

Cost of conflict: The consequences of war in Donbas, Ukraine

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About the authors

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Introduction

War does not end with the last bullet unloaded or papers signed. Wars continue years after peace but in different ways: demining minefields, prosecuting criminals, fighting discrimination of minorities, and steering wartime narratives. Unfortunately, the longer a conflict goes on, the harder it is to achieve peace. Conflicts fragment societies by aggravating existing tensions among social groups and creating new ones. Understanding these harmful consequences is, therefore, a prerequisite for a realistic strategy of conflict resolution.

This report provides an overview of the consequences (or ‘costs’) of the war in Donbas, Ukraine. It offers a concise overview of the key historical and economic developments surrounding the war. At times, the report sacrifices some depth of analysis, but only to achieve clarity of the main message, which has two points.

First, the main costs in the region arise because of a policy driven humanitarian crisis. Despite being a highly militarized area, Donbas is no longer an area of active, large-scale military engagement. Donbas today is an area of a large-scale protracted humanitarian crisis affecting five million people. This crisis is, however, by far and large, a consequence of restrictive state policies imposed onto the separatist-controlled areas. These policies, designed in the early days of the conflict to undermine pro-Russian sentiment in the region in the separatist-controlled areas, achieved little success but ruined economic connectivity of the region and forced involuntary pendulum migration of Ukrainian citizens from the separatist-controlled areas to mainland Ukraine, and back.

Second, Ukrainian society is still polarized on critical issues. Prior to the war, the split was pronounced around the perspective of greater economic and political integration (EU or Russia). These days, however, the division line is most pronounced around a future peace deal: how should Ukraine restore Donbas, if at all?

Both points give only limited space for optimism for a future peace deal. With public opinion divided, the Ukrainian government will be constrained in addressing the consequences of the humanitarian crisis. Any change to policies concerning the breakaway region is likely to face severe opposition both, from the population and political contenders. This, in turn, makes chances of unification and restoration highly dependent on idiosyncratic political events. Until then, the war in minds is likely to continue and its scars to deepen.

The Cost of Conflict in Ukraine

Russia's military operation in Crimea caught the Ukrainian government, and indeed global leaders, by surprise.¹ Heated negotiations surrounding the destruction of Ukraine's nuclear arsenal prior to 1994 – which at some point involved speculation of nuclear war – and subsequent discussions on Ukraine's membership in NATO, indicates Ukraine's national security was a critical issue even before 2014.² It might, therefore, seem surprising that Ukraine's armed forces – which inherited from the Soviet Union one of the largest stocks of military weapons in Europe – were incapable of preventing military incursions in Crimea and armed insurgency in Eastern Ukraine, resulting in a prolonged and costly conflict.

Pre-War Development

Ukraine was ill-prepared to combat internal or external threats for two main reasons. First, as recognized by Admiral Ihor Tenyukh, acting Ukrainian minister of defense in March 2014, Ukraine's military command was not adequately equipped to identify strategic military threats: "A military-political and military-strategic mistake was made in determining the appropriate vectors of active military threats to the country [Ukraine]. We have never considered a danger coming from Russia."³ Although engagement with NATO had been discussed since the Orange Revolution of 2004, the confusion and disorganization shown by Ukraine's military in Crimea suggested a stark absence of an action plan.

Second, Ukraine's economy was underperforming compared to its neighbors, resulting in limited capacity to modernize its armed forces. Ukraine's GDP per capita was 30 percent below the average of post-Soviet states in 2010 (Figure 1), although it was slightly above average in 1990. Economics literature typically attributes poor economic performance to pitfalls in the implementation of market reforms and progress of state governance institutions at the early stage of Ukraine's economic and political transition.⁴

¹ Simpson, J. (2014). Russia's Crimea plan detailed, secret and successful. BBC.com, March 19th, 2014. Link: <https://archive.is/0442Q>

² Rudenko Y., Kravets, R., & Sarakhman. E. (2018). Leonid Kravchuk: Putin should sit down with Poroshenko at the negotiating table. *Ukrainskaya Pravda*, June 18th, 2020. Link: <https://archive.is/wip/IF78f>

³ Verkhovna Rada (2014a). Law Nr. 1669-VII "On temporary measures for the period of carrying out anti-terrorist operation" (in Ukrainian). Link: <https://archive.is/4W9sm>

⁴ Adarov, A., Astrov, V., Havlik, P., Hunya, G., Landesmann, M., & Podkaminer, L. (2015). How to Stabilise the Economy of Ukraine. *wiiw Background Study*, (201504).

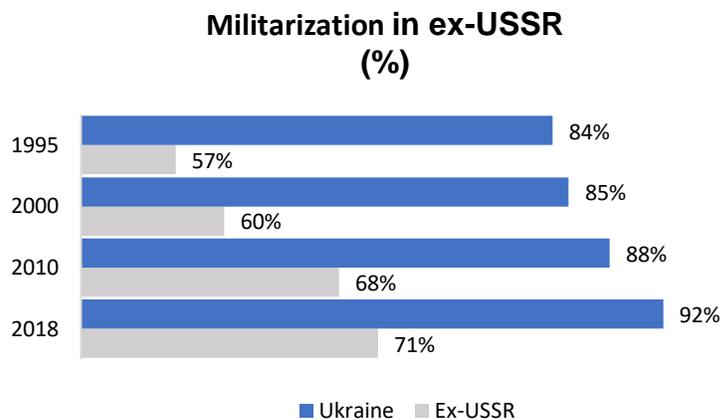
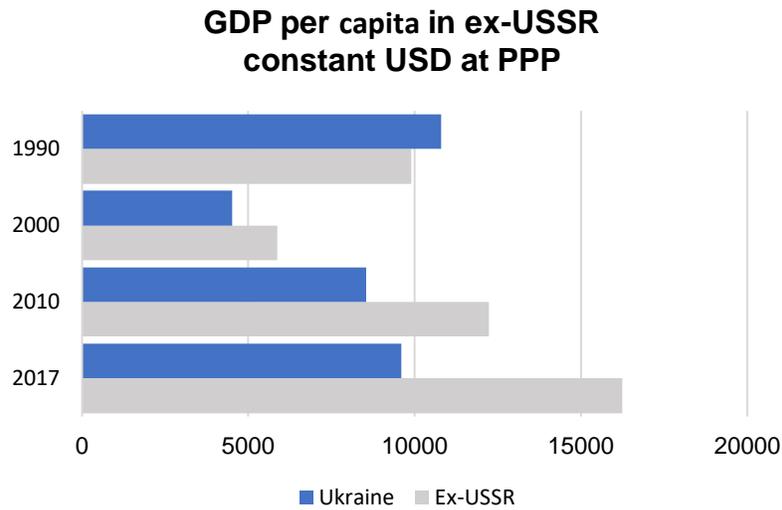


Figure 1: Economic performance and militarization of Ukraine since 1990

Source: Top panel: Penn World Tables 9.1 (2020); bottom panel: Mutschler, M., & Bales, M. (2020). Global militarization index 2019. Bonn International Center for Conversion. Link: https://www.bicc.de/uploads/tx_bicctools/BICC_GMI_2019_EN.pdf

On the one hand, Ukraine’s political development was hindered by vested interests shortly after the collapse of the Soviet Union. Powerful industrial lobbies and oligarchs used parliamentary parties to establish control over state subsidies, preserve market barriers to entry, and block implementation of

equitable policies.⁵ On the other hand, Ukraine's electoral process and the political preferences of Ukrainians were characterized by a strong 'West-East divide.' Although political polarization was most pronounced at the extreme geographical ends of the country (Figure 2), it provided ground for tight political competition that resulted in a tug-of-war between political parties and hindered implementation of long-term reforms.⁶

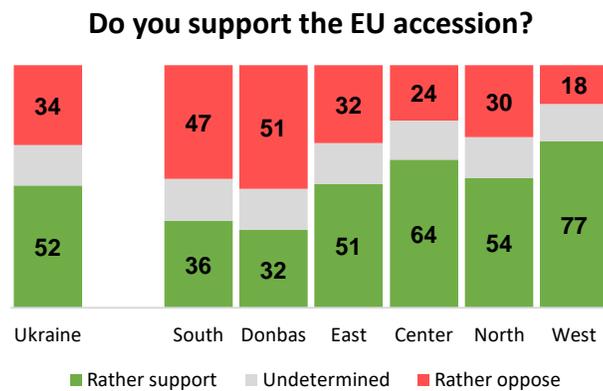
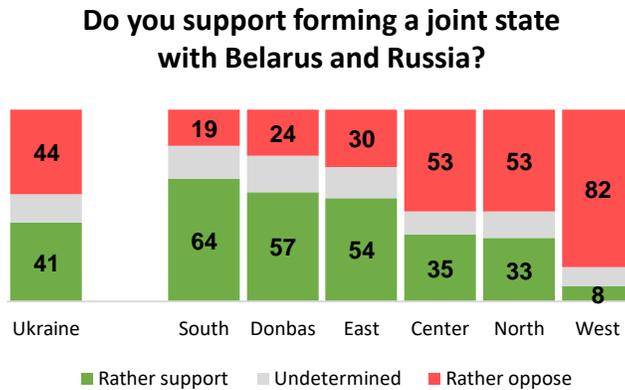


Figure 2: Foreign policy preferences in Ukraine, by macro regions

Sources: Rating Group Ukraine (2012). Dynamics of Ideological Markers. Link: http://ratinggroup.ua/files/ratinggroup/reg_files/rg_national_markers_122012.pdf

5 Blockmans, S., Cenușă, D., Emerson, M., Hriptievchi, N., Kakachia, K., Kalitenko, O., ... & Movchan, V. (2018). The Struggle for Good Governance in Eastern Europe. CEPS Paperback, 27 September 2018.

6 Frye, T. (2001). The perils of polarization: Economic performance in the post-communist world. *World Pol.*, 54, 308.

For example, the victory of pro-western leaders in 2004 did not result in greater EU integration, primarily because of internal political confrontations between the apparatus of President Viktor Yushchenko and supporters of Yulia Tymoshenko, who led the party with the largest number of seats in the Parliament.⁷ Ukrainian leaders were therefore unable to establish transparent market and governmental institutions, leading to poor state governance, high levels of perceived corruption, and lack of public trust in state institutions.⁸⁹

Meanwhile, most of the military infrastructure inherited from the Soviet Union was not properly maintained or modernized, largely due to Ukraine's poor economic performance in the post-transition period, as well as poor governance. This, together with an unexpected military incursion from Russia, partly explains why the Ukrainian conflict became so costly and long-lasting.

The Costs of Conflict in Ukraine: A Bird's-Eye View

Although the Ukraine-Russia conflict encompasses both the takeover of Crimea and the armed insurgency in Donbas, most of Ukraine's attention has been devoted to the latter. This is because the takeover of Crimea did not result in large-scale fatalities and destruction of capital assets. According to available estimates, Russian incursion into Crimea caused two fatalities, while the war in Donbas is estimated to have taken 13,000 lives.¹⁰ The highest spikes in casualties were in August 2014 and February 2015, shortly before negotiations in Minsk.

⁷ Kravets, R., Rudenko, Y. & Sarakhman E. (2018). Viktor Jushhenko: Tymoshenko and Yanukovich — are both of a kind (in Ukrainian). *Ukrainska Pravda*. August 13th, 2018. Link: <https://archive.is/wip/ax3T8>

⁸ Blockmans, S., Cenușă, D., Emerson, M., Hriptievchi, N., Kakachia, K., Kalitenko, O., ... & Movchan, V. (2018). *The Struggle for Good Governance in Eastern Europe. CEPS Paperback, 27 September 2018*.

⁹ Adarov, A., Astrov, V., Havlik, P., Hunya, G., Landesmann, M., & Podkaminer, L. (2015). How to Stabilise the Economy of Ukraine. *wiiw Background Study, (201504)*.

¹⁰ Memorybook (2020). Book of memory of the dead. Link: <https://memorybook.org.ua/>

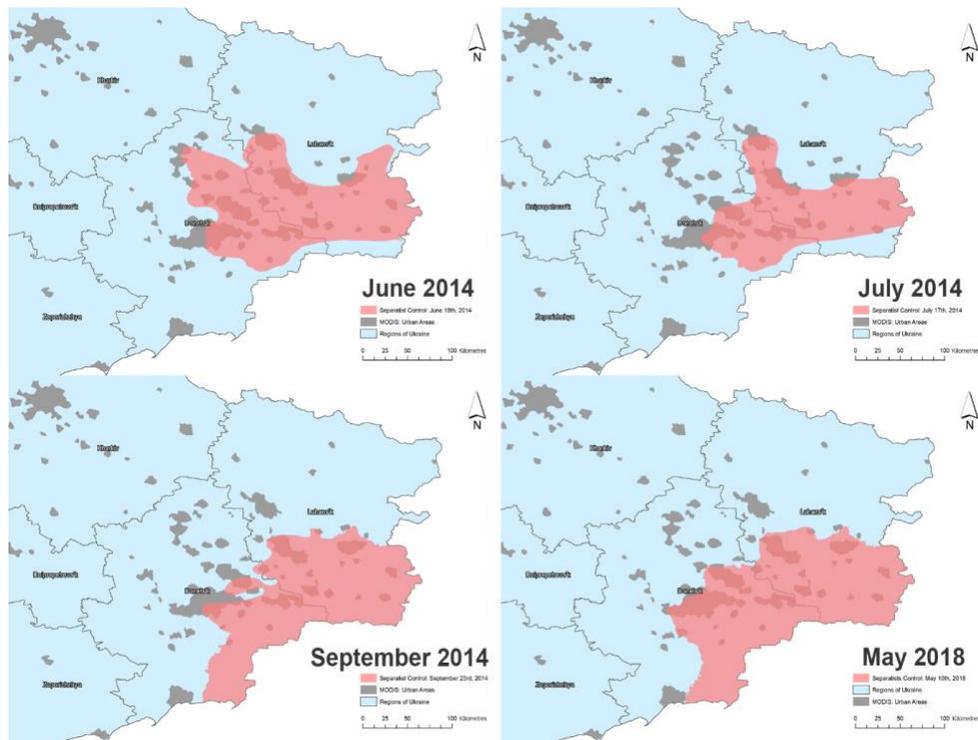


Figure 3: Territorial control of separatists during the war in Donbas: 2014 – 2018

Source: Havlik, P., Kochnev, A., & Pindyuk, O. (2020). *Economic challenges and costs of reintegrating the Donbas region in Ukraine* (No. 447). wiiw Research Report.

The Donbas War took place in densely populated urban areas with opposing sides actively employing heavy arms – including artillery, tanks, and multiple-launch rocket systems – to expand territorial control. Many cities, including the major urban area of Donetsk, were taken over by opposing forces multiple times. Unsurprisingly, this caused collateral damage for civilian property and mass displacement of the local population. By the end of 2019, Ukraine was home to approximately 1.46 million internally displaced people (IDPs).¹¹

¹¹ UNHCR (2021). Registration of Internal Displacement. <https://app.powerbi.com/view?r=eyJrIjoiY2RhMmExMjgtZWRLMS00YjcwLWI0MzktNmEwNDkwYzdmYTM0IiwidCI6ImU1YzYzOTgxLTY2NjQtdEzNC04YTBjLTY1NDNkMmFmODBiZSIsImMiOjE5>

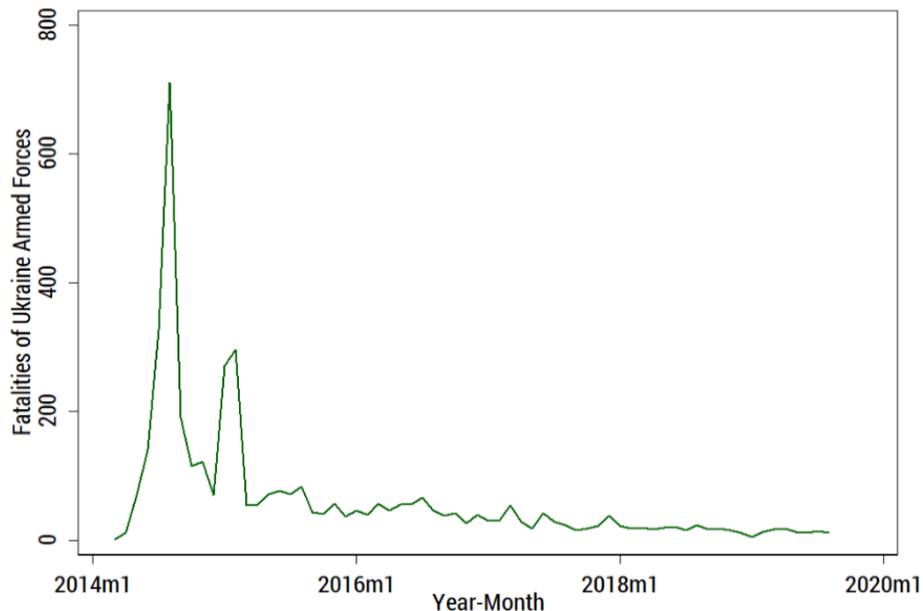


Figure 4: Fatalities of Ukraine’s Armed Forces from 2014 to 2020

Source: Havlik, P., Kochnev, A., & Pindyuk, O. (2020). *Economic challenges and costs of reintegrating the Donbas region in Ukraine* (No. 447). wiiw Research Report.

The economies of the conflict-affected regions of Donetsk and Luhansk have not improved with declining levels of violence, despite armed violence causing Ukraine’s economic downturn in the first place. This is largely because the roots of the crisis – negative expectations, lack of state capacity, and a humanitarian crisis – have not been addressed. The Donbas region’s once highly integrated economy is now divided along the line of contact between government and separatist controlled areas, with the latter subject to severe economic restrictions.

The self-proclaimed separatists’ polities are not formally recognized by any UN member state. This implies that any economic contract inside separatist controlled areas will bear no legal force according to both Ukrainian and international law.¹² With the separatist controlled areas effectively cut-off from investment, trade, and banking, the regional value chains of Donetsk and Luhansk regions were torn

¹² Vekhovna Rada (2014b). Transcript of the plenary parliamentary session on March 11th, 2014. (In Ukrainian). Rada.gov.ua. Link: <https://archive.is/rGNWv>

apart. This resulted in a rapid contraction of the local economy and a large-scale humanitarian crisis that affected five million people.¹³

Direct economic costs and the role of trade

There are several key considerations in understanding the war's impact on Ukraine's economy. First, the size and structure of the Donbas economy determined the impact of local economic disruption on Ukraine's aggregate economy. Together, the Donetsk and Luhansk regions accounted for around 16 percent of Ukraine's total GDP prior to the war in 2014, compared to Crimea's contribution of 3.8 percent of GDP at the end of 2012.¹⁴ Second, Donbas was highly integrated into regional value chains and international trade mechanisms. The local economy was built on mining, metal, machine-building, and energy industries, which were interconnected through a dense network of railways. Finally, the war in Ukraine coincided with a number of large-scale economic events: a sovereign debt crisis in Ukraine, the signing of a trade agreement between Ukraine and the EU, and a macroeconomic crisis in Russia. These likely had negative spillover effects on Ukraine's bilateral trade.

When combined with the conflict, the region's structure and connectedness to the Ukrainian economy caused significant economic effects. First, it is estimated that the conflict had a severe impact on output and productivity measured by both conventional (GDP) and non-conventional (nighttime luminosity) measures of economic activity.¹⁵ Even though the impact of war on Ukraine's economy is recognized as significant in magnitude – it is estimated the average decline of GDP per capita between 2014 to 2017 by 17.6 percent¹⁶ – economic contraction in the Donbas region was much stronger. Available estimates suggest that regional economies contracted by two (government-controlled areas) to three (separatist-controlled areas) times between 2014-2015 (see Figure 6).

Second, the conflict severely disrupted regional and international trade. Regional value chains were severely hit after the government of Ukraine introduced economic restrictions on separatist-controlled areas, withdrew public services, prohibited banking operations, and set up severe limits on movement

¹³ UNOCHA (2020). Humanitarian needs overview: Ukraine: 2020. Link: <https://reliefweb.int/sites/reliefweb.int/files/resources/Ukraine%20Humanitarian%20Needs%20Overview%202020%20%28Issued%20January%202020%29.pdf>

¹⁴ Adarov, A., Astrov, V., Havlik, P., Hunya, G., Landesmann, M., & Podkaminer, L. (2015). How to Stabilise the Economy of Ukraine. *wiiw Background Study*, (201504).

¹⁵ Bluszcz, J., & Valente, M. (2020). The Economic Costs of Hybrid Wars: The Case of Ukraine. *Defence and Peace Economics*, 1-25. Link: <https://www.tandfonline.com/doi/full/10.1080/10242694.2020.1791616>

¹⁶ Bluszcz, J., & Valente, M. (2020). The Economic Costs of Hybrid Wars: The Case of Ukraine. *Defence and Peace Economics*, 1-25. Link: <https://www.tandfonline.com/doi/full/10.1080/10242694.2020.1791616>

of goods and people across the line of contact.¹⁷ While these measures had a significant impact on the separatist economies, many enterprises in the government-controlled areas were suddenly cut off from suppliers and purchasers. Ukraine's energy sector was a notable example of this. Ukrainian energy plants no longer had access to sufficient anthracite coal to continue electricity production. Indirect estimates suggest that trade restrictions could account for at least a half of the observed economic downturn in the separatist controlled areas.¹⁸

Humanitarian and environmental effects

While the economic effects of the conflict were severe, the overall impact extends well beyond the economy. The Donbas population continues to live through a humanitarian crisis. According to the UN Office for the Coordination of Humanitarian Affairs, 3.4 million people in the Donetsk and Luhansk regions (50 percent of the pre-war population) struggle to secure access to food, sanitation, shelter, legal assistance, and basic public services such as healthcare and education.¹⁹ Much of that is caused by recurrent damage to critical infrastructure that provides electricity, water, sanitation, and heating. Restrictions on movement of people and goods across the line of contact is equally important. Prior to the war, most public services were concentrated in Donetsk and Luhansk. With these cities falling under control of the separatists, many households from nearby locations and rural areas are now forced to commute to other cities to receive critical services such as healthcare and education.

¹⁷ Kochnev, A. (2020a). Dying light: War and trade of the separatist-controlled areas of Ukraine. *Working paper*. Link: <https://dx.doi.org/10.2139/ssrn.3579099>; Kochnev, A. (2020b). Marching to Good Laws. The Impact of War, Politics, and International Credit on Reforms in Ukraine. Working paper. Link: <http://dx.doi.org/10.2139/ssrn.3579111>; Kochnev, A. (2020c). *Requiem for Donbas: Three Essays on the Costs of War in Ukraine*. Doctoral dissertation. Universität Linz. Link: <https://epub.jku.at/obvulihs/download/pdf/5295005?originalFilename=true>

¹⁸ Kochnev, A. (2020a). Dying light: War and trade of the separatist-controlled areas of Ukraine. *Working paper*. Link: <https://dx.doi.org/10.2139/ssrn.3579099>

¹⁹ UNOCHA (2015). Ukraine: Overview of the population displacement (as of 21 August 2015). Link: https://www.humanitarianresponse.info/sites/www.humanitarianresponse.info/files/documents/files/ukr_displacement_21_august_2015.pdf

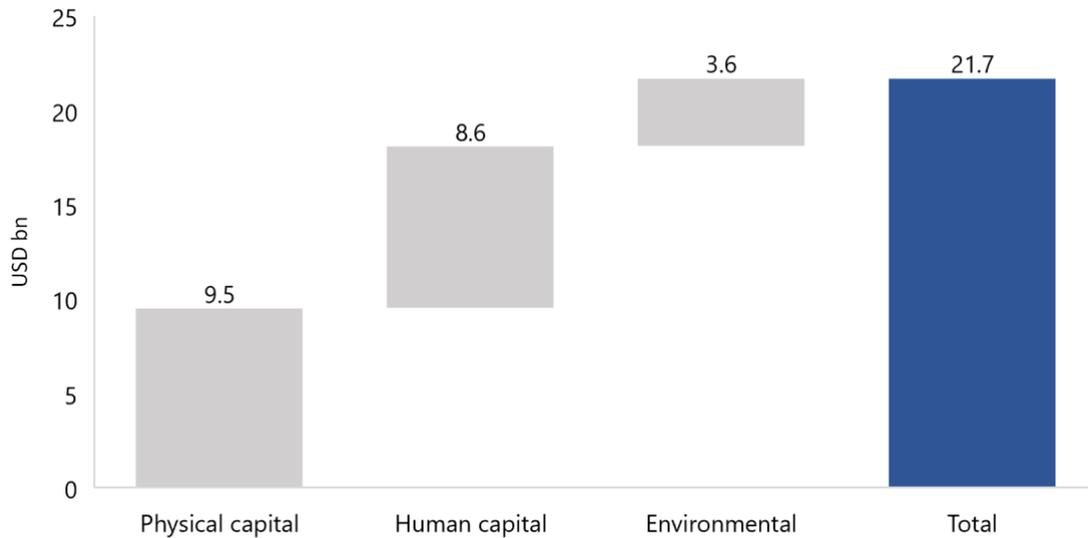


Figure 5: Stock losses of Ukrainian economy due to War in Donbas.

Source: Havlik, P., Kochnev, A., & Pindyuk, O. (2020). *Economic challenges and costs of reintegrating the Donbas region in Ukraine* (No. 447). wiiw Research Report.

The conflict also caused mass migration from affected regions. In 2015, at the peak of the economic crisis in Donbas, data accounted for 2.6 million displaced people, 40 percent of the region’s total.²⁰ The majority (56 percent) of this group were IDPs, with 36 percent seeking legal status in Russia.

²⁰ UNOCHA (2015). Ukraine: Overview of the population displacement (as of 21 August 2015). Link: https://www.humanitarianresponse.info/sites/www.humanitarianresponse.info/files/documents/files/ukr_displacement_21_august_2015.pdf

Population displacement as of Aug. 21, 2015 (millions)

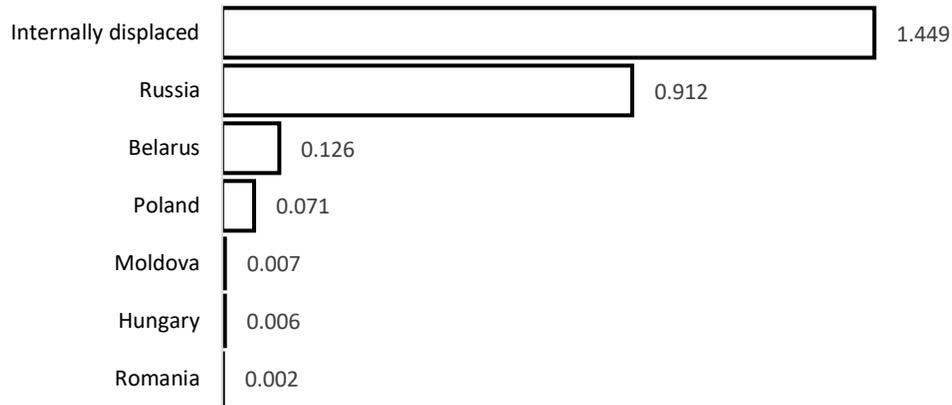


Figure 6: Destination of the displaced population at the peak of the crisis.

Source: UNOCHA (2015). Ukraine: Overview of the population displacement (as of 21 August 2015). Link:

https://www.humanitarianresponse.info/sites/www.humanitarianresponse.info/files/documents/files/ukr_displacement_21_august_2015.pdf

While the progress of those seeking legal status abroad remains unclear, challenges facing IDPs are well-known but largely unresolved. The integration of 1.4 million IDPs into the rest of the country has been a long-term issue for Ukrainian authorities. According to UN Organization for Migration (IOM), 91 percent of IDPs face difficulties in finding employment, the average income is 40 percent below the national average, and many are unable to fully integrate into local communities (51 percent reported full integration).²¹ The difficulties faced by IDPs in securing housing and income in government-controlled areas causes involuntary migration. This means populations of separatist controlled areas frequently request IDP status to gain access to public services and collect pensions in government-controlled areas, before returning across the contact line.

While measurable environmental damage has so far been relatively limited, there are concerns around technological and natural disasters. The line of contact, which until July 2020 witnessed frequent

²¹ IOM (2019). National monitoring system report: On the situation of internally displaced persons. June 2019. Link: https://displacement.iom.int/system/tdf/reports/Ukraine_DTM_National%20Monitoring%20System%20Report_Round%202014_June%202019.pdf?file=1&type=node&id=6707

skirmishes and artillery shelling, is located close to large industrial enterprises. These enterprises could emit significant levels of heavy metals and chemical substances, causing mass poisoning of the densely populated urban areas of Donetsk and Luhansk. At the same time, the region faces a double risk with the dense coal mining system of Donbas. The majority of the coal mines located in separatist-controlled areas are currently idle, benefiting from no proper maintenance. If these coal mines are not properly closed, the region may face irreversible environmental damage caused by increased geological instability and contamination of ground waters by heavy metals and radioactive chemical elements.²²

Impact on Politics and Political Preferences

The political implications of the conflict is another widely discussed topic with multiple considerations. On the one hand, the conflict itself is in part a result of EU-Russian tensions over Ukraine. Protests in Kyiv in 2013 and 2014, which removed Viktor Yanukovich from power and triggered a takeover of Crimea and support of separatists by the Kremlin, followed Yanukovich's sudden withdrawal from Association Agreement negotiations with the EU. The agreement would have guaranteed reduced tariff rates and a framework for political integration. One popular narrative in Ukrainian media is that Russia's military operation in Crimea was conducted to secure the naval base in Sevastopol, while separatists were supported as a way to increase polarization and undermine the process of Euro-integration.²³ If true, Russia's success in this respect has been limited.

²² OSCE (2017). 'Environmental assessment and recovery priorities for Eastern Ukraine'. Link: <https://www.osce.org/project-coordinator-in-ukraine/362566?download=true>

²³ Bershidsky, L. (2019). Five years later, Putin is paying for Crimea. March 16th, 2020. Bloomberg.com. Link: <https://www.bloomberg.com/opinion/articles/2019-03-16/russia-s-annexation-of-crimea-5-years-ago-has-cost-putin-dearly>

Perceptions of the Customs Union created by Belarus, Kazakhstan, and Russia

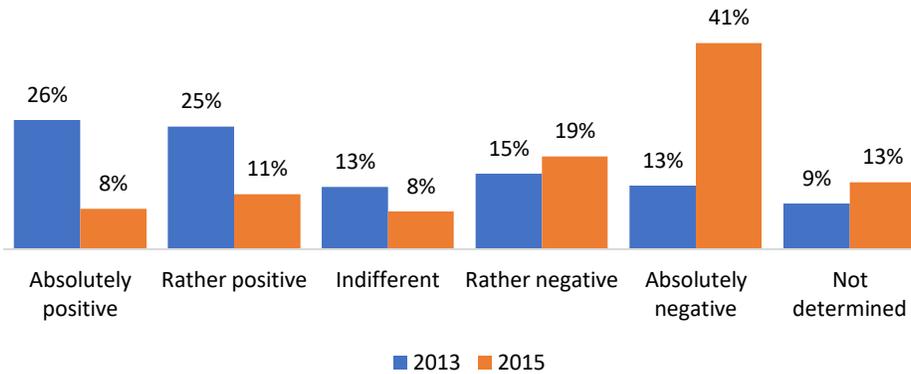


Figure 7: Attitude of Ukrainians toward economic integration with Russia

Source: Eurasian Monitor (2020b). Integration barometer. 4th wave. Link: <https://eurasianmonitor.org/uploads/s/g/f/f/gffzlsnrpxne/file/5D8V63P5.xlsx>

Russia’s actions in Crimea and the Donbas region shifted political preferences in Ukraine. Public support for economic integration with Russia fell sharply, with the share of respondents opposing integration rising from 28 to 60 percent (Figure 7).²⁴ Moreover, while post-2014 governments have had mixed success in integrating Ukraine with the EU, Ukrainian politics is currently heavily dominated by a pro-western integration narrative. The unexpected landslide election of President Volodymyr Zelensky in 2019 did not deviate Ukraine from this path, with the current government continuing to promote a reformist and pro-European agenda. While Zelensky used the election campaign to highlight his points of difference with predecessor Petro Poroshenko, euro-integration has remained a unifying point between the two.

The impact of conflict on Ukraine’s EU foreign policy was also significant. While Ukraine was considered to be one of the many “association countries” for the EU at the beginning of integration talks, it became a symbol for the EU to demonstrate its commitment to support integration initiatives. If anything, the war in Donbas has facilitated greater integration of Ukraine in the political and economic space of the EU.

²⁴ It is necessary to note that the differences in response rates could have been driven by different samples. The post-2014 surveys most likely did not cover Crimea, the Donbas and Luhansk regions in full, which were the strongest supporters of integration with Russia in the pre-war surveys.

In a similar vein, one can hardly find support for the negative impact of war on Ukraine’s reform progress. Drawing on data between 2015 and 2019, Kochnev finds little to no correlation between conflict intensity and measures of reform progress in Ukraine.²⁵ If anything, reform progress appears to be more closely linked with the electoral cycle, changes in income levels, and popular support of the ruling party.

The effect of the war on political polarization in Ukraine is mostly evident in terms of preferences regarding a future peace deal. Survey results suggest that residents of the separatist controlled areas demonstrate positive attitudes toward Russian integration and are critical of western institutions and the ruling Ukrainian elites.²⁶ This is largely at odds with nation-wide views, which indicate no clear majority regarding the future reintegration of the region. A survey conducted prior to last year’s local elections indicated that 45 percent of respondents do not support the idea of a “free economic zone” in Donbas.²⁷ Such differences in political preferences pose a threat to a sustainable peace deal and economic and political integration. The government of Ukraine therefore confronts a double challenge in the peace process: a potential peace deal should not only address preferences of the population residing within the separatist controlled areas, it should also convince the population of “mainland” Ukraine. Whether or not it will manage to do so is one of the most intriguing and pressing issues of internal Ukrainian politics.

Conclusion

It is critical to understand the most pressing issues of the war in Ukraine. In the short-term, this is the humanitarian and economic crises. The local Donbas population has experienced a decline in living standards by three to four times within a single year, far outpacing that of the post-Soviet transition. This is considered to be amongst the steepest economic downturns in the 20th century.²⁸ The immediate challenge for Ukraine in recovering physical infrastructure, markets, and state capacity is critical for mitigating the negative impact.

At the same time, the conflict has prompted – even if indirectly – some positive political change in Ukraine. On the one hand, the conflict in Ukraine reduced political polarization regarding the reform

²⁵ Kochnev, A. (2020c). *Requiem for Donbas: Three Essays on the Costs of War in Ukraine*. Doctoral dissertation. Universität Linz. Link: <https://epub.jku.at/obvulihs/download/pdf/5295005?originalFilename=true>

²⁶ Vedernikova, I., Kravchenko, V., Mostovaya, Y. & Silina, T. (2020). The compatibility test (In Russian). Znak.ua. Link: https://zn.ua/internal/test-na-sovmestimost-335429_.html

²⁷ KIIS (2020). Opinions and views of the population on the “poll” initiated by the President: October 2020. (In Ukrainian). Link: <https://www.kiis.com.ua/?lang=eng&cat=reports&id=974&page=1>

²⁸ Gaidar, Y. (2012). *Russia: A long view*. MIT Press.

implementation process, which is considered one of the major obstacles in implementing Ukraine's long-term development policies. On the other hand, the gap in political preferences between Donbas and non-Donbas population has widened, making any attempts of conflict resolution more difficult.

