Analysis of Impact of Conflict on Socio-Economic Situation in Eastern Ukraine

*Main findings*
BACKGROUND: The Food Security and Livelihoods Cluster (FSLC) with World Food Programme support has worked with the Ukrainian Center for Social Reforms (UCSR) on an analysis of the impact of conflict on socio-economic situation and the vulnerability of populations in eastern Ukraine.

DATA USED FOR ANALYSIS: The analysis is based on secondary data, mainly on the official information of the State Statistics Service of Ukraine (SSSU), with a focus on average indicators for Ukraine, Dnipropetrovska, Kharkivska, Zaporizka oblast and Government Controlled Areas (GCA) of Donetska and Luhanska oblasts.

The analysis is based on the pre-conflict data (GCA and NGCA combined) and up to 2015 with some preliminary 2016 data where available. After 2014, only GCA data is available. The analysis was done on all five eastern oblasts however, it is clear that Luhanska and Donetska oblasts have been most affected.

Therefore, this paper focuses on Luhanska and Donetska GCA and the average of Ukraine for comparison.

FOCUS OF ANALYSIS: The analysis framework was developed to look at three main areas:

1. The impact of conflict at household (HH) level – i.e. looking at the impact on the social-economic situation by analysing the main social indicators (including the trends of the pre-conflict period and the most recent available official data) (pages 4 – 8)
2. The impact at business level – i.e. enterprises, labour market and employment (pages 8 – 10)
3. The impact at macro level – i.e. the overall economic situation (pages 10 – 11)

MAIN FINDINGS

The analysis shows that the conflict has had an impact on all of Ukraine – especially the five eastern oblasts, with Luhanska and Donetska oblasts having been most affected due to the direct impact (such as loss of control of territory, infrastructure, markets and resources) and indirect impact through negative structural changes and poverty.

The analysis illustrates that all levels of socio-economic indicators including at macro level, enterprise and labour force level and household level have been affected by the conflict:

- Consumer prices has increased two times between 2014 and 2016 (in 2010 prices), which has directly impacted the level of “real income” in Donbas. There has been a reduction of “real income” by 55% in Donetska (GCA) and by 64% in Luhanska (GCA).
- Poverty by actual cost of living has increased from 2013 to 2015: the percentage of the population living below the actual minimum subsistence level has increased from 20% in 2013 to 74% in 2015 in Luhanska oblast (GCA) and from 22% to 66% in Donetska oblast (GCA).
- The physical value of the Gross Regional Product decreased from 2013 to 2015 in both Luhansa GCA (by 70%) and in Donetska GCA (by nearly 60%). Between 2013 and 2015, the number of enterprises reduced, especially large and medium-sized businesses: Luhanska oblast (GCA) lost 70% of total enterprises whilst Donetska oblast (GCA) lost almost 60%.

---

1 The Ptouka Institute for Demography and Social Studies is the Official State Organisation, who under umbrella of Ukrainian Academy of Science undertake the official calculation of poverty for the MoSP.
2 Please refer to the SSSU web-site www.ukrstat.gov.ua
3 Detailed information (which also covers Dnipropetrovska, Kharkivska, Zaporizka oblasts) is available on request: info.ukraine@fscluster.org. The findings were presented during the May rounds of FSLC meetings in the field and in Kyiv.
4 Please refer to the website for the Kyiv PowerPoint Presentation in May 2017: http://fscluster.org/ukraine.
5 Based on comparison of 2016 prices to 2010 prices.
6 Based on 2010 prices.
Between 2013 and 2016, the level of unemployment among the working age population in Donetska (GCA) increased to 14.6% (up from 8.2%) and in Luhanska (GCA) to 16.9% (up from 6.7%).

**BACKGROUND & CONTEXT:**

**PRE-CONFLICT:** The conditions for economic growth were favourable in Eastern Ukraine before the conflict and especially in Luhanska and Donetska oblasts. The majority of coal-mining, metallurgical, coke-chemical, chemical, machine-building industry were concentrated in these two oblasts and a significant number of highly skilled workers were employed by these enterprises. Luhanska and Donetska oblasts occupied 9% of the territory pre-conflict, produced 25% of industrial production and 8% of agricultural production in Ukraine and these two oblasts accounted for 23-27% of Ukraine’s total exports. The geographic position of raw materials and markets was also favourable – in this way, products, diversified industry, developed networks of transport, communications, high population density distinguished Luhanska and Donetska oblasts as one of the most developed economic regions of the country.

**POST CONFLICT:** In late 2014, Luhanska and Donetska oblasts were divided into Government controlled areas (GCA) and non-government controlled areas (NGCA). This had a negative impact on the overall socio-economic situation and complicated infrastructure (including electricity and water supply systems), communication and accessibility in the region as well as access to social assistance.

In Donetsk oblast, due to the division of the railway network and destruction of roads (causing transport cost increases) and energy infrastructure, many enterprises, especially heavy industry, were forced to reduce, suspend or stop production processes. Before the conflict, Donetsk oblast was above the national average on all the major economic indicators (such as Gross Regional Product (GRP), Gross Added Value, (GAV), turnover, export/import, investments, household income) whereas Luhanska oblast was level with the national average for Ukraine. By 2015 however, Donetsk oblast (GCA) was below the national average on all indicators whilst Luhanska oblast (GCA) had fallen even further and was now among Ukraine’s poorest regions.

Since 2014, the Donbas region has experienced a deterioration in the overall socio-economic situation, which has changed the situation for many households and worsened living standards. The findings of this analysis underscores that the region is experiencing a difficult period with almost all key indicators at macro level (i.e. GRP, GAV, turnover, export/import, investments) and at business level (i.e. enterprises, labour market and employment) showing negative trends, which have a negative impact at livelihoods and household level.

The analysis suggests that conflict may directly or indirectly have caused or reinforced economic decline and rising unemployment as a result of enterprise closures, the breakdown of economic ties, the physical destruction of production facilities and of social / financial / banking, transport and communication infrastructure.

---

8 Donetska economic region had a developed network of roads, railways, gas mains, oil pipelines, lines of power grids and water supply system, which have been interrupted.
IMPACT AT HOUSEHOLD LEVEL

This section covers the impact of conflict at household level in Luhanska and Donetska GCA and on the social-economic status of households by looking at the main social indicators such as poverty (minimum subsistence level), income, expenditure etc.

DEFINITIONS OF POVERTY:

- The “minimum subsistence level” is a value sufficient to cover basic needs.\(^9\) This value is the basis for classifying the poor as a category.
- However, the “actual minimum subsistence level” is used to monitor the dynamics of living standards (based on consumer price statistics) and calculated monthly by the Ministry of Social Policy of Ukraine.
- For this analysis, “poverty by actual cost of living” has been used – this refers to the percentage of the population living below the actual minimum subsistence level (also sometimes referred to the percentage of the population “living below the poverty line”).\(^10\)

POVERTY: Conflict and the knock-on effects of conflict (for example inflation, fuel/electricity shortages, power cuts, nationalization and economic/trade blockade, rising unemployment as a result of enterprise closures etc.) have caused an increase of poverty.

Between 2013 and 2015, the percentage of the population living below the actual minimum subsistence level increased oblast from 20% in 2013 to 74% in 2015 in Luhanska oblast and from 22% to 66% in Donetska oblast, while the average for Ukraine (GCA only) has increased from 22% up to 58%.

GROUPS VULNERABLE TO POVERTY: The groups most vulnerable to poverty are households with children and households consisting of elderly (75+), especially in rural areas. The highest proportion of poor are found within households with children in Luhanska where 89% in 2015 (up from 20% in 2013) of these households live below the actual minimum subsistence level whereas in Donetska oblast, 71% of households with people 75 years or older in 2015 live below the actual minimum subsistence level (up from 28% in 2013) with 73% in Luhanska (up from 30% in 2013).

\(^9\) According to the methodology (http://zakon2.rada.gov.ua/laws/show/z0347-00/page) of the Ministry of the Social Policy of Ukraine (MoSP), the minimum subsistence level is a value sufficient to ensure the normal functioning of the human body. The minimum subsistence level is calculated per capita and for those who belong to the main social and demographic groups. The value of the legally statutory minimum subsistence level is approved annually by the Verkhovna Rada of Ukraine as part of the State Budget. Every month (as per Ukrainian law), MoSP undertakes monitoring and calculates the actual minimum subsistence level based on statistical data on consumer prices.

\(^10\) This indicator is calculated based on the methodology of the poverty complex estimation of MoSP (http://zakon3.rada.gov.ua/laws/show/z1785-12#n17). The indicator is based on the level of expenditure – i.e. it reflects on the equivalent aggregate expenditure per capita lower than actual minimum subsistence level.

Other indicators of poverty can be found on the official web-site of the State Statistics Service of Ukraine (SSSU) (http://ukrstat.gov.ua/). The SSSU indicators for example, is based on the level of income – i.e. they calculate the differentiation of the living standard of the population based on the equivalent of an average total monthly income per capita lower than the legally statutory minimum subsistence level and based on the equivalent to average total monthly income per capita lower than actual minimum subsistence level. The methodology and poverty indicators used by the World Bank are based on the SSSU indicators and methodology. (http://data.worldbank.org/indicator/SI.POV.NAHC?locations=UA)
DEPTH OF POVERTY: The depth of poverty is defined as the average amount of income, which the population living below the actual minimum subsistence level require to reach the actual minimum subsistence level.

In 2015, in order to reach the level of actual minimum subsistence level (or to move above the poverty line), the population across Ukraine, on average, needed to increase their income by 27%, while in Donetska oblast, the income had to be increased by 31% and in Luhanska oblast by 34% to reach this level.

The progression of the depth of poverty between 2013 and 2015 among vulnerable social demographic groups is shown in the below graph.
INCOME: The table on the right on the distribution of household income, shows that 12.3% in Luhanska and 8.4% Donetska oblasts live below 1,200 UAH per month/person – which is nearly 50% (or 1,057 UAH) less than the actual minimum subsistence level. In 2015, the depth of the poverty\(^{11}\) in Donetska and Luhanska was 29% while the Ukrainian average was 25%.

Pre-conflict, this region was one of the fastest growing in terms of income when compared to the rest of Ukraine, with Donetska and Luhanska oblasts experiencing a 30% growth of income between 2010 and 2013.

At the same time, the average income in Donetska oblast was 13% higher than the national average and Luhanska oblast was almost level with the national average.

However, in 2015 the situation changed and income levels across Donbas fell. When compared to the Ukrainian average, income levels in Donetska oblast by 2015 were now 12% lower whilst in Luhanska oblast, they were 18% lower.

The pension size generally in Ukraine for the majority of pensioners falls below the actual minimum subsistence level. The low income level combined with high tariffs for housing services cause a high demand for subsidies for housing services and fuel. In 2016, the share of households who received such subsidies in average in Ukraine was 36% but only 19% in Donetska oblast and 15% in Luhanska oblast.\(^{12}\)

Pensions have traditionally been higher in the mining rich Donetska and Luhanska oblasts – in 2016, the average pensions were 16% higher in Donetska oblast and 9% higher in Luhanska oblast when compared with all of Ukraine. The same trend applies to salaries – in 2016 in Donetsk, the average salary was 16% higher than the Ukrainian average and the oblast could therefore be expected to feature lower poverty levels than the Ukrainian average however, the opposite is the case. It is in this context that the increase of the percentage of the population living below the actual minimum subsistence level in both Luhanska and Donetska oblast (see page 3) should be seen. Despite relative high incomes and pensions, poverty levels have increased at a higher rate than the national average.

INCOME VS INFLATION: Between 2014 and 2016 (in 2010 prices), consumer prices increased two times across all regions of Ukraine but at the same time, the level of real income\(^{13}\) decreased by 55% in Donetska oblast and by 64% in Luhanska oblast.

---

11 See definition of depth of poverty on page 4.
12 WFP is currently undertaking a Desk Review (secondary data and expert interviews) on “Social Protection and Safety Nets in Ukraine”. This is expected to be published after October, 2017.
13 Real income in the form of cash income, is determined on the basis of real prices for goods and services and withheld taxes. It is calculated based on a comparison of 2016 prices with 2010 prices.
During this period, food prices increased by 89% in Donetska oblast (in 2010 prices) and by 88%, in Luhanska oblast while the average of Ukraine was 74%.

Negative trends in Donetska and Luhanska oblasts (GCA) when assessing the main indicators such as real income, food and consumer prices, GRP levels are captured in the graphs above: the economic decline after 2013 and the impact on the household level are clear with little indication of a change to this trend in the near future. For example, real income dropped by 84% between 2013 and 2015 (compared to the baseline of 2010) in Luhanska oblast and by 81% in Donetska oblast between 2013 and 2015 (compared to the baseline of 2010) whereas the Food Price Index increased by 85% between 2013 and 2015 (compared to the baseline of 2010) in Donetska and by 81% in 2015 in Luhanska oblasts.

AVERAGE RESOURCES PER MONTH PER HOUSEHOLD (INCOME STRUCTURE):
Five household income resources include salary; pensions and social benefits; revenues from the sale of agricultural products; income from entrepreneurship and self-employment; cash help from relatives or/and other people, other cash income.

Overall, there has been a reduction of the share of salaries and social benefits and an increase in the share of revenues from the sale of agricultural products and cash help from relatives or/and other people, other cash income.

Salaries make up the largest share of household income across Ukraine. In 2013, this proportion was 57% in Donetska oblast and 55% in Luhanska oblast. By 2015, this had decreased to 55% in Donetska oblast and to 48% in Luhanska oblast.
When compared to 2013, 2015 also saw a reduction in the share of income from pensions and other social benefits by 2% in Donetska oblast and by 3% in Luhanska oblast.

There has been an increase share income of revenues from the sale of agricultural products in 2015 up to 5% (from 1% in 2013) in Donetska oblast and up to 6% (from 2% in 2013) in Luhanska oblast.

The share of income from entrepreneurship and self-employment has increased in 2015 in Luhanska oblast to 5% (up from 3% in 2013), while in Donetska oblast it decreased to 2% in 2015 (down from 4% in 2013).

The share of household income from cash assistance, or from support from relatives and/or other people and other income remained almost at the same level from 2010-2013 and was 4.7% in Luhanska oblast and 4.9% in Donetska oblast. However, in 2015, the share of such assistance increased to 9.5% in Luhanska oblast and 5.8% in Donetska oblast, indicating that people increasingly since 2014 have relied on help from the relatives and others and less on more regular sources of income such as salaries and social benefits.

EXPENDITURE: Pre-conflict, household expenditure in Donetska oblast was 6% higher and in Luhanska oblast – 8% lower than the national average. After the conflict, by 2015, expenditure in Donetska oblast decreased to be 15% lower and in Luhanska oblast – 25% lower than the national average.

BUSINESS STATISTICS INCLUDING LABOUR MARKET AND EMPLOYMENT

This section focuses on the impact of conflict on business (at enterprise level) in Luhanska and Donetska oblasts (GCA), which mostly rely on the large and medium enterprises and how the conflict, as a result, impacts on the labour force.

REDUCTION IN NUMBER OF ENTERPRISES: Due to the loss of control of territory and the closure of many enterprises, the number of large and medium-sized businesses in particular, has sharply decreased. Due to the impact of conflict on infrastructure (i.e. of transport, energy etc.), many enterprises have reduced, suspended or stopped their production processes. In particular, this has affected industry with a significant proportion of enterprises located in the area near the contact line in GCA.

During the period from 2013 to 2015, Luhanska oblast lost 70% of total enterprises and Donetska oblast

---

14 Business statistics includes only legal units and not individual entrepreneurs, government bodies, and non-profit organizations.

15 This is also reflected in the recent REACH (2017) Thematic Assessment of Local Enterprises and Labour Markets in Eastern Ukraine Assessment: “businesses are suffering from disrupted trade relationships and a lack of demand for products, with 70% of assessed businesses reporting decreasing revenues since the conflict began”. Please refer to: http://www.reach-initiative.org/ukraine-local-economy-trade-relationships-and-labour-markets-disrupted-by-conflict-in-eastern-regions
almost 60%, whereas the percentage for all of Ukraine by comparison was 21%.

In 2013, there were 28 economically active large enterprises in Luhanska oblast (whole region including NGCA), whereas in 2015 in GCA, there were only 7. These 7 enterprises employed some 44% of the workforce in the oblast in 2015.

In 2013 in Donetska oblast (whole region including NGCA), there were 108 economically active large enterprises whereas in 2015, there were 40, providing employment for almost 52% workers in the oblast.

After 2013, the structure of business in terms of large/medium/small and micro enterprises and of employees/turnover remains unchanged. The graph below illustrates that the economy of the Donbas region relies on large and medium enterprises and even more so after 2014.

Taking into account the current trend of enterprise closures and given the recent blockade and its probable impact on large and medium sized enterprises, it is likely that unemployment levels will increase further in the Luhanska and Donetska regions.

IMPACT ON LABOUR FORCE: In 2015, due to the loss of control over territory, the number of the economically active population in Donetska oblast (GCA) declined by 55% or one million people, and in Luhanska oblast by 63% or 600,000 people.

The loss of control of these areas caused a 6% of reduction of total labour supply in Ukraine. The largest decline in employment was observed in Donetska and Luhanska oblasts with 180,000 and 98,300 people respectively, from 2013 to 2015.

During 2014-2016, there was an increase in the share of the rural population due to loss of control over territory and an increase in the level of unemployment, especially in the Donetska and Luhanska oblasts.17

In 2016 Luhanska and Donetska oblasts had the highest levels of unemployment when compared to the rest of Ukraine (9.5%), respectively at 14.6% and 16.9%.18

16 Generally, across Ukraine, the rate of unemployment is higher amongst rural populations when compared to urban populations.

17 During the first quarter of 2017, unemployment has increased to 18.3% in March (up from 16.9% in December 2016) in Luhanska oblast (GCA) and in Donetska oblast (GCA) to 15.6% (up from 14.6%). This is the highest increase in the unemployment rate since 2008. Please refer to the SSSU web-site: www.ukrstat.gov.ua

18 This is also reflected in the recent REACH (2017) Thematic Assessment of Local Enterprises and Labour Markets in Eastern Ukraine Assessment", which covers the five Eastern oblasts and which states that “the impact of conflict on individuals’ employment has also been severe and varied between the oblasts, with Luhansk and Donetsk being the most impacted at the
However, Luhanska and Donetska oblasts also had the lowest percentage of unemployed, who apply to State Employment Service and received appropriate official unemployment status. Therefore, whereas across Ukraine, the number of registered unemployed\(^{19}\) is 28% compared to the percentage of all unemployed\(^{20}\), in Donetsk oblast, this ratio is only 19% and in Luhanska oblast – 17%.

Between 2013 and 2015, there has been an increase in the level of salary arrears in Donetsk and Luhanska oblasts. In May 2013, salary arrears amounted to 217 million UAH in Donetsk and 61 million UAH in Luhanska oblast (despite being less populated than Donetsk oblast). By December 2015, this had increased to 389 million UAH in Donetsk oblast and to 516 million UAH in Luhanska oblast, while the average in Ukraine was 80 million UAH.

**MACRO ECONOMIC INDICATORS**

*This section focuses on the impact of conflict on the main macro economy indicators such as Gross Regional Product (GRP), Gross Added Value (GAV), turnover, export/import, investments.*\(^{21}\)

**GROSS REGIONAL PRODUCT:** The conflict has had a direct negative impact on all macroeconomic indicators.

There has been a reduction of the Gross Regional Product (GRP) between 2013 (pre-conflict) and 2015. In Luhanska oblast, the Physical Value GRP reduced by 70% and in Donetsk oblast by nearly 60% (in 2010 prices).

Similarly, the GRP share of Donbas region of the total GRP of Ukraine decreased from 14% in 2013 to 7% in 2015.\(^{22}\)

**DETERIORATION OF INDUSTRY:** Between 2013 and 2015, basic financial and economic indicators of industry have deteriorated – with almost all types of economic activity having reduced. In this period, the individual level, and “Workforces have shrunk in 24% of surveyed enterprises, with almost one-fifth of active households who have lost their employment since the conflict began.” Please refer to: [http://www.reach-initiative.org/ukraine-local-economy-trade-relationships-and-labour-markets-disrupted-by-conflict-in-eastern-regions](http://www.reach-initiative.org/ukraine-local-economy-trade-relationships-and-labour-markets-disrupted-by-conflict-in-eastern-regions)

\(^{19}\) Registered unemployed persons, in accordance with current legislation, are persons of working age who are registered in the local government state employment centres. For further details, please see: [http://ukrstat.gov.ua/Zakon/engl/Metod/2015/Employment.htm](http://ukrstat.gov.ua/Zakon/engl/Metod/2015/Employment.htm)

\(^{20}\) According to the ILO methodology, “all unemployed” refers to persons aged 15-70 (registered and not registered in the state employment service). For further details, please see: [http://ukrstat.gov.ua/Zakon/engl/Metod/2015/Employment.htm](http://ukrstat.gov.ua/Zakon/engl/Metod/2015/Employment.htm)

\(^{21}\) Information from 2014 onwards does not reflect the situation in NGCA as enterprises, for the most part, stopped reporting to the Government.

\(^{22}\) It is likely that the recent blockade will have a further negative impact on the indicators for 2017 however, the full information for 2017 will be available through SSSU by end of 2018.
Gross Added Value (GAV) of mining and quarrying reduced by 75% in Luhanska oblast and 48% in Donetska oblast; and the GAV of construction reduced by 56% in Luhanska oblast and 51% in Donetska oblast. At the same time, the total volume of sold industrial products (goods and services) decreased by 21% in Donetska oblast and 68% in Luhanska oblast from 2013 to 2015.

REGIONAL EXPORT / IMPORT: From 2013 to 2015, Donetska oblast saw a 72% reduction in the export of goods whereas Luhanska oblast experienced an 88% reduction.

At the same time, regional imports of goods decreased in Donetska oblast by 73% and in Luhanska oblast – by 81%.

Key changes in foreign economic activity: During this period, the geographical structure of import to /export from the two major markets, EU and Russia, has changed in Luhansk and Donetsk regions. The decline in total exports was caused by a change of the overall structure and direction of exports.

Between 2013 and 2015, the geography of foreign economic activity has changed in all regions. A number of export & import destinations were reoriented from CIS countries (first of all, Russia) to the EU and other countries, but this reorientation has not compensated for past export/import volumes.

Still, Russia remains a major partner for all eastern regions of Ukraine, especially for the Donbas region. This means that the economy may experience a continued negative trend in case of continued and further escalation of the conflict.

INVESTMENTS IN INDUSTRY: The majority of the overall volume of capital investments in Donetska oblast (62% in 2013) has traditionally gone into industry, of which 70% was allocated to the mining industry, development of quarries and processing industry. However, increasingly the risk (real and assumed) associated with engaging in business in conflict affected areas, impacts the level of investment. As a result, between 2013 and 2015, capital investments saw a reduction by 70% in Donetska oblast and by 82% in Luhanska oblast. In the context of ongoing conflict, it is not likely that this trend will be reversed in terms of an increase in the regional capital investment portfolio.23

23 This is also reflected in the recent REACH (2017) Thematic Assessment of Local Enterprises and Labour Markets in Eastern Ukraine Assessment”, which covers the five eastern oblasts: “there is little foreign investment in the area, while facilities and production technologies are outdated and require significant investment to remain competitive”. Please refer to: http://www.reach-initiative.org/ukraine-local-economy-trade-relationships-and-labour-markets-disrupted-by-conflict-in-eastern-regions