризики впровадження радикальних пропозицій щодо реформування єдиного соціального внеску (ЄСВ) в Україні й визначити доцільність їх реалізації.

**Матеріали й методи.** Використано методологію Єврокомісії для розрахунку імпліцитної ставки податків на працю в Україні, методи компаративного аналізу реформування соціальних внесків в Україні та країнах ЄС; теоретичного узагальнення причин поширення неоліберальних стратегій; фактологічного і статистичного аналізу.

**Результати.** Визначено особливості та спільні риси реформування соціальних внесків в Україні й постсоціалістичних країнах ЄС з найбільшими масштабами їх зниження. Доведено, що критичне сприйняття реформи ЄСВ 2016 р. в Україні значною мірою пов'язане зі встановленням внеску виключно для роботодавців. Обґрунтовано фіскальні, економічні та соціальні аспекти процесів реформування і можливі ризики реалізації в Україні пропозицій щодо скасування ЄСВ.

**Висновки.** Найочевиднішими наслідками скасування ЄСВ в Україні можуть бути зниження рівня добробуту працюючих і пенсіонерів, зростання нерівності та бідності. Не виключені певні суперечності й в очікуваних результатах. Хоча в короткостроковому прогнозі ймовірним є підвищення темпів економічного зростання, в довгостроковій перспективі значною є загроза зниження його якості.

*Ключові слова:* податкове навантаження на працю, перекладання податків на працю, реформа соціальних внесків, джерела фінансування соціальних витрат, неоліберальні стратегії.