



# Peace in Ukraine (III): The Costs of War in Donbas

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*Preventing War. Shaping Peace.*

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# Principal Findings

**What's new?** The six-year-old war in Ukraine's south east has split the Donbas region and torn its socio-economic fabric. In 2017, Kyiv banned trade with the Luhansk and Donetsk breakaway statelets, which seized Ukrainian industrial assets on the territory they control. The repercussions have harmed residents and may undermine prospects for reintegration.

**Why does it matter?** Under the Minsk framework, peace will require Kyiv to reintegrate the breakaway regions while offering them a measure of political autonomy. Creating the conditions for Donbas's successful economic reintegration will be crucial to a sustainable peace.

**What should be done?** Kyiv should re-forged economic ties across the front line, including by expanding access to pensions for those in separatist-controlled territories and searching for ways to stimulate cross-line trade. It should also continue to plan and seek financial commitments for Donbas's economic reintegration.

## *Executive Summary*

The war in Ukraine's Donbas plunged an economically troubled region into ruin. A 427km front line cuts through what used to be the most densely populated and industrially productive part of the country. Supply and market links have been shattered. Giant enterprises have shed jobs or collapsed. Entire communities have fallen into poverty, now exacerbated by the COVID-19 crisis. Areas controlled by Kremlin-backed separatists depend heavily on Russia, which does not recognise their independence and spends a great deal for what translates into meagre support to residents. Peace, predicated on reintegration of the separatist areas in accordance with the Minsk framework, is the best route to recovery. But peace will require the restoration of economic ties and rebuilding. Kyiv should start moving in that direction by helping breakaway residents get government pensions, easing trade restrictions and seeking a deal to restore industrial assets to their Ukrainian owners' control. Ultimately, Kyiv must find partners to help pay for Donbas's modernisation – an effort with which Moscow and others should help.

While the conflict that has beset Ukraine's Donbas region has certainly added to its troubles, some of those woes long predate the conflict. For decades this corner of south-eastern Ukraine has struggled with a decaying industrial economy, out-migration and a growing sense of frustration among the population. Consisting mainly of the Donetsk and Luhansk oblasts (administrative units akin to provinces), Donbas was responsible for roughly one quarter of Ukraine's industrial production in the decades before the war. But its people had precious little to show for it. Wage arrears were the worst in the country, life expectancies were low, carbon emissions were through the roof and – thanks in part to lagging birth rates and high infant mortality – the population was ageing. A handful of powerful businesspeople with ties to President Victor Yanukovich and his party were riding high, but their good fortune hardly compensated for the sense of alienation and grievance among those who were not so lucky.

It was this frustration with the status quo that helped set the stage for the region's division in 2014. While mistrust of both Moscow and Kyiv ran high, some locals were especially concerned that the pro-West Maidan movement that drove Yanukovich from office in February of that year would tether the country more tightly to Europe and sell short their regional identities and economic interests. Some worried that if Ukraine grew closer to the West, Russian markets might shut out Donbas goods; they were optimistic that, if it stayed closer to Russia, Moscow might better protect their wages and more generously support their industries' modernisation. Others pinned few hopes on their eastern neighbour. Personal views notwithstanding, many simply kept their heads down when forces crossed the Russian border to join local separatists in forcibly dividing the Luhansk and Donetsk oblasts.

The result was a fractured Donbas, with separatist-controlled de facto statelets in the east, government-controlled territory in the west and war along the front line that runs through the middle. Hopes that Russia's intervention might usher in a brighter economic future have foundered on grim realities. The persistence of conflict is perhaps first among them. Although the parties negotiated the two "Minsk agreements", which are supposed to create a path to peace, not much has been done to implement

them. To many in Kyiv, reintegration under Minsk both would cost billions of reconstruction dollars and, because of Donbas's expected pro-Russian sympathies, could torpedo aspirations of European integration. To de facto leaders, reintegration would dispel dreams of joining Russia and could expose them to prosecution for crimes against the Ukrainian state. To Russia, while carrying out Minsk arguably would be preferable to the status quo, the status quo, which keeps Kyiv off balance, may be preferable to flexibly interpreting the 2014-2015 framework or striking another deal that is more favourable to Ukraine.

Meanwhile, the two sides are drifting farther apart, and the costs of conflict are continuing to mount. While cross-line commerce continued for the first few years of the war – with anthracite mined on the separatist side shipped to factories on the government side, and Ukrainian companies conducting operations in both areas – it has stopped. In 2017, Kyiv imposed a ban on all but humanitarian cross-line shipments, and the de facto authorities responded by seizing Ukrainian-owned industrial assets on their side of the line, vesting control in a newly created entity that has racked up wage arrears and run facilities into the ground.

On both sides of the front line, residents have settled into a new normal that drifts between dreary and dire. In government-controlled territory, an influx of foreign organisations and “pension tourists”, who (as required by Kyiv) visit from across the front line to collect their monthly stipends, has injected some resources into the local economy. Whether or not persuasively, Kyiv has also pledged to step up its own investment and make the government-controlled region a national showcase. Yet the overall trajectory is not good. Industrial production is down. Workers who used to travel to jobs in and around the eponymous provincial capitals, Donetsk and Luhansk, cannot because those areas lie in separatist hands. Leading employers have shed jobs. The inflow of displaced people has strained infrastructure and birthed new economic resentments.

In the statelets, the situation is worse. With Russia pushing for separatist-controlled Donbas's reintegration into Ukraine, Moscow has not recognised the de facto statelets' independence, making it illegal for Russian firms to engage in commerce with businesses located there. Businesses in the breakaway regions are thus in a situation where they cannot trade with entities in either Russia to the east or government-controlled Ukraine to the west. Although some have found ways to make do, these improvised arrangements are often inefficient, illegal or both. Nor has the 2017 seizure of Ukrainian-owned assets served the local work force, which has watched them fall into dysfunction and disrepair. Russia has helped stave off complete economic collapse through energy subsidies and budget support, but the social safety net is hardly adequate. Thousands of older residents subsist by maintaining an address in government-controlled territory, which, as indicated above, allows them to continue receiving their government pensions so long as they travel over the front line – ie, through a war zone – to collect them.

Bad as the situation is, Ukrainians on the government-controlled side of the front line are of mixed minds about whether it is one that Kyiv should try to fix. For political leaders in Kyiv who resist the idea of reintegration, there is some appeal in confining regional investment to government-controlled areas and watching the statelets wither economically. The most likely outcome of this strategy, however, is that it would

only continue the trends of recent years – extending the conflict, furthering the region’s economic decline, and increasing the local population’s immiseration and resentment. These developments in turn will deepen the hole that Kyiv will ultimately have to help pull Donbas out of when the parties are finally ready for peace.

Kyiv can and should aim higher, setting as its goals to ease humanitarian suffering and to coax the divided region toward a reintegrated economy that would meet the needs of residents on both sides of the front line.

It can start with a number of relatively modest concrete steps. One would be to work with the World Bank or other international financial institutions to devise ways to expand pension access across the line of separation and pay off debts to pensioners who have been locked out of the system. Another measure would be to reassure civil servants and others working for the de facto authorities that their legal exposure is limited because any post-reunification transitional justice mechanism will focus its prosecutorial energy on perpetrators of gross human rights abuses. As pandemic-related travel restrictions are tentatively relaxed, Ukrainian authorities should also look to stimulate small-scale cross-line trade, through helping citizens to take advantage of their December 2019 easing of restrictions on movement of goods and persuading the Russia-backed leaders in Donbas to reciprocate. Kyiv should also explore, albeit cautiously, a deal with the de facto authorities for returning seized industrial assets in the statelets to the control of Ukrainian owners.

Finally, Ukraine should consider with potential investors what a reintegrated, post-conflict regional economy would look like, who would pay for the reconstruction required to make it possible and how to start laying the groundwork for it now. Kyiv’s current planning is focused on how to build a more prosperous future for government-controlled areas. It should broaden its sights. Working with others to imagine a peaceful, prosperous and reunified region can be an important step toward making that vision a reality.

**Kyiv/Brussels, 3 September 2020**

# Peace in Ukraine (III): The Costs of War in Donbas

## I. Introduction

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The term Donbas, short for Donets Basin, has historically been an economic as well as a geographic designator. It was coined in the nineteenth century by mining engineers for the Tsarist government to describe a coal-rich area straddling sections of modern-day eastern Ukraine and western Russia. Under the Soviet Union, Donbas was an industrial powerhouse, producing disproportionate shares of the Union's coal and steel. Its population consisted largely of first- and second-generation migrants sent from other Soviet republics to staff its mines and factories. The region thus earned a reputation as one of the most "Sovietised" parts of the Union – a place where pre-existing identities, languages and patterns of life had been supplanted by a multicultural society held together by common pride in industry, with Russian as the lingua franca.

The post-independence collapse of Ukrainian industry savaged the national economy. It hit this area particularly hard. Luhansk and Donetsk oblasts, which together encompassed most of Ukrainian Donbas, lost 21.6 and 18.3 per cent of their populations, respectively, between 1993 and 2013. (While Ukraine's population was falling elsewhere, the average drop was comparatively smaller countrywide – 12.5 per cent.) The share of working-age people (20–64) in the two oblasts shrank by 13.5 and 12.1 per cent, respectively, during this same time period, compared with 3.9 per cent nationwide.<sup>1</sup> The region became known as a centre of organised crime as illegal mining took off and smuggling across the border with Russia flourished.

In the 2000s, Ukraine embarked on a controversial industrial revival campaign to tackle the problem. In 2006, then-Prime Minister Viktor Yanukovich, a former Donetsk governor, drove a push to increase the area's coal production after Russian gas provider Gazprom raised Ukraine's prices to market rates, forcing it to revisit the structure of its energy grid. Authorities were especially worried about the Ukrainian metallurgy industry, which accounted for about 30 per cent of GDP and relied on cheap Russian gas.<sup>2</sup>

But Donbas's industrial glory did not return. The region's signature anthracite mines, where production had peaked in the 1970s, were severely depleted. The remaining coal lay in deep, thin seams, making extraction unusually dangerous and resource-intensive. While coal production grew significantly – by 19 per cent between 2009 and 2012 – so did the amount by which production costs exceeded actu-

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<sup>1</sup> For statistics, see the charts of natural population dynamics by oblast (Природний рух населення) at the State Statistics Service of Ukraine website.

<sup>2</sup> "Українська металургія при нових цінах на газ" [Ukrainian metallurgy and the new gas prices], *Metallurgicheskii Biuleten*, 2006.

al value, and in greater measure.<sup>3</sup> If coal's production cost and value were roughly even in 2005, by mid-2009, the former exceeded the latter by roughly 55 per cent.<sup>4</sup> To keep the industry afloat, Kyiv increased already high subsidies.<sup>5</sup> By 2012, these amounted to about \$1.7 billion, or 3.8 per cent of the state budget.<sup>6</sup>

Soon after Yanukovich became president in 2010, Rinat Akhmetov, a Donetsk coal and steel magnate and Ukraine's richest man, gained majority shares in two state energy companies and six coal-fired thermoelectric power stations, all of which run on Donbas anthracite. Between these acquisitions and the subsidies, investment in Donbas coal looked less like a push for privatisation and energy security and more like a way to funnel favours to powerful figures who could rally electoral support for Yanukovich's Party of Regions.<sup>7</sup>

As Ukraine headed into the second decade of the 21st century, Donbas accounted for roughly 24 per cent of the country's industrial production, but the region itself had little to show for it.<sup>8</sup> If average salaries in Donbas were nominally among the highest in the country, living standards remained poor by many measures. Wages went unpaid at many workplaces, creating among the country's worst arrears. Household expenditures and actual income were below the national average, with Luhansk's among the country's lowest. Life expectancy was roughly two years below the national average, at just over 60 for men.<sup>9</sup> The region's population was nevertheless among the country's oldest, in part due to the continued outflow of working-age people, and in part because of low birth rates and relatively high infant mortality.<sup>10</sup> Ukraine at the time was the global leader in deadly mining accidents relative to production, and Donbas, of course, was mining country.<sup>11</sup>

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<sup>3</sup> Oleg Savitsky, "Towards the End of the Coal Age in Ukraine?!", Heinrich Böll Foundation – Kyiv, July 2015.

<sup>4</sup> Ibid., p. 37.

<sup>5</sup> The cost of the subsidies rose to 15 billion hryvnias out of about 5.06 trillion in total government expenditures. See "Найкращий спосіб підвищити прибутковість державних вугільних шахт – це приватизація – експерти" [The best way to increase profitability of state coal mines is privatisation, experts say], Ukraine Crisis Media Center, 15 June 2016.

<sup>6</sup> Ibid., p. 37.

<sup>7</sup> See, for example, "Наскільки реальні вугільні інновації Януковича?" [How realistic are Yanukovich's coal innovations?], Gal Info, 30 June 2011; "Україна переходить з газу на вугілля: насправді чи лише на папері?" [Ukraine is switching from gas to coal: for real, or just on paper?], Radio Svoboda, 26 September 2012; and Yuriy Vinnichuk, "Обогащення Рината Ахметова" [Enriching Rinat Akhmetov], Insider, 13 June 2014.

<sup>8</sup> "Analysis of Impact of Conflict on Socio-Economic Situation in Eastern Ukraine", Ukraine Food Security and Livelihoods Cluster, September 2017.

<sup>9</sup> See the charts of natural population dynamics by oblast at the State Statistics Service of Ukraine website.

<sup>10</sup> Ibid.

<sup>11</sup> Joseph Kahn, "China's coal miners risk danger for a better wage", *The New York Times*, 28 January 2003. In 2003, Ukraine had the highest rate globally of miner deaths per volume of coal produced – six deaths for every million metric tonnes. In 2007-2008, average male life expectancy for all of Ukraine was 62.3, as compared to 60.4 in Donetsk and 61.59 in Luhansk. Both of the latter figures include rural areas, most of which are now under government control, and where life expectancy is typically higher. See O.V. Lyubinets, "Стан та Прогноз Середньої Очікуваної Тривалості Життя в Україні" [The State of and Outlook for Average Life Expectancy in Ukraine], *Zdorov'ya Naseleynya: Tendentsii ta Prohnozy*, vol. 14, no. 2 (2010), p. 21.



The grim superlatives did not stop there. The density of pollution per square kilometre in the region was over six times the national average.<sup>12</sup> Luhansk and Donetsk oblasts together accounted for 44 per cent of the country's industrial emissions in 2013, contributing generously to Ukraine's status as a world leader in CO<sub>2</sub> emissions, as well as helping it secure the title of Europe's most CO<sub>2</sub>-intensive economy – beating out Russia and Kazakhstan.<sup>13</sup> Levels of violent crime and drug addiction were among the highest in the nation. Intravenous drug use also helped fuel one of the country's most severe HIV infection rates in Donetsk.<sup>14</sup>

Subsidies for Donetsk industry continued to eat into the national budget. While in 2011 the gross regional products of Donetsk and Luhansk accounted for roughly 12 and 4 per cent of national GDP, respectively, these two oblasts received 27 and 11 per cent of all central government subsidies and transfers to regions.<sup>15</sup> Already in 2004, a German government-supported study had argued that these regions' status as net recipients of government funds could be justified, and would in fact benefit the whole country, but only if the money was used to mitigate the public health and environmental damage caused by outdated infrastructure rather than to prop it up.<sup>16</sup> But the funds were put to other uses. Ukrainian activists accuse Yanukovich and his clan of pilfering the subsidies, with one report claiming that they stashed hundreds of millions in offshore accounts between 2010 and 2013 alone.<sup>17</sup> (Yanukovich denies having engaged in illegal self-enrichment.<sup>18</sup>) At the same time, disruptions of the steel trade were hurting the region, as global prices dropped and Russia placed new limits on imports from neighbouring states.<sup>19</sup>

Over the course of the 2000s, the Party of Regions became the country's dominant political force and its structures became increasingly intertwined with the ranks of industrial bosses in Donbas. Local power brokers, arguably seeking to deflect

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<sup>12</sup> S.V. Vytryshchak, S.V. Zhuk and A.K. Klymenko, "Неблагоприятные экологические факторы города Луганска и Луганской области как фактор риска для здоровья детей и подростков" [Unfavourable Ecological Conditions in Luhansk City and Oblast as Risk Factors for Child and Adolescent Health], *Ukrainskyi Zhurnal Klinichnoi ta Labaratornoi Medytsyny*, vol. 8, no. 4 (2013).

<sup>13</sup> "Викиди забруднюючих речовин в атмосферне повітря від стаціонарних джерел забруднення за регіонами (1990-2017)" [Emissions of Polluting Substances into the Atmosphere from Stationary Sources, by Region (1990-2017)], State Statistical Service of Ukraine; "Toward a Low Carbon Growth Strategy for Ukraine", DIW Econ, April 2013.

<sup>14</sup> See Iuliia Ogarenko, "Problems of Ukraine's Coal Sector and Greenhouse Gas Emissions from Coal Mining and Consumption", National Ecological Centre of Ukraine, 2010, pp. 18-19.

<sup>15</sup> See "Хватит Кормить Донбасс" [Stop Feeding Donbas], *Novosti Donbassa*, 8 May 2012.

<sup>16</sup> "Ukrainian Regions: Economic Development and Its True Costs", Institute for Economic Research and Policy Consulting in Ukraine, December 2004, p. 6.

<sup>17</sup> "Oleksandr Yanukovich Assets", Anti-Corruption Action Centre, 1 October 2014; "Директор госоператора рынка угля: 'Не операторы должны шахтам, а шахты операторам'" [Director of state operator for the coal market: 'The operators don't owe the mines, the mines owe the operators'], *Business Censor*, 14 July 2016.

<sup>18</sup> "Янукович: если бы я не уехал, война шла бы по всей Украине" [Yanukovich: if I hadn't left, there'd be war throughout Ukraine], *BBC Russian*, 22 June 2015.

<sup>19</sup> "Приказ министерство промышленности и торговли РФ от 18 марта 2009 No. 150 'Об утверждении Стратегии развития металлургической промышленности России на период до 2020 года'" [Order No. 150 'on confirmation of a strategy for the development of Russia's metal industry for the period up to 2020', Russian Ministry of Industry and Trade, 18 March 2009].

attention from their own role in their constituents' poor living standards, promoted the idea that "Donbas feeds Ukraine" – that other parts of the country were free-riding off the wealth that the region's industry produced. Although contrary to economic realities, the narrative fed local perceptions that the region did a lot of dangerous work for few rewards.<sup>20</sup>

The 2013-2014 Maidan movement against then-President Yanukovich was not particularly popular in Donbas, although some protesters did gather at considerable personal risk.<sup>21</sup> The president's about-face on longstanding plans to sign an EU Association Agreement had triggered the unrest. Instead of signing, Yanukovich had pledged to pursue closer ties with the Russian-led Customs Union. By the time Yanukovich agreed to step down in February 2014, the Party of Regions had put a lot of effort into making his Donbas stronghold into a bulwark against EU association.

Throughout the region, party heavyweights led "anti-Maidan" demonstrations, seeking to channel constituents' fears that a "European" Ukraine would see them economically and culturally sidelined. Agitators pointed to the risk that EU integration could diminish the Russian market for the region's industry – which had, of course, already shrunk over the past years – and to the fact that Russian-led Customs Union membership would mean reductions in the cost of the Russian gas on which their steel industries partly relied.<sup>22</sup>

Yet they also played on economic misconceptions and abstract cultural prejudices. Factories and mines bussed employees into Donetsk city *en masse*, where they held placards calling for "development and stability" and suggesting that theirs, not Maidan's, was the real people's movement. Protest leaders called for "economic federalisation", advancing the false narrative that theirs was a donor region.<sup>23</sup> "Why should we work while they sit there", a speaker at a 12 February 2014 demonstration asked, "and eat the bread paid for by the labour and blood of miners? And then they say that we're somehow the wrong sort over here?"<sup>24</sup>

This report examines the economic underpinnings of the Donbas conflict both historically and today. It is based on fieldwork in the region, dating back to the 2014 protests and counter-demonstrations, and continuing throughout the subsequent war and its aftermath. Crisis Group interviewed dozens of workers, pensioners and other residents on both sides of the front line that has come to divide eastern Ukraine, as well as officials from the Ukrainian government and the *de facto* statelets that sprung up in Donetsk and Luhansk in 2014. The research also includes conversations with protesters and fighters from Donbas, business owners and employees, humanitarian aid workers, civil society organisation personnel and independent experts, among others. It additionally draws on a broad review of the literature regarding the

<sup>20</sup> For an editorial overview of negative narratives about and within Donbas, see Kyrylo Sazonov, "Украденный Донбасс" [Stolen Donbas], *Glavkom*, 4 December 2014.

<sup>21</sup> See Oleksandr Lashchenko, "Что Майдан принес Донбассу?" [What did the Maidan bring to Donbas?], Radio Svoboda, 1 December 2017.

<sup>22</sup> See "Вступит ли Украина в Таможенный Союз (и спасает его)?" [Will Ukraine Enter the Customs Union (and Save It)?], Ponars Eurasia, April 2013.

<sup>23</sup> "В центре Донецка с лозунгами 'федерализм или развал' митинговали 'защитники Донбасса'" ['Defenders of Donbas' protest in downtown Donetsk under slogan 'federalism or bust'], 62.ua, 12 February 2014.

<sup>24</sup> *Ibid.*

region's history and economic development. Building on previous Crisis Group work, the report shows how various economic and related issues have shaped conflict and complicated peacemaking in eastern Ukraine and suggests some ways to address them.<sup>25</sup>

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<sup>25</sup> See Crisis Group Europe Reports N°s 252, *"Nobody Wants Us": The Alienated Civilians of Eastern Ukraine*, 1 October 2018; and 254, *Rebels Without a Cause: Russia's Proxies in Eastern Ukraine*, 16 July 2019; as well as Crisis Group Europe Briefing N°89, *The COVID-19 Challenge in Post-Soviet Statelets*, 6 May 2020.

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## II. Ties Fray

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### A. *The Birth of the “People’s Republics”*

Given the region’s post-Soviet history, it is not surprising that many Donbas residents tell a different story about the start of the war and the creation of the so-called Donetsk and Luhansk People’s Republics (DPR and LPR, respectively, and D/LPR collectively) than do many Ukrainian officials and political commentators. But their story also differs from narratives propagated by Russian state media and the de facto statelets’ friends in the Kremlin. Locals certainly did not endorse the attitudes expressed by key members of the post-Maidan administration of President Petro Poroshenko and other prominent figures in the nationalist wing of Kyiv’s intelligentsia, wherein a boorish, mercenary population thinking only of itself welcomed Moscow’s invasion and became accomplices to its crimes.<sup>26</sup> Nor do they always echo the story told in some Kremlin circles, in which humble and fearless workers rose up against an illegal fascist regime, using Soviet-era weaponry found in mines and old stockpiles.<sup>27</sup>

Various accounts from Donbas indicate instead that mistrust toward Moscow and Kyiv were present in nearly equal measure among the region’s industrial workers in 2014. More salient, perhaps, was abstract frustration with the status quo.<sup>28</sup> As one former cement worker from Donetsk put it, between wage arrears and unsafe workplaces, “people had been screwed around for so long” that they did not know whom to trust and wanted a new political and economic order.<sup>29</sup> Some believed that with Moscow’s help they could modernise their industries and guarantee stable incomes; following Russia’s annexation of Crimea, they hoped for the same in Donbas.<sup>30</sup> Others, particularly coal workers who had seen Moscow shut down its own mines just over the border in past decades, were sceptical.<sup>31</sup>

Yet while views on the prospect of joining Russia varied, opposition to the Maidan protest movement grew quickly among industrial workers as orders from Russia for Ukrainian products dried up. Fears that Russia would close its border to those goods also mounted.<sup>32</sup> Throughout March and April 2014, armed men, some from across the border, seized industrial enterprises as well as municipal buildings in the

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<sup>26</sup> Crisis Group interviews, adviser to National Security and Defence Council, Kyiv, January 2017, October 2018; youth political activists, Kramatorsk, September 2017; national deputy from the People’s Front party, Kyiv, March 2018; former army volunteer and parliamentarian, Kyiv, April 2019; military support volunteer, Mariupol, May 2018; and former army volunteer, November 2019.

<sup>27</sup> See, for example, “Шахты и оружие: что удивляет в российской версии?” [Mines and weaponry: Russia’s incredible story], BBC Russian, 13 March 2017.

<sup>28</sup> Crisis Group interviews with anti-Maidan protesters, Donetsk, May 2014.

<sup>29</sup> Crisis Group interview, retired cement worker from Donetsk, Svyatohirsk, November 2019.

<sup>30</sup> Crisis Group interviews, chemical plant worker from Sievierodonetsk, Kramatorsk, October 2017.

<sup>31</sup> Crisis Group interviews, charity workers, Rostov na Donu, February 2019; see also Brian Milakovsky, “Cut Off: What Does the Economic Blockade of the Separatist Territories Mean for Ukraine?”, Wilson Center, 9 January 2018; and Olga Musafirova, “Шахтеры Донбасса не поддерживают сепаратистов” [The miners of Donbas don’t support the separatists], *Novaya Gazeta*, 20 May 2014.

<sup>32</sup> Luke Harding, “Workers fear for the future in Ukraine’s industrial east”, *The Guardian*, 26 March 2014.

Donbas region.<sup>33</sup> Many local workers simply kept their heads down, neither resisting nor actively aiding the takeovers.<sup>34</sup>

The role of Rinat Akhmetov and his business empire in these early days of the conflict is the subject of fierce debate in Ukraine. According to statements by DPR founders, as well as some anti-DPR journalists, Akhmetov played both sides. In the wake of Yanukovich's overthrow, they say, Akhmetov sought to use the anti-Maidan protests to gain leverage over the new government in Kyiv and pressure it to route more financial resources to the region. He also allegedly offered funding to separatist battalions, possibly in a bid to avoid having them seize his assets – an allegation he denies.<sup>35</sup>

But by May 2014, as armed groups tightened their grip over Donetsk and nearby cities, and seized railway lines preventing industrial shipments, Akhmetov stepped in on the government's behalf. He called on his thousands of factory workers in the city of Mariupol, home to two of his giant steel mills, to take to the streets to repel pro-Russian demonstrators.<sup>36</sup> In the words of separatist fighter Aleksandr Khodakovsky, "When it came time to choose, Akhmetov of course chose what was dearer to him, in terms of his business prospects: a united Ukraine and the West".<sup>37</sup>

By October 2014, some 4,000 Ukrainians on both sides of the fight had been killed. Mariupol remained under government control. So did the lesser industrial centres of Kramatorsk, Sievierodonetsk and their respective surroundings. Otherwise, the region's major industrial areas, including the bulk of Akhmetov's empire as well as the assets of the steel giant Industrial Union of Donbas, were in rebel hands. The Russian-backed separatists were frank about both their need for marketable resources that would give them income and their interest in "nationalising" industrial enterprises.<sup>38</sup> Their leaders put out the message that industrial workers had voluntarily joined their ranks in large numbers, a narrative that Akhmetov's managers disputed.<sup>39</sup>

Meanwhile, Kyiv moved to extricate its institutions, and some of its citizens, from rebel-held areas. It passed legislation granting the roughly 400,000 people who had

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<sup>33</sup> See Crisis Group Europe Report N°235, *Eastern Ukraine: A Dangerous Winter*, 18 December 2014; Musafirova, op. cit.

<sup>34</sup> Musafirova, op. cit.

<sup>35</sup> Roman Honcharenko, "Король без королевства: Ринат Ахметов и кризис в Донбассе" [A king without a kingdom: Rinat Akhmetov and the Donbas crisis], Deutsche Welle, 15 October 2014; "Является ли Мариуполь Украина или Россией [sic], решает Ахметов – Гармаш" [Harmash: Akhmetov decides whether Mariupol is Ukraine or Russia], UkrLife TV, 2 December 2015.

<sup>36</sup> "Экстренное заявление Рината Ахметова в связи с ситуацией на Донбассе 19 мая 2019" [Emergency statement by Rinat Akhmetov regarding the situation in Donbas on 19 May 2019], System Capital Management, video, YouTube, 19 May 2014.

<sup>37</sup> "Ахметову пришлось смириться: легендарный комбриг ДНР предупреждал 'хозяина Донбасса', что Россия придет" [Akhmetov has had to accept fate: legendary DNR brigade commander warns 'master of Donbas' that Russia is coming], Federalnoye Aгенstvo Novostei, 5 February 2019.

<sup>38</sup> See, for example, "В украинские батальоны шли всякий сброд" [All sorts of trash were joining the Ukrainian battalions], Lenta, 14 September 2019.

<sup>39</sup> Crisis Group interview, Denys Didenko, head of the general director's office, D-ТЕК, March 2019; Roman Kalmiushky, "Павел Губарев объяснил причину нападения боевиков на шахту Ахметова" [Pavel Gubarev explains why fighters attacked Akhmetov's mine], 62.ua, 22 June 2014; and "Горняки шахты Комсомолец Донбасса требуют прекратить стрельбу со всех сторон" [Miners at Donbas Komsomolets mine call to stop the shooting from all sides], gordonua.com, 22 June 2014.

fled these areas the right to register as internally displaced persons (IDPs) and receive cost-of-living subsidies. In November, Kyiv announced that it would withdraw all government services and funding from these territories the following month, in order to prevent funds from reaching the separatists. By December, the number of registered IDPs had doubled, largely because so many pensioners had signed up hoping to retain access to their benefits.<sup>40</sup>

Yet Kyiv retained industrial ties with the separatist-held territories for reasons of economic and energy security. It supplied steel mills in these territories with iron ore through cross-line rail shipments. Coke from Akhmetov's enterprises in separatist-controlled areas was shipped across the line to supply his steel mills in Mariupol. Crucially, anthracite moved from east to west across the line to supply thermoelectric power stations, which ran on this form of coal. Ukrainian-registered entities in separatist-held areas paid taxes into the state budget – over a billion hryvnias (over \$38 million) in 2016, according to the state fiscal service.<sup>41</sup> Defenders of the arrangement argue that it maintained political and cultural ties with separatist-held territories as well.<sup>42</sup> Akhmetov's D-TEK conglomerate alone employed 40,000 men and women who were paid in the Ukrainian hryvnia, as opposed to the separatists' preferred ruble – and given days off on official Ukrainian holidays.

## B. *The 2017 Trade Cessation*

This arrangement was controversial among many who had fought with the Ukrainian government, as well as other hardline Ukrainian nationalists. They argued that trade demoralised government troops as it propped up the separatist regimes – whether through bribes, by providing buses for the statelets' employees (which all but functioned as public transport), by freeing the de facto authorities of the need to create jobs, or simply by giving jobs to people whom they viewed as disloyal.<sup>43</sup> Some also suspected Akhmetov of helping fund the separatist entities in return for the freedom to continue operating, thereby playing a double game in which Kyiv was complicit.<sup>44</sup> A spokesman for Akhmetov's System Capital Management denied this.<sup>45</sup>

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<sup>40</sup> See Crisis Group Report, “*Nobody Wants Us*”, op. cit.; “Ukraine Situation UNHCR Operational Update”, 31 December 2014.

<sup>41</sup> “Из-за торговой блокады бюджет потерял более миллиарда гривен – ГФС” [State fiscal service: the budget has lost over a billion hryvnias due to the trade blockade], *Ekonomichna Pravda*, 23 June 2017.

<sup>42</sup> Crisis Group interviews, Jock Mendoza-Wilson, director of international and investor relations, System Capital Management, Kyiv, October 2017; Georgy Tuka, deputy minister for temporarily occupied territories, Kyiv, September 2018; former Samopomich member, Kyiv, February 2019. Samopomich was a pro-Western political party. See also Milakovsky, “Cut Off: What Does the Economic Blockade of the Separatist Territories Mean for Ukraine?”, op. cit.

<sup>43</sup> Crisis Group interviews, Samopomich member, Kyiv, October 2017; security expert, Kyiv, October 2017; military support activist, Kramatorsk, October 2017; pro-Kyiv youth activist, Kramatorsk, October 2017; Serhey Harmash, Kyiv-based journalist, Kyiv, February 2019; and former volunteer fighter, Kyiv, November 2019.

<sup>44</sup> Crisis Group interview, Samopomich member, Kyiv, October 2017.

<sup>45</sup> Crisis Group interview, Jock Mendoza-Wilson, director of international and investor relations, System Capital Management, Kyiv, October 2017.

The trade arrangement did not last. In January 2017, members of the Donbas volunteer battalion linked to Samopomich, a Ukrainian political party that billed itself as pro-European integration but that was not part of the Poroshenko government, blocked railroads into separatist-held territories. Their goal in setting up this informal embargo, they said, was to prevent “trade in blood”.<sup>46</sup> According to both supporters and staunch critics of their blockade, however, ideology was not the driver. Rather, they say the Donbas battalion’s seed funder, oligarch Ihor Kolomoyskiy, who had active feuds with both Akhmetov and President Poroshenko, had orchestrated events to harm their interests as part and parcel of that rivalry.<sup>47</sup> Ukrainian police tried and failed to break up the blockade.

Meanwhile, de facto separatist authorities expropriated Ukrainian-registered enterprises, reportedly often forcibly.<sup>48</sup> On 1 March, the de facto head of the DPR, Aleksandr Zakharchenko, announced that 40 coal and steel factories, employing over 40,000 workers and including the key D-TEK and Donbas Steel enterprises, were under new management.<sup>49</sup> “None of the Ukrainian owners”, he said, had “gotten in touch” to conclude agreements.<sup>50</sup>

In reality, de facto authorities were struggling to take control. Some pro-Kyiv activists say they received distressed calls from workers reporting violent scuffles lasting for days.<sup>51</sup> But the de facto authorities eventually prevailed. On 15 March, D-TEK issued a press release announcing that it had lost control of its entities in both the DPR and LPR, including mines, coal processing plants, a tidal power station, a thermoelectric power station, and related electricity networks and service providers.<sup>52</sup> The same day, President Poroshenko announced the cessation of all cross-line shipments as well as mass transit, with exceptions only for humanitarian aid.

The trade stoppage spelled the virtual end of Akhmetov’s foothold in separatist-held territory, at least for the time being. D-TEK offered to evacuate staff to government-controlled areas, although representatives say only a few top and middle managers took the company up on it.<sup>53</sup> The new blockade also deprived Ukraine of all of its anthracite mines, as these were now all on separatist-held territory, drastically altering its energy consumption and import patterns.

<sup>46</sup> Svetlana Dorosh, “К чему приведет блокирование торговли на Донбассе?” [What will come of the trade blockade in Donbas?], BBC Ukraine, 13 February 2017.

<sup>47</sup> Crisis Group interviews, corporate spokesperson, Kyiv, February 2019; former Samopomich member, Kyiv, March 2019; and former military volunteer, Kyiv, November 2019.

<sup>48</sup> Crisis Group interviews, Georgy Tuka, deputy minister for temporarily occupied territories, October 2018 and March 2019; activist with pro-government volunteer battalion, February 2019.

<sup>49</sup> Elena Poltavskaya, “Во главе угля: кто помогает восстанавливать экономику Донбасса” [Who’s helping to restore Donbas’s economy], *Izvestiya*, 24 December 2018.

<sup>50</sup> “Под внешнее управление в ДНР перешли порядка 40 предприятий украинской юрисдикции – Захарченко” [Zakharchenko: roughly 40 Ukrainian enterprises in the DPR have fallen under external control], DAN News, 1 March 2017.

<sup>51</sup> Crisis Group interviews, activist with pro-government volunteer battalion, Kyiv, February 2019; D-TEK staff member, Kyiv, February 2019.

<sup>52</sup> “Д-ТЕК заявляє про втрату управління підприємствами, розташованими на тимчасово неконтрольованій території” [D-TEK announces loss of control over enterprises located on temporarily occupied territory], D-TEK, 15 March 2017.

<sup>53</sup> Crisis Group interview, Denys Didenko, head of the general director’s office, D-TEK, March 2019.

Today, Donbas's economy has reached what is for most people a dreary equilibrium on both sides of the line of separation. For the majority of the population, the new realities, albeit decidedly less lucrative than the old, have nonetheless become normal. After two years of dramatic decline in 2014-2015 and the additional shock of trade cessation in 2017, industrial production on both sides of the line is stabilising at a very low level. Consumer prices, after years of rapid increase, are also steady, albeit at a level well above what they were before the war. Pre-existing industrial supply chains and markets have been replaced by new ones, although few Donetsk and Luhansk residents are particularly excited by these arrangements, which feel more like stopgaps than the building blocks of a shining future.

Amid the everyday hardships that many citizens on both sides of the line face are a few perks for some. These include new forms of licit commerce and subsidy, as well as opportunities for corruption and illegal trade. For people in government-held areas, there are now openings to work with foreign organisations; others here can benefit from a program, administered by the de facto separatist authorities, that provides financial assistance and free medical treatment.<sup>54</sup> Some D/LPR residents have been subsisting in part on a combination of low utility prices, due to subsidised Russian gas, and pension payments from both Ukrainian and de facto authorities. Some, dependent on these modest but important sources of income, are fearful of any steps toward reintegration that could result in their loss. Yet this fear should not be mistaken for active or enthusiastic support for the current situation. Nor should it deter the two sides from taking steps to make peace by rebuilding economic bridges.

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<sup>54</sup> See the website of the DPR's Program for the Reunification of the People of Donbas, which claims to engage in "financial, in-kind and other material aid to residents of districts of Donbas under Ukrainian control", as well as the LPR website of the same name advertising the Miloserdie program, providing "help to citizens from the ranks of the peaceful population living on the territory of the Luhansk People's Republic, including those temporarily under Ukrainian control [ie, government-controlled Luhansk oblast]".



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### III. A Bleak Normalcy in Government-controlled Donbas

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#### A. *From Suburbs to Frontier Towns*

The 427km line of separation running through Donbas has not only shaped new economic realities, but it also complicates efforts to gain an accurate picture of the situation. Even the number of people living in Donetsk and Luhansk oblasts – in what previously was the country’s most densely populated corner – is unclear.<sup>55</sup> According to a detailed 2019 study comparing pre-war and post-war government statistics, as well as figures from the de facto authorities, 3.2 million people remain in separatist-held areas.<sup>56</sup> If 2018 Ukrainian government statistics are to be believed, roughly 3.1 million people live in government-controlled Donetsk and Luhansk. Insofar as official statistics suggest that these areas have suffered net population losses, the D/LPR number, at least, appears to be inflated.<sup>57</sup>

The part of Donbas that Kyiv controls had been less populous, less urban and less industrially developed than the areas across the line. The war shifted this dynamic. Oblast authorities in government-controlled Luhansk and Donetsk moved from their separatist-controlled eponymous cities to the smaller and much less developed towns of Sievierodonetsk and Kramatorsk. Kyiv has invested in new infrastructure, saying it wants to turn government-controlled Donbas into a “showcase” of a new, vibrant Ukraine to remind residents that they are better off than their neighbours across the line and to show those neighbours what they are missing.<sup>58</sup> Foreign money has flowed in as aid from the U.S., EU and international organisations. International organisations and NGOs have set up offices staffed in part by foreigners with greater purchasing power than the vast majority of locals.

Overall, residents of government-controlled Donbas say the area’s cities have grown prettier and commerce livelier than before the war. Some residents say the transformation of local towns has resulted in real quality-of-life improvements, such as new social and educational opportunities.<sup>59</sup> “Before the international presence,

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<sup>55</sup> Before the war, the combined population of Donetsk and Luhansk oblasts totalled approximately 6.6 million. Because Kyiv recognises all of Donetsk and Luhansk oblasts as Ukrainian, the government keeps estimates for the total population of these oblasts, rather than merely the parts that it controls. Yet in keeping with its non-engagement with those it terms occupiers, Kyiv has not until recently recognised the birth and death certificates that they issue. Nor have the sides systematically shared information on migration. The separatist authorities, meanwhile, are believed to substantially inflate their constituents’ numbers, partly to attract more funds from Russia. Thus, neither Kyiv’s estimate of 6.2 million for both oblasts as a whole, nor the de facto authorities’ figure of 3.7 million for the territories they control, inspire confidence. Kyiv’s ministry for temporarily occupied territories and displaced persons has estimated that 2.8 million remain in separatist-held territories, but this figure is likely considerably lower than the total, as Kyiv wishes to downplay the urgency of humanitarian engagement with these areas, and thus elide the ministry’s shortcomings.

<sup>56</sup> For detailed estimates, see Yuriy Vishnevsky, “Демографія ОРДЛО” [Demography of the D/LPR], *Delovaya Stolitsa*, 2 December 2019.

<sup>57</sup> *Ibid.*

<sup>58</sup> “Стратегія розвитку 2021” [Development Strategy 2021], Mariupol city official website, 8 April 2020.

<sup>59</sup> Crisis Group interviews, civil society workers, Sievierodonetsk, May 2018; journalist, Sievierodonetsk, May 2018; entrepreneur, Mariupol, May 2018; youth worker, Kramatorsk, April 2019.

there was nothing but dives here”, said a young resident of Sloviansk, a city of 110,000 people about 65km from the front line that now hosts offices of the International Committee of the Red Cross and Save the Children, among other global outfits.<sup>60</sup> A young activist in Selydove, a settlement of about 23,000, likewise said it “was a really grim little town” before the war, noting that developments such as construction of a new road from his town to neighbouring Kurakhove, built to bypass separatist-held territories, had given the town a boost.<sup>61</sup> “There’s real asphalt here now”, said a driver from Kramatorsk, referring to highway repairs carried out by the national government in 2018. “We’ve never had that before”.<sup>62</sup>

Displaced people have also enriched these communities by lending their talents. In the sleepy county seat of Novopskov, a well-regarded neurologist from Luhansk city operates a private practice and provides ultrasound scans that are beyond the local hospital’s capabilities.<sup>63</sup> In provincial Starobilsk, seven women displaced from LPR-held areas set up a thriving community centre in a disused movie theatre.<sup>64</sup> A significant proportion of the legal and humanitarian aid workers in front-line areas are transplants from across the line.

At the same time, much of the new economic activity has come at the expense of vulnerable segments of the population, including local pensioners and IDPs living on fixed incomes. Increased housing prices illustrate the problem. Property owners sought to capitalise on the 2014-2015 influx of new government workers, security personnel, foreign aid workers and IDPs, causing rental prices to spike. Rental costs in Sievierodonetsk’s barren downtown, for example, and in the quiet front-line town of Volnovakha, have risen to levels that rival some middle-class districts inside Kyiv’s city limits, with well-maintained two-bedroom apartments going for about \$200-320 a month before utilities.

Those are steep prices given many locals’ means. The average non-IDP pensioner in government-controlled Donbas received roughly \$140 per month as of May 2020.<sup>65</sup> The average IDP pensioner, regardless of which side of the line he or she actually resides on, receives more, due to the historical prevalence of higher-paying industrial jobs in areas now held by separatists.<sup>66</sup> An able-bodied IDP also benefits from non-pension government support of slightly under \$20.<sup>67</sup> Still, the sum of subsidies and pensions for an IDP generally does not exceed \$275 per month per individual, and more often falls far below. IDPs who find work in government-controlled areas can

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<sup>60</sup> Crisis Group interview, humanitarian volunteer, Sloviansk, October 2017.

<sup>61</sup> Crisis Group telephone interview, Selydove resident, October 2019.

<sup>62</sup> Crisis Group interview, driver, Kramatorsk, April 2019.

<sup>63</sup> Ivan Bukhtiyayev, “Новички, которым заслужено везет” [Beginners who deserve their luck], Farwater, 27 July 2017.

<sup>64</sup> “Как переселенки меняют жизнь райцентра на Луганщине” [How displaced women are changing life in a Luhansk region district centre], *Vostochniy Variant*, 16 June 2020.

<sup>65</sup> Dollar values in this paragraph are converted using the April 2020 mid-month exchange rate and rounded to the nearest five. “Луганська Обласна Державна Адміністрація”, Facebook post, Luhansk Oblast Administration, 15 May 2020.

<sup>66</sup> These jobs generally granted extra pay for dangerous working conditions.

<sup>67</sup> “Сколько в 2020 году будут платить переселенцам” [How much will they pay displaced people in 2020?], Delo.ua, 1 December 2019. The higher value applies to households with one disabled member.

generally afford rent – provided salaries are paid on time – with average monthly salaries for government-controlled Luhansk and Donetsk reaching roughly \$340 and \$430, respectively, in the first quarter of 2020.<sup>68</sup>

Those inclined to sell property located in de facto-controlled territory and buy in the government-controlled counterpart must take account of collapsing prices in their home areas. In Luhansk city, for example, prices of many apartments have halved, such that families hoping to relocate from the former provincial capital must consider whether to, say, sell an apartment valued at \$45,000 before the war for \$20,000 and buy a poorly maintained replacement for a similar price in Sievierodonetsk, or to save money with a \$11-12,000 unrenovated flat in neighbouring Rubizhne.<sup>69</sup>

Because of these high prices and a dearth of state-funded affordable housing options for IDPs, those IDPs who remain in their areas of displacement tend to be those who arrived with larger financial cushions and/or more marketable skills, while the less educated or financially secure typically returned to their homes in separatist-held areas as hostilities cooled in 2015. Many among the latter have become what are known in the region as “pension tourists” – registered IDPs who maintain legal addresses in government-controlled territory, live in separatist-held territories, and make regular journeys across the front line to obtain their pensions and register their presence in government-controlled Ukraine.

Numerous towns near the front line have developed whole new businesses revolving around pension tourism. Hostels have proliferated where those coming to collect their pensions can bunk for about \$2.50 and up, although one can occasionally find an ill-maintained private apartment for as little as about \$4 per night.<sup>70</sup> Other services offered to registered IDPs have included fake addresses, whose owners, for about \$2-5 per month, offer to pose as relatives in case of surprise home visits by authorities. (Ukraine’s Supreme Court deemed these home visits illegal in 2018, but they continued on an ad hoc basis at least into mid-2019.<sup>71</sup>) Some IDPs make money by holding a place for pensioners in line at branches of Oshchadbank, the only bank from which pensioners can retrieve their payments, and where one can stand in a queue for hours.<sup>72</sup>

Combined, such factors have rendered some towns practically unrecognisable, according to residents. Before the war, Donetsk oblast’s Volnovakha district had an economy that revolved largely around its location near a busy railway station with links to Mariupol, Donetsk city and Crimea. Trains no longer go to Donetsk and Cri-

<sup>68</sup> “Соціально-економічне становище Донецької області за січень-квітень 2020 року” [Socio-economic Conditions in Donetsk Oblast, January-April 2020], Donetsk oblast statistics office, 4 June 2020; “Заробітна плата штатних працівників у 2020 році” [Average Salary for Full-time Employees 2020], Luhansk oblast statistics office. Dollar values are rounded to the nearest ten, calculated at the 1 April 2020 rate. The exchange rate has since risen, but so have consumer prices.

<sup>69</sup> See, for example, Anastasia Poltavets, “Чего нам ждать от рынков недвижимости?” [What should we expect from the housing market?], Visti, 20 March 2018.

<sup>70</sup> Crisis Group field observations, Kramatorsk, Sievierodonetsk, Mariupol, Starobilsk and Bakhmut, September 2017-November 2019.

<sup>71</sup> “Замкнутый круг: почему переселенцев продолжают проверять по месту жительства” [A vicious circle: why displaced persons are still getting residence checks], vpl.in.ua, 19 May 2020.

<sup>72</sup> Crisis Group interviews, Right to Protection staff, Mariupol and Novotroitske, May 2018, and Sievierodonetsk, June 2019; Proliska staff, Lysychansk, June 2019.

mea, while a 2015 explosion, believed to have been an act of military sabotage, interrupted service on other lines. Instead, taxi and bus drivers constantly ferry people back and forth from the front-line crossing point of Novotroitske, 10km away.<sup>73</sup>

Volnovakha now has roughly 50,000 registered IDPs, on top of its “permanent” population of just under 96,000.<sup>74</sup> Most IDPs live across the line, in separatist-controlled territory. The town is dotted with nightly rentals catering to visiting pensioners. Those who cannot afford to pay \$2-5 or more per night have been reported to rent bunks in a disused train carriage for less than the equivalent of 50 cents.<sup>75</sup> At the other end of the housing market, military personnel are known to rent one-room apartments at about \$300 a month.<sup>76</sup> New cafés and restaurants depend on their patronage, as does the sushi stall next to one of the checkpoints.<sup>77</sup>

Starobilsk, 70km from the front line in Luhansk oblast in a largely rural section of government-controlled territory, had a pre-war population of 17,000. Now it is officially home to some 46,000 residents, including 29,000 registered IDPs, of whom about 8,000 reportedly live there, while the rest visit periodically to claim their pensions.<sup>78</sup> The influx of new residents has strained the town’s already inadequate communal infrastructure.<sup>79</sup> When Luhansk National University split in two in 2014, with some faculty and students choosing to stay in the LPR, the section that remained under Ukrainian authority moved to Starobilsk with about 3,000 faculty members.<sup>80</sup> Some have been housed in the same dormitories as their students, although city authorities for Sievierodonetsk (the provisional oblast capital) announced plans in January 2020 to move the university there given the strain it was putting on Starobilsk. For pension tourists, shops in the tiny downtown mall have been converted into bare-bones hostels.<sup>81</sup>

These transformations have generated new social tensions. Visiting pensioners note the proliferation of new legal and semi-legal forms of commerce that revolve around their marginal status, expressing a resulting sense of alienation from Ukrain-

<sup>73</sup> Crisis Group observations, Volnovakha and Novotroitske, May 2018.

<sup>74</sup> “Чисельність наявного населення (за оцінкою) по містах та районах на 1 січня 2020” [Present Population (Assessed) in Cities and Districts per 1 January 2020], Chief Statistics Department of Donetsk Oblast; “Переселенці в Донецькій області: скільки і где зареєстровані” [Displaced People in Donetsk Oblast: How Many are There and Where are They Registered?], City of Avdiivka, 4 February 2019.

<sup>75</sup> Crisis Group interview, Right to Protection staff, Mariupol, May 2018.

<sup>76</sup> “Кому на войне жить хорошо? Как жители Волновахи зарабатывают на конфликте” [Who does well in war? How residents of Volnovakha are making money off the conflict], Belsat, 11 June 2019.

<sup>77</sup> Crisis Group interviews, city housing authorities and Right to Protection staff, Mariupol, June 2018. Crisis Group observations, Novotroitske and Volnovakha, June 2018.

<sup>78</sup> “В районах Луганщины переселенцев почти вдвое больше, чем местных жителей” [Luhansk districts have almost twice as many displaced people as local residents], *Donetskiye Novosti*, 15 November 2018.

<sup>79</sup> Crisis Group observation, Starobilsk, December 2017; Crisis Group interview, Lysychansk, May 2019.

<sup>80</sup> “Университет в изгнании: Видит ли Украина свой самый восточный форпост высшего образования?” [University in exile: does Ukraine notice its easternmost outpost of higher education?], *Ostrovok*, 26 October 2015.

<sup>81</sup> Crisis Group discussion, Svyatohirsk, November 2019.

ian authorities and sometimes the local population. “On one hand, it’s great that there’s all this nice new stuff here – but it’s at our expense”, said a pensioner from Donetsk, who was renting a bunk for \$6 per night at a pleasant hostel in Mariupol while she sorted out some documentation.<sup>82</sup> Pensioners at this and other hostels in government-controlled Bakhmut, Kramatorsk and Sievierodonetsk, echoed this sentiment during Crisis Group visits throughout 2017-2019.

At the same time, pensioners residing in Kyiv-controlled areas have been known to express anger that their counterparts across the line typically enjoy higher incomes than they do, when IDP payments and aid from the de facto authorities are factored in.<sup>83</sup> Residents of Kyiv-controlled areas complain of long lines at banks, ATMs and grocery stores caused by pension tourists descending on their towns.<sup>84</sup>

At times, these frustrations interact with broader political or social resentments in a toxic brew. For example, a displaced young man from a DPR-held city who fiercely opposed reintegrating Donbas in the near-to-medium term said: “When you see miners who, to put it mildly, are not well disposed toward Ukraine, coming over here and receiving huge pensions while our own pensioners are barely getting by, this naturally contributes to social tensions”.<sup>85</sup>

Other tensions arise on the job market. Locals of working age complain that IDPs are taking their jobs.<sup>86</sup> Indeed, people who have relocated from the large and relatively cosmopolitan cities of Donetsk or Luhansk may be more likely to have foreign language skills or experience at large companies on their résumés. Their qualifications may be a double-edged sword as far as some people on the government-controlled side of the line are concerned: they bring valuable skills, but they are also tough competitors for jobs.<sup>87</sup>

The COVID-19 crisis has introduced new socio-economic challenges. From the standpoint of reported cases and deaths, government-controlled parts of Donbas are among the parts of the country least affected by the epidemic. Yet the limited capacity of local health facilities, the fact that the region’s flagship facilities were mostly in Donetsk and Luhansk before the war, and the disproportionate share of elderly among this population meant a fairly strict quarantine, which is now tentatively easing, and significant losses to local businesses. The pandemic-driven return of migrant labourers from EU countries also reduced remittance income for many families. Finally, because of prohibitions on civilian crossings of the front line – which remained partly in place as of late July – pension tourism, and with it spending by pensioners from separatist-controlled areas in government-controlled areas, has been curtailed.

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<sup>82</sup> Crisis Group interview, Mariupol, June 2018.

<sup>83</sup> Crisis Group interviews, civil society worker, Svyatohirsk, November 2019; pension tourists, Sievierodonetsk, February 2019.

<sup>84</sup> Crisis Group interviews, Right to Protection staff, Mariupol and Novotroitske, May 2018; civil society worker, Shchastya, February 2020; and Crisis Group observations, Svyatohirsk, November 2019.

<sup>85</sup> Crisis Group fieldwork, Svyatohirsk, November 2019.

<sup>86</sup> Crisis Group interviews, youth worker displaced from Donetsk, Kramatorsk, May 2019; civil society worker displaced from Luhansk, Sievierodonetsk, May 2019; civil society worker displaced within Donetsk oblast, Svyatohirsk, November 2019.

<sup>87</sup> Crisis Group interviews, NGO worker, Sievierodonetsk, April 2019; NGO workers, Sloviansk, January 2020.

## B. *Struggling Industries*

If commerce in government-controlled Donbas has grown livelier in the past two years, workers with technical qualifications are still hard pressed to find well-paying jobs. Industrial production in government-controlled Donetsk and Luhansk oblasts in 2018 stood at about 20 and 15 per cent of 2013 levels, respectively, compared with 80 per cent throughout the rest of the country.

There are two sets of reasons. First, much of the region's heavy industry is concentrated in separatist-controlled territory to which many residents of what is now government-controlled territory used to commute for work.<sup>88</sup> Secondly, industrial production in government-controlled areas has suffered steep drops due to the combined effects of shelling, interrupted supply chains – particularly after the 2017 trade cessation – and the outflow of qualified workers. Unemployment in government-controlled areas of Donetsk and Luhansk oblasts is around 15 per cent, the highest among Ukraine's oblasts and well above the national average of 8 per cent.<sup>89</sup> Wage arrears in the coal industry are a chronic problem. In October 2019, miners in government-controlled Ukraine, mostly in Donetsk and Lviv oblasts, were owed about \$52.8 million in back pay.<sup>90</sup> Lawmakers have taken action to reduce these debts significantly following a string of strikes held in the mine shafts underground.<sup>91</sup>

The fate of several significant entities illustrates the war-related struggles of industries in government-controlled areas. The D-TEK-run Luhansk thermoelectric plant is just outside Shchastya, a one-time suburb of Luhansk city located 5km from the front line. The plant is also now the sole energy supplier for government-controlled sections of the oblast. Shelling destroyed one of its transformers in late 2014, and the cross-line trade cessation has cut the plant off from its anthracite supply since 2017. Its parent company now imports anthracite from a mine it owns in Russia's Rostov oblast, although there are reports – which D-TEK rejects – of the plant continuing to use Donbas anthracite after the 2017 blockade, with product being laundered through Russia.<sup>92</sup> Still, it occasionally has to power down and rely on gas when Russian railways block shipments.

People familiar with the industry have warned that given the unreliable coal supply and the expense of gas, which Kyiv rebuffed requests to subsidise before mandating coal as the primary fuel for power stations in June 2020, the plant borders on

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<sup>88</sup> Another stark indicator of the previous concentration of heavy industry in areas under separatist control is industrial emissions. By 2015, this figure had dropped to just over 900,000 tonnes, and in 2018 it stood at 790,000 tonnes. Luhansk, traditionally third in the yearly rankings behind Donetsk and neighbouring Dnipropetrovsk, reduced its industrial emissions from 442,000 tonnes in 2013 to just over 46,000 in 2018 and dropped to eighth place.

<sup>89</sup> Calculations based on “Індекси промислової продукції за регіонами” on the State Statistics Service of Ukraine website.

<sup>90</sup> “Работники шахты “Капитальная” поднялись на поверхность после двух дней пребывания под землей из-за долгов по зарплате” [Workers at the Kapitalnaya mine come to the surface after two days underground to protest salary arrears], Lb.ua, 6 February 2020.

<sup>91</sup> “Українські шахти закривать не будут – Шмыгаль” [Ukrainian mines will not be shut – Shmyhal], gordonua.com, 7 March 2020.

<sup>92</sup> Crisis Group interview, D-TEK spokesperson, Kyiv, January 2019. Brian Milakovsky, “The War-time Donbas Economy: Can It Be Saved?”, talk at the Wilson Center, Washington, 10 March 2020.

non-viability.<sup>93</sup> This is bad news for livelihoods in Shchastya, where the plant is still the town's main employer, even though its pre-war staff of some 1,600 workers has shrunk to roughly 600.<sup>94</sup> It also bodes ill for regional energy security. Those parts of the oblast under Kyiv's control at present were previously tied to energy grids that are now on the other side of the line but not to grids in other areas that Kyiv now controls. Hence the energy provided by the plant cannot easily be obtained elsewhere.

The coke plant in the town of Avdiivka, a former suburb of Donetsk city whose outskirts straddle the front line, likewise has suffered. It has been shelled hundreds of times, resulting in the 2015 death of an employee. Three of its five former coal suppliers, as well as its sulfuric acid suppliers, are in separatist-held territory. One supplier on the separatist-controlled side of the line, the Zasyadko mine, has come under regular fire and experienced frequent service interruptions since the fighting first broke out. After the 2017 blockade, the plant had to switch its supply to imported coal and sulfuric acid. While managers say it has been functioning at pre-war capacity since mid-2017, they also have warned of possible shutdowns on several occasions due to raw material shortages.<sup>95</sup>

Although other entities struggle with the loss of cross-line links, Donbas Water embodies the risks of sustaining these ties. The sole remaining cross-line utilities provider, Donbas Water serves over one million people on both sides. It operates under Ukrainian state legislation, employing 12,500 people, 7,500 of whom reside in D/LPR areas, and all of whom risk harassment and accusations of treachery by partisans on both sides. Donbas Water retains its headquarters in separatist-held Donetsk city. Staff there meet virtually with counterparts at a new headquarters in the quiet government-controlled town of Pokrovsk. The company is deeply in debt for several reasons. The DPR charges households less for utilities; some customers, such as front-line residents, cannot pay. Others, including enterprises that the de facto authorities expropriated in 2017, may be able to pay, but do not.<sup>96</sup>

Donbas Water's chief filtration station and pumping stations lie near the front line just outside Donetsk city. This infrastructure has suffered weapons strikes from both sides, threatening the water supply of 345,000 people. Hits to chlorine pipes have raised the spectre of deadly leaks. At least twelve employees have been killed on the job since the war began. Many others have been injured, including by small arms fire that the UN assessed was aimed at them.<sup>97</sup>

<sup>93</sup> Crisis Group interview, local official, February 2020. "Прем'єр-міністр України Шмигаль Д.А.", Telegram post, Ukrainian Prime Minister D.A. Shmyhal., 17 June 2020.

<sup>94</sup> Crisis Group correspondence, expert on local industry, Shchastya, November 2019.

<sup>95</sup> "Авдеевский коксохим на грани остановки – гендиректор" [General director: Avdiivka coke and chemical on the brink of shutting down], Ukrinform, 22 June 2018; "Авдеевский коксохим заявляет о дефиците серной кислоты из-за импортных квот" [Avdiivka coke and chemical announces deficit of sulfuric acid due to import quotas], UAprom, 26 February 2020.

<sup>96</sup> See Sophie Lambroschini, "Water in Conflict", Civil M+ and DRA, 2019; Dmytryi Kyrylov, "«Это надолго»: в 'ДНР' впервые повысили коммунальные тарифы" ["This is long-term": DPR raises utilities prices for the first time], Radio Svoboda, 2 September 2019.

<sup>97</sup> "Report on the Human Rights Situation in Ukraine, 16 February to 15 May 2018", UN High Commissioner for Human Rights, p. 6. In an August 2020 report, Crisis Group recommended that the warring sides put a priority on disengaging forces in the filtration station's vicinity. See Crisis Group Europe Report N°260, *Peace in Ukraine (II): A New Approach to Disengagement*, 3 August 2020.

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#### IV. Illicit and Licit Cross-line Trade

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Illicit and informal trade across the front line has declined significantly since the first few years of the war. It is nevertheless key to the livelihoods of many front-line residents, and it may be a boon to some consumers in the statelets. West-east trade, from government-controlled to separatist-held areas, makes up the vast majority. The business model rests on the high quality and low price of Ukrainian consumer goods, particularly foodstuffs, relative to those available across the line. The scale and frequency of smuggling peaked in 2015-2016, when it relied on truck convoys carrying consumer goods. Drivers allegedly paid off representatives of the security services, state fiscal services, national police and others they encountered at various checkpoints.

According to a former member of Fantom, a special subdivision of Ukraine's tax police set up to deal with cross-line contraband, guards on both sides of the line would negotiate temporary local ceasefires in return for the payoffs they received.<sup>98</sup> This Fantom member said the illicit trade lost some of its appeal as units like his became more effective, but never ceased entirely. Some smugglers started using vans and cars to avoid detection.<sup>99</sup> Smuggling declined but still remained conspicuous at places like the pedestrian crossing of Stanytsia Luhanska, fuelling the broad conviction that various authorities (security personnel, local administrators or both) were getting a cut.<sup>100</sup>

Another explanation – besides the advent of Fantom – for the drop in smuggling relates to Ukrainian forces' gradual eradication of the so-called grey zone, areas between the two warring sides' positions where there is no functioning state or quasi-state structure. Between 2015 and the end of 2018, the Ukrainian military periodically announced the "liberation" of new villages along the front line, largely at the hands of the National Guard. These advances reportedly secured negligible strategic benefit. Several interlocutors with military ties believed the purpose was to limit smuggling. According to them, units composed of former volunteer battalions that had been integrated into the National Guard advanced on their own initiative, driven by the desire to crack down on those trading with the enemy.<sup>101</sup> Others suspect that some units simply wanted a share of the trade.<sup>102</sup>

Regardless of their motivation, these operations prompted fresh bursts of displacement and injury, harming civilians.<sup>103</sup> In some cases, they produced new limita-

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<sup>98</sup> Crisis Group interviews, volunteer battalion commander, October 2019; former member of volunteer anti-smuggling brigade, Kyiv, November 2019; Crisis Group interview, economic policy expert, Kyiv, December 2019. The former Fantom member said each Ukrainian government-controlled checkpoint received 60,000 hryvnias, or roughly \$2,400 at the mid-2016 exchange rate, per convoy.

<sup>99</sup> Crisis Group interviews, volunteer battalion commander, October 2019.

<sup>100</sup> Crisis Group interviews, including Luhansk residents, Sievierodonetsk, October 2018; aid worker, Sievierodonetsk, June 2019; aid worker from Lysychansk, Kyiv, October 2019; civil society workers, Shchastya, January 2020.

<sup>101</sup> Crisis Group interviews, volunteer battalion commander, October 2019; former member of volunteer anti-smuggling brigade, Kyiv, November 2019.

<sup>102</sup> Crisis Group interviews, security expert, Kyiv, October 2019; pastor, Svyatohirsk, November 2019.

<sup>103</sup> "Thematic Report: Civilian Casualties in Eastern Ukraine, 2016", Organization for Security and Cooperation in Europe, September 2017, pp. 27-30; Denys Tymoshenko, "Эвакуация Чигарей:



tions on civilian movement and took away a source of livelihood from front-line dwellers who, having lost their pre-war means of generating income, relied on cross-line buying and selling of goods.<sup>104</sup>

While opportunities for illicit trade may have declined since their peak, Kyiv took several steps starting in mid-2019 to ease legal and practical limits on conducting commerce across the line of separation. Authorities renovated the damaged Stanytsia Luhanska bridge, the sole crossing point for 200km of the front line, which is also pedestrian-only. In December, Kyiv loosened restrictions on cross-line movement of goods, replacing a list of permissible items with an exhaustive list of prohibited ones. It also lifted its previous weight limit of 75kg in goods per person, in effect allowing for cross-line trade in bulk, although the other side did not necessarily reciprocate. With the COVID-19-related closure of crossing facilities, this form of commerce came largely to a halt.

While, on the whole, full, bilateral easing of restrictions and opening of crossings stand to benefit front-line communities, they also create some concerns that will need to be managed. On the government-controlled side of the line, some fear that large businesses will move in – drawn by new commercial opportunities – and squeeze out local traders.<sup>105</sup> This anxiety is particularly felt in Donetsk oblast, which has four motor crossings, as opposed to Luhansk with its single footbridge at Stanytsia.

In addition, as the authorities make plans to open Luhansk motor crossings at both Zolote and Shchastya, some Shchastya residents express fear that their town could turn into a hub not just for desirable legal business, but also for illegal trade and bribe-taking along the lines of what has happened at Stanytsia.<sup>106</sup> Recommendations for addressing these concerns are discussed below.

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стоит ли ВСУ идти в ‘серую зону?’” [The evacuation of Chyhari: should the UAF be going into the ‘grey zone’?], Radio Svoboda, 12 April 2018.

<sup>104</sup> Crisis Group interview, schoolteacher, Novoluhanske, July 2019. “Humanitarian Access in Eastern Ukraine: An Overview”, Right to Protection, 2019.

<sup>105</sup> Crisis Group interviews, aid worker, Lysychansk, October 2019; Brian Milakovsky, development expert, Kyiv, October 2019.

<sup>106</sup> Crisis Group interviews, international expert on socio-economic effects of conflict, Kyiv, November 2019; Shchastya residents, January 2019; Sarah Lain, Centre for Humanitarian Dialogue, February 2019.

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## V. Dire Straits in the Statelets

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Like their neighbours across the line, residents of separatist-held areas have partially adjusted to the new war economy, but their new normal is one of dire stagnation. Broken links with government-controlled areas have forced the statelets to orient what remains of their industries toward Russia, whose market is less interested in what they produce. The result is mass unemployment, with Russian subsidies and Ukrainian pensions filling the gaps.

Moscow and Kyiv prop up the de facto statelets' residents' generally poor living standards in an expensive, unhappy and uncoordinated collaboration. Excluding military expenditures, Russia spends roughly \$1.5-2 billion a year, or about 0.1 per cent of its GDP, on the de facto republics, according to Ukrainian government sources and non-government experts.<sup>107</sup> As of 2017, Ukrainian officials estimated that Moscow was covering about 50 per cent of the DPR's budget and about 80 per cent of the LPR's.<sup>108</sup> Russia also has covered all the LPR's energy needs since 2017, when Kyiv cut off the territory due to unpaid debts.<sup>109</sup> Both statelets get their gas from Russia's Gazprom, which keeps household energy costs low relative to those in government-controlled Ukraine. Kyiv's contribution to the statelets' economies takes the form of electricity it provides to the DPR, and the pensions that many so-called pension tourists currently cannot collect due to COVID-19 travel restrictions.

### A. Reorienting to Russia

If industries in government-controlled Donbas have managed to compensate for some of the markets and supply chains lost as a result of the conflict, it has been much more difficult to do so in the statelets, where businesses face logistical, legal and economic barriers of another magnitude. Even businesses in Russia and Belarus cannot legally work with counterparts in statelets that their own governments do not recognise, although neither Moscow nor Minsk imposes legal penalties on companies that ignore the prohibition. Many, however, do not wish to run afoul of Western sanctions on the de facto authorities.

In 2015, politically connected businesses in the breakaways started working around this dilemma by conducting financial transactions through Abkhazia and South Ossetia, two other post-Soviet de facto statelets that have the advantage of being recognised by Russia.<sup>110</sup> Yet these schemes are mostly for high-level smuggling of industrial goods, not for the average small or medium-sized trader.

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<sup>107</sup> “В минреинтеграции подсчитали расходы на России на оккупацию Донбасса” [Reintegration ministry adds up Russia's spending for its occupation of Donbas], Zn.ua, 18 May 2020; Thomas de Waal and Nikolaus von Twickel, *Beyond Frozen Conflict* (Brussels, 2020), pp. 92-93.

<sup>108</sup> “Дерьмо не тонет. Тука рассказал, как Кремль финансирует ЛДНР, а богатеет Курченко”, [Shit doesn't sink: Tuka explains how the Kremlin is financing the D/LPR while Kurchenko gets rich], Glavred, 23 January 2018.

<sup>109</sup> “Россия начала поставки электроэнергии в Донбасс” [Russia begins electricity deliveries to Donbas], BBC Russian, 25 April 2017.

<sup>110</sup> For a good overview of these arrangements, see Anton Troianovski, “To avoid sanctions, Kremlin goes off the grid”, *Washington Post*, 21 November 2018.

The statelets' unrecognised status, along with their precarious food supply in the war's early years, created an opening for middlemen who buy in bulk in their home countries and then sell in bulk in the de facto republics, sometimes unbeknownst to the original producers.<sup>111</sup> Such grey imports from Russia and Belarus are the source of many consumer products.

The dairy industry presents a valuable illustration of the problems businesses in the de facto republics face. Even before the 2017 trade cessation, limits on cross-line shipments led to scarcities in consumer goods as well as production drops in some industries. Pre-war milk processing in Donbas had been concentrated in areas that are now under separatist control.<sup>112</sup> With the advent of a front line, plants in DPR territory were cut off from large raw milk suppliers in Ukraine's Zaporizhzhia and Kharkiv oblasts, while smaller suppliers were largely concentrated in villages along the front line that were not easily accessible.<sup>113</sup> The territory's major cattle farm likewise was cut off from its feed supplier in government-controlled Ukraine. In the winter of 2014-2015, DPR authorities reported milk shortages throughout their de facto territory.<sup>114</sup>

Locals on both sides of the statelets' Russian borders turned to creative solutions that alleviated but did not erase the problem. As Russian producers could not legally ship their products into the unrecognised republic, staff at the Donetsk city plant drove each morning to the Russian border to meet them and fill up their tubs with the raw milk that they then processed.<sup>115</sup> As Russian raw milk was and still is costlier than its Ukrainian counterpart, such schemes inevitably increased prices. According to a December 2015 report, milk labelled as "produced in the republic" cost about \$0.86 cents per litre at the then-exchange rate as compared to prices in government-controlled areas ranging from roughly \$0.37 to 0.74.<sup>116</sup> Today, while milk shortages have disappeared, this price differential largely remains in place.

Official Russian statistics suggest that deals struck to keep milk and other food products flowing to the statelets have been a gift to some Russian producers. According to Russian government figures, exports to Ukraine in 2018 totalled \$9.5 billion, while Ukraine's corresponding statistics say the country imported about \$5.2 billion in goods from Russia.<sup>117</sup> The separatist-held areas almost certainly account for the

<sup>111</sup> See, for example, "Донбасс – крупнейший экспортный рынок для пива и мяса из России" [Donbas is the biggest export market for Russian beer and meat], *Vedomosti*, 20 February 2017.

<sup>112</sup> Production of milk in government-controlled areas presently stands at about 5 per cent of pre-war levels. "Виробництво окремих видів продукції за 2011-2018 роки" [Production of specific products, 2011-2018], Chief Statistics Department of Donetsk Oblast.

<sup>113</sup> "Молочные Реки 'ДНР'. Обзор молочки на прилавках ДНР" [Rivers of milk in the DNR: an overview of milk products on DNR shelves], *OstroV*, 23 December 2015.

<sup>114</sup> "В ДНР пообещали помочь Луганской республике молоком" [The DNR promises to help the Luhansk Republic with milk], *Korrespondent*, 30 January 2016.

<sup>115</sup> "Молочное производство в Республике – исследование DNR Live" [Milk production in the Republic – DNR Live investigation], *DNR Live*, 2 July 2017; "Rivers of milk in the DNR", *op. cit.*

<sup>116</sup> "Сколько стоят продукты на Украине" [How much food items cost in the Ukraine (sic)], *Optimist*, 8 December 2015.

<sup>117</sup> "Итоги внешней торговли с отдельными странами", Russian Federation Federal Customs Service website; "Експорт-імпорт товарів за країнами світу у 2016 році" [Export-import of Products by Country, 2016], State Statistics Service of Ukraine website.

\$4.3 billion difference. Ukraine barely imported any meat or meat products from Russia in 2013-2014, yet in 2016-2017 Russian state fiscal service statistics indicated that 30 per cent of the country's meat and beer exports were now going to Ukraine – despite Kyiv's trade embargoes on these Russian products. According to various investigative reports, separatist-held territories accounted for these imports, with major meat processing plants in both statelets using supplies from Russia.<sup>118</sup>

The Russian region that has gained the most from the statelets' economic straits is Rostov, just across the border from Donbas. Per an early 2017 news report, the number of firms specialising in bulk sales there had doubled in the past two years to 328, while the number of companies specialising in transportation of goods had also risen 160 per cent to 787.<sup>119</sup> Economists and residents credit the statelets with reviving Rostov's market. The region's exports totalled 5.8 billion dollars in 2013, a number that dipped to 4.7 billion in 2014 before rising to 9.1 billion in 2018.<sup>120</sup> "They worship us in Rostov", said a Donetsk city resident.<sup>121</sup>

The affection may not go both ways, however, with statelet residents complaining that food products from across the border fall far short of those from Ukraine and often appear to be poor-quality items unloaded by firms on consumers with little choice.<sup>122</sup> "They're dumping all sorts of crap on us", was another Donetsk resident's analysis.<sup>123</sup> Exports fell to 8.3 billion in 2019.<sup>124</sup>

If Rostov's small business community gained from the conflict, Russian officials are hardly celebrating it as a success. Bulk sellers tend to operate outside the formal economy and therefore pay no taxes. Moreover, this trade does little to alleviate the breakaway regions' dire economic situation, which Moscow must continue to subsidise. Some Russian officials believe that they should legalise trade with the statelets in order to open it up to legal business and taxation.<sup>125</sup> But legalising trade with unrecognised states could be seen as tantamount to recognition, which Russia has so far made a conscious decision to avoid, given that its preferred outcome remains returning the territories to Kyiv's nominal jurisdiction.

Reintegration would likely end Rostov's windfall, rendering its products less competitive as higher-quality, more affordable products many statelet residents have missed return to the shelves, and as firms reorient their supply chains back to neighbouring parts of Ukraine. Yet reintegration would also ensure that those firms that could compete for the Donetsk and Luhansk markets could do so legally.

<sup>118</sup> "Donbas is the biggest export market for Russian beer and meat", op. cit.

<sup>119</sup> "Кто и как зарабатывает на поставках продуктов в ДНР и ЛНР" [Who earns on produce shipment to DNR and LNR and how they do it], *Vedomosti*, 20 February 2017.

<sup>120</sup> "Внешняя торговля субъектов Российской Федерации" [External Trade by Subjects of the Russian Federation], Russian Federal Customs Service website.

<sup>121</sup> Crisis Group discussion, Donetsk city resident, Kyiv, October 2019.

<sup>122</sup> Crisis Group interviews, Donetsk city residents, Kyiv, October 2019; economist, Kyiv, October 2019; Svyatohirsk, November 2019.

<sup>123</sup> Crisis Group interviews, October 2019; Svyatohirsk, November 2019.

<sup>124</sup> "External Trade by Subjects of the Russian Federation", op. cit.

<sup>125</sup> Crisis Group discussion, Russian official, Moscow, May 2019.

## B. *The Coal Trade*

Prior to the 2017 trade cessation, Ukrainian-registered industrial entities were still the major employers in the statelets. As mentioned previously, Akhmetov's enterprises alone employed 40,000 men and women. After the blockade, Russia and its proxies gained the opportunity – or, as the case may be, burden – of keeping these entities functioning and their workers employed and paid. Coal lay at the crux of the problem. De facto authorities now had over 60 mines to manage, although many had already stopped work and been left to flood when hostilities began. As for those still functioning, the statelets had lost access to the industries and heating plants across the front line that depended on their product. “We have neither the means nor the mechanisms of payment for coal shipment [to government-controlled areas]”, the de facto heads, Aleksandr Zakharchenko and Igor Plotnitsky, announced. “We will reorient all our production processes toward the Russian market and toward other countries”.<sup>126</sup>

Moscow now had to navigate a competing set of interests. On one hand, it was keen for the statelets both to avoid economic collapse and to become more economically self-sufficient so that it could spend less of its own budget on their upkeep. To that end, it wanted to help them sell their products. A former Kremlin official said Putin had, following the blockade, “given orders” to his inner circle to find domestic markets for Donbas's coal and steel, although this aide also conceded that the orders proved ineffective.<sup>127</sup>

On the other hand, Russia's domestic markets already had coal surpluses, and its coal export market was crowded. Mines just over the border from the statelets in Rostov, in what is known as Russian Donbas, had long since been “optimised”, ie, mostly closed, leaving most Russian anthracite to be mined in southern Siberia's Kuzbas region. There, together with metallurgy, coal is the economic mainstay of an otherwise depressed area. But the Kuzbas coal industry was already approaching crisis by 2017, with production surpluses and falling global demand.<sup>128</sup> In short, Donbas coal was one of the last things that many Russian officials or consumers needed or wanted around.<sup>129</sup>

On 14 March 2017, Zakharchenko announced the first shipments of 95 wagons of coal across the Russian border. He admitted to “problems with marketing and with certain types of documents” – in other words, trouble with exporting as an unrecognised political entity and with finding buyers. The first hurdle proved easier to clear than the second: in April, the DPR leadership issued a decree inaugurating a new company, Vneshtorgservis (VTS), that would manage coal and metallurgy assets, and

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<sup>126</sup> “Совместное заявление Глав ДНР и ЛНР Александра Захарченко и Игоря Плотницкого” [Joint statement by DPR and LPR heads Aleksandr Zakharchenko and Igor Plotnitsky], Donetsk News Agency, 27 February 2017.

<sup>127</sup> Crisis Group interview, former Kremlin official, Moscow, August 2019.

<sup>128</sup> “Кузбасс: кризис моно модели” [Kuzbas: monomodel in crisis], *Novosti Sibirskoi Nauki*, 27 August 2018; “Угольная отрасль в ожидании доброй надежды” [The coal industry is waiting for a ray of hope], *Kontinent Sibir*, 31 March 2020.

<sup>129</sup> Crisis Group interview, former Kremlin official, Moscow, August 2019. See also Denys Kazanskiy, “The age of marauders”, *The Ukrainian Week*, 2 February 2020.

the marketing and export of product.<sup>130</sup> The company was registered in South Ossetia. Its purported heads included a former deputy governor of Russia's Irkutsk region, now a deputy head of the DPR, and a young Ukrainian billionaire associate of ex-president Yanukovich who had settled in Moscow.<sup>131</sup>

Investigative journalists and anti-corruption activists have explored the resulting schemes extensively in English-language, Ukrainian, Russian, Belarusian and Polish publications, and D-TEK staff corroborate the general picture, if not the details.<sup>132</sup> The schemes are reported to work roughly as follows. Coal reaches Russia from the statelets by rail, through an arrangement with Russia's state railroad. It then gets mixed with Russian coal, either from one of Rostov's few remaining mines, or in Kuzbas, rendering it harder to identify as Donbas coal. It is then shipped abroad from two ports in Rostov oblast. Some reports also have it moving by rail farther west via Belarus, or through Abkhazia.<sup>133</sup> Through such schemes, some coal originating in the statelets has almost certainly found its way to government-controlled Ukraine, which, following the 2017 blockade, increased imports of Russian anthracite – meaning that Ukraine has probably bought its own coal from Russia.<sup>134</sup> Firms registered in Switzerland and other tax havens all reportedly play bit parts in these schemes.<sup>135</sup>

VTS gradually consolidated control over most of the statelets' coal and steel assets throughout 2017 and 2018.<sup>136</sup> The August 2018 assassination of Aleksandr Zakharchenko may or may not have been an element of this consolidation.<sup>137</sup> Many mines, however, remained in disuse: Ukraine's minister of ecology and natural resources announced in 2018 that 36 flooded mines in the D/LPR were beyond repair and were now threatening to poison the surrounding water and soil.<sup>138</sup>

<sup>130</sup> “Указ Главы Донецкой Народной Республики № 77 от 04.04.2017” [Head of Donetsk People's Republic Order No. 77, 4 April 2017].

<sup>131</sup> Плуя Varabanov and Yekaterina Yeremenko, “Партнер у нас один – Российская федерация” [We have one partner – the Russian Federation], *Kommersant Vlast*, 6 May 2017.

<sup>132</sup> Crisis Group interview, D-TEK staff, Kyiv, February 2019; “Кровавый уголь: кто в Беларуси зарабатывает на поставках антрацита из Донбасса?” [Blood coal: who in Belarus is making money delivering Donbas anthracite?], Belsat, 29 October 2019; Karolina Baca-Pogorzelska and Michal Potocki, *Czarne Zloto* [Black Gold], excerpts at *Novaya Polsha*; Joby Warrick and Steven Mufson, “Dirty fuel”, *Washington Post*, 12 June 2020; “Схема на \$290 миллиард: кому Россия продает уголь из Донбасса” [A \$290 billion scheme: who does Russia sell Donbas coal to?], *Liga Business*, 26 June 2019; “Киев научит Европу распознавать уголь из Донбасса” [Kyiv will teach Europe to recognise coal from Donbas], RBC, 14 June 2017.

<sup>133</sup> “A \$290 billion scheme: who does Russia sell Donbas coal to?”, op cit.

<sup>134</sup> Inna Koval, “Лишний уголь: почему бастуют шахтеры оккупированного Донбасса” [Excess coal: why miners in occupied Donbas are striking], *Mind*, 15 June 2020.

<sup>135</sup> Crisis Group interviews, Moscow, September 2019. Nick Kennedy, “Why ‘blood coal’ is critical for Russian success in Ukraine”, *International Policy Digest*, 10 May 2019. In December 2019, the website Delo.ua reported that the Swiss company Adelon AG had denied any role in this or any other criminal scheme. The company stated that it dealt only with Russian coal from the Kuzbas basin. “Швейцарская Adelon AG отрицает причастность к поставкам угля с оккупированных территорий” [Swiss firm Adelon AG denies involvement in deliveries of coal from occupied territories], Delo.ua, 30 December 2019.

<sup>136</sup> De Waal and von Twickel, *Beyond Frozen Conflict*, op. cit., pp. 96-98.

<sup>137</sup> Crisis Group interview, spokesman for Ukrainian oligarch, Kyiv, January 2019. Milakovsky, “The Wartime Donbas Economy: Can It Be Saved?”, op. cit.

<sup>138</sup> “Podiia [Event] with Mykola Veresnya”, Pryamyi TV, 14 January 2018.

Ultimately, neither consolidation nor the sophisticated smuggling schemes detailed above could turn Donbas coal into a hot commodity. The one country that had depended on it, Ukraine, still needed some but had partly moved its thermoelectric power stations to gas coal, which is dirtier but readily available in government-controlled territory.<sup>139</sup> Moreover, VTS has aroused the ire of miners and local officials due to its alleged chronic non-payment of salaries, as well as running up large debts for the product itself.<sup>140</sup> By the end of 2019, VTS allegedly owed about \$390 million to its daughter entities, resulting in massive wage arrears and regular miners' strikes.<sup>141</sup> A project billed as a means of saving jobs and making the statelets self-sufficient appears instead to be viewed by many residents as something that left them even worse off.<sup>142</sup>

By the spring of 2020, as COVID-19 ravaged economies and drove down fossil fuel usage worldwide, some economists were asking whether coal had a future – not just in Donbas, but at all.<sup>143</sup> Miners in the D/LPR were reporting having gone months on end without pay, and strikes, the largest since before the war, broke out throughout the territory. In May 2020, the de facto heads of both statelets announced that VTS-run enterprises in their jurisdictions would be closed, with others consolidated into a new, dramatically streamlined holding.<sup>144</sup> The move looks like a virtual admission of what many workers had long since realised – that these schemes heralded as part of an industrial pivot to Russia were unlikely to deliver much besides disappointment.

### C. *The Labour Market*

Ukrainians who oppose the speedy reintegration of Donbas sometimes argue that “all the decent people have long since left” the separatist-held areas – wherein “decent” serves as shorthand for educated, financially solvent and loyal to the Ukrainian state.<sup>145</sup> It is true that many able-bodied adults who had easily transferable skills and did not support the separatist cause have left – as have many who may have been in-

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<sup>139</sup> Inna Koval, “Угольное спасение: почему ТЭС переходят на газовый уголь вместо антрацита” [Coal salvation: why thermoelectric power stations are switching to gas coal instead of anthracite], *Mind*, 6 November 2017.

<sup>140</sup> “Структуры Курченко не платят за вывоз угля и металла из ОРДЛО” [Kurchenko's structures don't pay to ship coal and metal out of the D/LPR], *Zn.ua*, 18 March 2020; “Угольщики Донбасса пожаловались властям на долги компании Курченко”, *RBC*, 10 July 2020.

<sup>141</sup> Svetlana Burmistrova and Vladimir Dergachyov, “Курченко получил отсрочку по долгу за уголь Донбасса” [Kurchenko gets extension on his debt for Donbas coal], *RBC*, 22 November 2019.

<sup>142</sup> Crisis Group interviews, economic analyst based in Sievierodonetsk, Kyiv, October 2019; former deputy mayor and current resident of DPR-held city, Svyatohirsk, November 2019; expert on peacebuilding dialogue, Svyatohirsk, November 2019.

<sup>143</sup> Jonathan Watts and Jillian Ambrose, “Coal industry will never recover after coronavirus pandemic, say experts”, *The Guardian*, 20 May 2020.

<sup>144</sup> “Сергей Козлов: Шахты получают импульс к развитию” [Sergei Kozlov: mines will have new impetus to develop], LPR website, 7 May 2020.

<sup>145</sup> Crisis Group interviews, youth club workers, Kramatorsk, August 2017; military support volunteer, Mariupol, April 2018; former volunteer fighter, Kyiv, November 2019; researcher with international organisation, November 2019. See Facebook post, Olga Malchevska, 26 April 2019; and Olga Malchevska, “The killer queues of Ukraine”, *BBC World*, 28 May 2019.

different or opposed to the Ukrainian government's cause.<sup>146</sup> Those who left include state employees who took up the government's offer to transfer to posts in government-controlled areas, as well as other white-collar professionals, such as information technology workers, whose jobs were not tied to a physical location. It also includes some skilled industrial workers, many of whom have sought work in Poland or Russia. The remaining working-age population is largely faced with an unsavoury set of options: grinding poverty, grey market work or jobs in the de facto civil, security and military structures.

Low salaries in the statelets are a sore point, both for residents and their de facto leaders. As of January 2019, the official minimum wage in the DPR and LPR was 2,514 and 6,064 rubles per month respectively, or about \$40 and \$100 at the then-exchange rate.<sup>147</sup> In April 2020, the DPR raised the minimum wage to 3,168 rubles, but with the ruble having fallen to a four-year low as oil prices crashed, this hike amounted to an increase of only \$4. Meanwhile, the minimum wage in the LPR remains at 6,064 rubles, which now comes to less than \$85.<sup>148</sup> The official minimum wage in government-controlled Ukraine is about \$175.

Average monthly salaries in the statelets also compare poorly with those across the line. While the exact figure for the LPR is unknown, it is likely similar to that for the DPR: about \$185 as of April, as opposed to about \$340 and \$430 in government-controlled Donetsk and Luhansk in the same period.<sup>149</sup> Leonid Pasechnik and Denis Pushilin, the de facto heads of the LPR and DPR, respectively, have both promised to raise pensions, as well as salaries for civil and public service workers, to equal those in Rostov oblast, where the average salary in the general work force is now around \$480 and the average pension in the low \$200s, by 2022.<sup>150</sup> They did so in separate

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<sup>146</sup> Crisis Group interviews, current and former residents of Donetsk and Luhansk oblasts, including Vostok SOS staff, Sievierodonetsk, October 2017; Donbas SOS staff, Sievierodonetsk, August 2017; former Donetsk and Horlivka residents in Kramatorsk, August 2017; current Donetsk residents in Kramatorsk, October 2017; residents of Luhansk and Antratsyt, Sievierodonetsk, December 2017; former resident of Luhansk, Stanytsia Luhanska, December 2017; former residents of Donetsk, Kyiv, January 2018; Right to Protection staff, Kyiv, April 2018; Donetsk residents, Mariupol, May 2018; city authorities, Mariupol, May 2018; Right to Protection staff, Mariupol, May 2018; former Horlivka resident, Kramatorsk, May 2018; former Donetsk residents, Kyiv, June 2018; international organisation staff, Kramatorsk/Mayorsk, July 2018; former Donetsk resident, Sloviansk, October 2018; former Donetsk resident and parliamentarian, Kyiv, February 2019; current and former Donetsk and Luhansk residents, July 2019 and October 2019.

<sup>147</sup> "В народном совете прошла информационно-консультативная встреча депутатского корпуса с министерством труда и социальной политики" [People's council holds informational-consultative meeting with deputy corps and labour and social policy ministry], DPR People's Council website, 21 January 2019; "Размер минимальной зарплаты в ЛНР с 1 января будет составлять 6064 руб. – Минсоцполитики", Luganskiy Informatsionny Tsentr, 24 December 2019.

<sup>148</sup> "Правительство Донецкой Народной Республики, постановление от 30 апреля 2020г No.22-1", DPR website, 30 April 2020.

<sup>149</sup> Nikolaus von Twickel, "The State of the Donbass: A Study of Eastern Ukraine's Separatist-Held Areas", 3 DCFTAs, 1 March 2019.

<sup>150</sup> "Денис Пушилин: к первому января 2022 года зарплаты и пенсии в Республике будут доведены до уровня Ростовской области в РФ" [Denis Pushilin: salaries and pensions in the Republic will be raised to the level of the Russian Federation's Rostov oblast by January 2022], Denis Pushilin website, 9 January 2020; "Зарплаты и пенсии в ЛНР за два года должны вырасти до уровня Ростовской области – Пасечник" [Salaries and pensions in the LNR should



but nearly simultaneous and identical statements, suggesting coordination with the Kremlin.

Pushilin at the same time promised to “expend every effort to bring the salaries of our coal miners and metal workers to comparable levels”, yet notably did not say how many such jobs he hoped to retain.<sup>151</sup> The DPR claimed that miners earned an average of about \$400 in 2018 at the then-exchange rate, but this contention seems dubious. Miners in Rostov were reportedly earning less than \$300 in January 2019, and comparisons of job postings suggest that coal workers in the oblast generally earn multiples of what their D/LPR counterparts do in similar positions.<sup>152</sup> Yet many in the DPR were not even getting their low wages. Investigative journalists began reporting at the time that authorities were placing industrial workers on unpaid leave *en masse* and preventing them from exiting the territory.<sup>153</sup>

Experts and residents offered various explanations for the unpaid leave policy. Some argued that authorities wanted to hold on to all the qualified workers they could keep. Other contended that authorities sought to limit outside knowledge about the dire state of local industry.<sup>154</sup> Concurrently, some speculated that *de facto* authorities do not let industrial workers leave because they are recruiting for the 20,000-30,000 strong People’s Militia, which forms the bulk of the statelets’ Russian-led forces. Militia pay was and remains lower – about \$230 to \$390 per month in late 2019 – but is said to at least be regular.<sup>155</sup> With downsizing picking up speed in 2020, and rumours of increasing harassment and imprisonment of those who strike for their wages, enlistment may become an increasingly attractive option.<sup>156</sup>

Apart from joining with separatist forces, one can make decent money in the *de facto* civil services. Bucking the trend of lower salaries in the statelets, some positions in their 38 “government” ministries may pay more than civil service positions across the line. The best-paid civil servants in the D/LPR may earn up to \$780 per month. By comparison, Ukrainian government ministers received nominal salaries

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rise to the level of Rostov oblast within two years – Pasechnik], Luganskiy Informatsionny Tsentr, 9 January 2020; “Среднемесячная номинальная начисленная заработная плата по видам экономической деятельности” [Average monthly nominal allocated worker’s salary by type of economic activity], Rostovstat, March 2020; “Страховые пенсии неработающих пенсионеров Ростовской области вырастут с начала 2020 года 19” [Social security pensions for non-working pensioners will rise from the beginning of 2020], Rostof, December 2019.

<sup>151</sup> “Денис Пушилин: к первому января 2022 года зарплаты и пенсии в Республике будут доведены до уровня Ростовской области в РФ”, Glava DNR, 9 January 2020.

<sup>152</sup> “СМИ: шахтеры Ростовской области объявят голодовку из-за долгов по зарплате”, [Press: Rostov oblast miners announce hunger strike due to salary arrears], Donnews, 19 January 2019; “Зарплата шахтера: сколько получают горняки?” [A miner’s wage: how much do workers make?], dprom.online, 24 April 2020.

<sup>153</sup> Hanna Krasnoperova, “Почему шахтеров не выпускают из ОРДЛО” [Why they’re not letting miners out of the D/LPR], Radio Svoboda, 26 May 2018; “МинУгля ДНР рассказал про зарплаты шахтеров в ДНР” [DNR coal ministry discusses miners’ salaries in DPR], Donetsk Afisha, 16 February 2019.

<sup>154</sup> Crisis Group discussions, Donetsk residents, Svyatohirsk, November 2019.

<sup>155</sup> Crisis Group discussions, Donetsk residents, Svyatohirsk, November 2019. “Сколько платят наемникам ЛДНР” [What they pay the D/LPR mercenaries], Radio Svoboda, 1 July 2019.

<sup>156</sup> See, for example, the “Шахтеры Донбасса” group on VKontakte, post from 10 June 2020.

of roughly \$650 per month before getting raises in 2020.<sup>157</sup> Among the former are many who may not have initially supported the separatist cause. Some claim that they stayed out of a sense of duty to their communities, and ended up trapped when they were blacklisted by Ukrainian security services or vigilante groups, meaning that they could not hope to relocate to government-controlled Ukraine without unpleasant run-ins with the law.<sup>158</sup> Some are also banned from leaving by the de facto authorities themselves, who view them as potential carriers of state secrets. In these cases, decent salaries sweeten what is otherwise a bad deal.

“Those of my acquaintances who are more socially adapted, have an income and a higher quality of life believe in the Republic and want it to develop”, a resident of a DPR-held city with strong local networks told Crisis Group. On the other hand, she reported that vulnerable individuals of working age, including sex workers and HIV-positive people, say they feel “their country is Ukraine and they want to live in Ukraine”.<sup>159</sup> Another DPR resident, a former deputy mayor who had kept up relations with a broad range of professionals and civil servants on both sides of the line, disputed the notion that the republic’s higher earners actually believe in the statelet’s development. Their support, he argued, was based on “having no way out; fear of losing what they have, and fear of, God forbid, responsibility”.<sup>160</sup> The final words allude to fears of prosecution for crimes against the state upon the regions’ return to Kyiv’s jurisdiction. Such fears, even for rank-and-file civil servants, reflect the absence of a clear approach to transitional justice on Kyiv’s part, which might help spell out who is and is not likely to be a target for law enforcement.

#### D. *Pensions and Pensioners*

The official retirement age for men in Ukraine is 60. For women, it is 59.5. Thus, because at least one quarter of the statelets’ population is over 60, pension payments play a substantial role in the region’s economy.<sup>161</sup> These are paid both by local authorities, courtesy of Moscow, and by Kyiv, in a microcosm of the warring sides’ grudging burden sharing.

While expert estimates for Russia’s non-military spending on the statelets hover around \$2 billion annually, the de facto authorities spend roughly \$1.1 billion annually on their 1.1 million pensioners.<sup>162</sup> As of mid-2019, the average monthly pension in the DPR was 6,145 rubles, or roughly \$97 using the exchange rate at the time, while

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<sup>157</sup> See “Пристайко о зарплатах министрам в 16 тысяч гривен: это неуважение к государству” [Prystaiko on 16,000 hryvnia ministerial salaries: disrespect for the state], Focus, 17 January 2020.

<sup>158</sup> Crisis Group interviews, DPR residents, Svyatohirsk, November 2019; DPR resident, Kyiv, October 2019; researcher formerly based in Donetsk, Kyiv, October 2019.

<sup>159</sup> Crisis Group correspondence, DPR resident, November 2019.

<sup>160</sup> Crisis Group discussion, DPR resident, April 2020.

<sup>161</sup> One quarter is likely a significant underestimate. Twenty-three per cent of Ukrainians are elderly, while 36 per cent of Donetsk and Luhansk oblast residents are, according to the UN Office for the Coordination of Humanitarian Affairs (OCHA). See “Ukraine 2020 Emergency Response Plan for the COVID-19 Pandemic”, OCHA, 26 March 2020.

<sup>162</sup> “Экс-советник Путина оценил траты России на ‘ЛДНР’”, [Ex-adviser to Putin assesses Russia’s spending on the ‘D/LPR’], Glavred, 18 November 2018.

the LPR equivalent was just under 5,000 rubles or about \$79. Authorities acknowledge that these payments, officially known as financial assistance, not pensions, are below subsistence levels.<sup>163</sup>

Kyiv, for its part, has paid out roughly \$750 million annually between 2015 and 2018 in pension payments to registered IDPs, although records show this amount accounts for just half of those who were on the pension rolls before the war in areas now held by the separatists.<sup>164</sup> For the 500-600,000 people who receive these payments, this income is crucial. Despite small incremental increases over the following year, in 2019 the International Organization for Migration found that 41 per cent of registered IDP pensioners in the statelets lived on less than \$115, compared with 28 per cent of IDP pensioners across the line.<sup>165</sup>

Under Poroshenko, Kyiv took numerous steps to limit pension access for residents of the de facto republics. These include the aforementioned requirement that recipients formally reside in areas Kyiv controls, as well as regulations limiting the amount of back pay the state owes if pensions are cut off for an extended period. Today, the number of ostensibly eligible people from the separatist-held territories who lack access to their government pensions exceeds the number who receive them. According to official figures from November 2019, pensioners who lived in the present-day D/LPR prior to the conflict (that is, those who currently reside there, as well as those who have relocated) include roughly 700,000 who are not getting their Ukrainian state pensions.<sup>166</sup> This number does not include those who have reached pension age since the conflict began.

Legal experts and IDP rights activists characterise Kyiv's pension access limitations as an attempt to economise at the expense of a vulnerable and largely voiceless demographic, an assessment some officials share.<sup>167</sup> Certainly, financing pensions creates a major funding challenge for Kyiv. Pensions are meant to be paid for with taxes on all officially employed Ukrainians. But the fact that Ukraine's population is disproportionately elderly translates into a large ratio of pensioners to working people. Low legal retirement ages, and the large percentage of working-aged people employed in shadow economies, exacerbate the problem.<sup>168</sup> The loss of tax revenue from workers residing in the statelets does not help. Thus, Ukraine's national pension

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<sup>163</sup> "Размер минимальной пенсии в ЛНР с 1 января составляет 4,8 тысячи рублей" [Minimum pension in LNR is 4,800 rubles as of 1 January], GTRK LNR (State Television and Radio Broadcasting Company of the Luhansk People's Republic), 20 January 2020.

<sup>164</sup> See von Twickel, *The State of the Donbass*, op. cit.

<sup>165</sup> "Ukraine 2020 Emergency Response Plan", OCHA, op. cit., p. 45.

<sup>166</sup> "В раду внесли законопроект выплате пенсий жителям оккупированной территории" [Draft law on pension payments to residents of occupied territory submitted to parliament], *Ukrainska Pravda*, 27 November 2019.

<sup>167</sup> Crisis Group interviews, Right to Protection staff, Kyiv, September 2018 and April 2019; social policy ministry employee, Kyiv, September 2019; human rights official, Kyiv, September 2018; Georgy Tuka, deputy minister for temporarily occupied territories, Kyiv, April 2019.

<sup>168</sup> "The Ukrainian Pension System at a Crossroads: Key Policy Messages from the Recent ILO Report", International Labour Organization (ILO), 29 January 2020.

fund has long faced overwhelming shortfalls. In 2016, Kyiv's deficit ballooned to 5.5 billion, or 6 per cent of GDP.<sup>169</sup>

The International Monetary Fund (IMF) made reducing the deficit a key requirement for macro-economic assistance, and by the end of 2019, Kyiv could point to considerable success, with the deficit down to \$1.2 billion.<sup>170</sup> The Fund attributes the decline to Kyiv's adoption in October 2017 of a law reducing options for early retirement and providing incentives to work longer. In February 2020, Ukraine's social policy ministry promised further reductions over the course of the year, thanks to efforts to legalise shadow economies.<sup>171</sup> The ministry made this pledge before the COVID-19 outbreak, whose resulting restrictions have led to a spike in unemployment and a resulting drop in income taxes reaching the pension fund.<sup>172</sup>

This picture looks even grimmer, moreover, when one considers that Ukraine's unpaid debt to pensioners in non-government-controlled areas totals \$3.5 billion as of early 2020.<sup>173</sup> In 2018, Ukraine's Supreme Court, citing international precedent and human rights norms, ruled in essence that Kyiv's moves to restrict pension access to citizens residing in areas under government control were illegal.<sup>174</sup> It follows that Kyiv is legally obligated to repay these debts in full. Doing so inevitably would increase the deficit substantially, but the World Bank and other international financial institutions may be able to help, as described below.<sup>175</sup>

Kyiv's economic struggles, and the significance of its pension payments to the economy of separatist-held areas, render its policies deeply controversial on both sides of the line. Some nationalist activists and politicians have argued over the years that citizens living in the statelets should be cut off from their Ukrainian pensions entirely, suggesting that paying pensions reduces the financial burden on Russia and may benefit disloyal citizens.<sup>176</sup> Others, including some former social policy ministry staff, as well as Ukrainian legal activists who were instrumental in bringing the issue to the Supreme Court's attention, criticise existing limitations on pension access, calling them illegal and immoral.<sup>177</sup>

<sup>169</sup> Ron Van Rooden, "Ukraine urgently needs to reform its pension system", *Ekonomichna Pravda*, 18 April 2017.

<sup>170</sup> Facebook post, Yulia Sokolovska (Соколовська Юлія), social policy minister, 21 February 2020.

<sup>171</sup> Ibid.

<sup>172</sup> "Огляд основних підсумків роботи Пенсійного фонду України за січень-травень 2020 року" [Overview of main conclusions of work of Pension Fund of Ukraine, January-June 2020], Pension Fund of Ukraine, 3 June 2020.

<sup>173</sup> "Draft law on pension payments to residents of occupied territory submitted to parliament", op. cit.; "Дорогое 'примирение': на сколько придется раскошелиться украинцам на пенсии жителям ОРДЛО?" [An expensive 'reconciliation': how much will Ukrainians have to shell out for pensions for D/LPR residents?], *Delovaya Stolitsia*, 2 December 2019.

<sup>174</sup> Рішення Верховного Суду від 03.05.2018 № 805/402/18 (№ Пз/9901/20/18) – про припинення виплати пенсії внутрішньо переміщеній особі [Supreme Court Decision No. 805/402/18 of 3 May 2018 on the cessation of payment of pensions of internally displaced persons].

<sup>175</sup> See IMF Country Report No. 19/3, 8 January 2019, p. 15.

<sup>176</sup> Crisis Group observations, Svyatohirsk, November 2019. Crisis Group interviews, civil society activist, Shchastya, January 2020; military support volunteer, Mariupol, May 2018; members of leading parliamentary coalition, Kyiv, May 2017.

<sup>177</sup> Crisis Group research, Svyatohirsk, November 2019. Crisis Group interview, social policy ministry staff, September 2018. See also Crisis Group Report, "Nobody Wants Us", op. cit.

While both positions have a degree of validity, the human costs and reputational risks of not paying pensions outweigh the potential benefits of any savings – as Crisis Group has written previously.<sup>178</sup> These costs and risks notably include harming citizens in separatist-held areas and, by extension, tarnishing the government’s image there. Studies by international aid groups in 2017 and 2018 found that at least one third of the statelets’ residents that were 60 or older could not cover both food and medicine with their incomes.<sup>179</sup> One household survey conducted in 2017, after Kyiv had removed a large number of people from its pension rolls, found that a majority of the food-insecure cited reduced pension income as a major contributor to their difficulties.<sup>180</sup> While pensioners throughout Ukraine have trouble meeting their daily needs, whether due to low incomes, late pension payments or high household gas prices, those relying solely on de facto authorities’ small payments have been particularly disadvantaged.

Pensioners’ problems eased somewhat over 2018-2019 as food prices stabilised and de facto payments rose, but interviews with numerous pension tourists suggest that their experiences of financial hardship have left them deeply embittered and therefore less amenable to reintegration.<sup>181</sup> Hardship has only increased as a result of pandemic-related traffic restrictions, which as discussed above meant that thousands of pensioners in the statelets could not get access to Ukrainian pension payments. Front-line crossings were closed on both sides from March to June 2020, while the DPR was still refusing passage as of early July.

A common argument heard from members and supporters of the Poroshenko administration in Kyiv is that continued payment of Ukrainian pensions to some D/LPR residents could prolong the conflict.<sup>182</sup> As they see it, citizens who receive both Ukrainian and de facto statelet pensions will resist any resolution that deprives them of one or the other.<sup>183</sup>

This claim is at best an exaggeration. True, recipients of dual pensions fare better than those receiving only de facto statelet pensions or the small number of IDPs residing in government-controlled areas who receive no pension at all. But this bar is low, and the idea that they benefit from the conflict is dubious. Given the cost of cross-line travel and the small amount of de facto pensions, their spending power is roughly equivalent to that of pensioners in government-controlled areas. Unlike the latter, however, they must expend considerable effort and face tremendous risk to get their money. According to Organization for Security and Cooperation in Europe

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<sup>178</sup> Crisis Group Report, “*Nobody Wants Us*”, op. cit.

<sup>179</sup> Crisis Group interviews, independent researcher based in Donetsk, Kyiv, April 2018; OSCE Special Monitoring Mission staff based in Donetsk, Maiorsk, July 2018. See also “Joint Food Security Assessment”, Ukraine Food Security and Livelihood Cluster, September 2017; and “Food Security and Socio-economic Trend Analysis – Eastern Ukraine”, Ukraine Food Security and Livelihood Cluster, March 2018.

<sup>180</sup> “Joint Food Security Assessment”, op. cit.

<sup>181</sup> Crisis Group interviews, pensioners from Luhansk and Antratsyt, Sievierodonetsk, October 2017; pensioners from Donetsk and Makeevka, Kramatorsk, May 2018; pensioners from Luhansk and Alchevsk, Sievierodonetsk, October 2018; pensioners from Donetsk, Svyatohirsk, November 2019.

<sup>182</sup> Crisis Group interview, foreign affairs ministry staff, Kyiv, July 2018.

<sup>183</sup> There is some evidence that local residents see dual pensions as one advantage of the current situation. Crisis Group interviews, Donetsk resident, Svyatohirsk, November 2019.

(OSCE) monitors, eighteen people died of health-related causes while waiting to cross the front line between December 2018 and April 2019 alone.<sup>184</sup> Interviews with so-called pension tourists suggest that most feel the downside of their situation acutely.<sup>185</sup> As one pensioner from separatist-controlled Luhansk put it: “Yes, I have two pensions, totalling [\$183] – and shelling, too. Jealous?”<sup>186</sup>

In contrast, the legal and financial impact of the government’s failure to pay pensions is growing. Human rights activists have warned for years that people who have had their Ukrainian pensions cut off could bring their cases to the European Court of Human Rights, and that the Court would almost certainly decide in their favour, while also potentially awarding damages at least in the low thousands of euros for each plaintiff.<sup>187</sup> Kyiv’s strategy seems to have been to simply delay decisions in cases filed by pensioners deprived of their payments, banking on the fact that in order to appeal to the Court, plaintiffs need to have exhausted domestic remedies.<sup>188</sup> While the approach avoids financial costs, at least for the time being, it further alienates the population living in the statelets.

Poroshenko administration officials and their allies largely framed their support for pension restrictions in moral and political terms. Asked in April 2019 about Kyiv’s failure to simplify pension access, Social Policy Minister Andriy Reva, now a leading member of Poroshenko’s European Solidarity party, said he felt “absolutely no sympathy” for “those who want to receive two pensions, here and over there”, characterising them as separatist collaborators.<sup>189</sup> Regional officials in government-controlled Donetsk oblast, appointed directly by the president, expressed disdain for the Supreme Court’s decision, and depicted draft legislation that would delink IDP status from pension eligibility as the work of useful idiots doing the Kremlin’s bidding.<sup>190</sup>

The new government has taken a different view, however, with President Volodymyr Zelenskyy explicitly promising to expand pension access for residents of separatist-held areas. Yet, so far, its efforts have been blunted by the same economic anxieties that shaped the previous administrations’ policies. His ruling party filed draft legislation delinking pension eligibility from IDP status in fall 2019. The law would end the requirement for pensioners to cross the front line at least once every 60 days to

<sup>184</sup> “Status Report”, OSCE Special Monitoring Mission to Ukraine, 8 April 2019.

<sup>185</sup> Crisis Group interviews, pensioners from Luhansk and Antratsyt, Sievierodonetsk, October 2017; pensioners from Donetsk and Makeevka, Kramatorsk, May 2018; pensioners from Luhansk and Alchevsk, Sievierodonetsk, October 2018; pensioners from Donetsk, Svyatohirsk, November 2019.

<sup>186</sup> Crisis Group fieldwork, Sievierodonetsk, January 2020. Dollar value reflects the hryvnia-to-dollar exchange rate at the time.

<sup>187</sup> Oleksyi Vinogradov, “Бюджет может упасть на колени”: сколько Украина должна пенсионерам ОРДЛО? [“The budget could be brought to its knees’: what Ukraine owes D/LPR pensioners], Radio Svoboda, 25 October 2019. For the outcome of a past case when a Ukrainian appealed to this Court over cuts to his pension, see “Case of Pichkur vs. Ukraine”, European Court of Human Rights, Judgment, Final, 7 February 2014.

<sup>188</sup> See “Non-exhaustion of Domestic Remedies”, European Court of Human Rights Practical Guide on Admissibility Criteria, updated on 31 August 2019.

<sup>189</sup> See Facebook post, Olga Malchevska, 26 April 2019; and Malchevska, “The killer queues of Ukraine”, op. cit. Reva said the report had taken his remarks out of context. See “Мпази хто? Через що посварилися український міністр і журналістка BBC” [Who’s scum? Why a Ukrainian minister is quarreling with a journalist from the BBC], Media Sapiens, 11 May 2019.

<sup>190</sup> Crisis Group interview, Donetsk oblast administration officials, Kramatorsk, July 2018.

“prove” their displaced status. Instead, they could cross when convenient to pick up pension payments. For those who could not make the journey, the International Committee of the Red Cross or OSCE could deliver the money to their houses. The draft failed its first reading in February 2020, after the finance ministry noted that implementation would cost an additional \$4.7 billion annually.<sup>191</sup>

Soon after Zelenskyy assumed the presidency, Moscow made residents of the de facto republics eligible for fast-tracked Russian citizenship. It later expanded eligibility to all of Donetsk and Luhansk, including parts under Ukrainian government control.<sup>192</sup> In Kyiv, some Zelenskyy critics argued that this step rendered any government humanitarian outreach to the de facto republics moot, as Russia was both ready to accept the people there and determined to make it more difficult for Ukraine to reintegrate them.<sup>193</sup> But Moscow’s decision requires newly minted citizens to relocate permanently to Russia in order to receive pensions, which, in turn, will likely be at the minimum level allowed by Russian law. Locals say very few pensioners are likely to take up this offer, as the potential benefits would not outweigh the sacrifice of leaving their homes.<sup>194</sup> For retired industrial workers, Russian citizenship would also mean forfeiting sizeable Ukrainian state pensions.<sup>195</sup>

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<sup>191</sup> “Рада провалила закон про пенсії жителям окупованих територій” [Rada refuses to pass law on pensions for residents of occupied territories], *Pravda*, 5 February 2020. Some political observers argue that the underlying problem runs deeper, in that humanitarian outreach to the separatist-held areas does not fit into the ministry’s overall ethos. Crisis Group interviews, Yevgeniy Gontmakher, economist, Moscow, September 2019; EU political analyst, Kyiv, January 2019. For a discussion of the law, see “At-will employment, zero-hour contracts, short-term contracts: draft law ‘on labor’”, *Trudovi Initsiatyvy*, 8 January 2020. For an example of the economic arguments against paying pensions that some experts in Kyiv espouse, see “An expensive ‘reconciliation’: how much will Ukrainians have to shell out for pensions for D/LPR residents?”, op. cit.

<sup>192</sup> See Anna Arutunyan, “Is Russia Changing Its Calculus in Eastern Ukraine?”, Crisis Group Commentary, 11 June 2019.

<sup>193</sup> See, for example, “Ползущая аннексия: зачем Путину раздавать российские паспорта жителям ДНР” [Creeping annexation: why Putin is giving out Russian passports to residents of the DPR], *Fakty*, 24 April 2019.

<sup>194</sup> Crisis Group interviews, aid worker, Lysychansk, July 2019; Donetsk residents, Svyatohirsk, November 2019.

<sup>195</sup> Ibid.

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## VI. Preparing to Reintegrate Donbas

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A vocal group of self-described pro-European and patriotic Ukrainians oppose reintegration of Donbas in the short to medium term. They see the prospect of reintegrated statelets as a Trojan horse for Russia sympathisers, which would undermine Ukraine for decades to come, if not forever.<sup>196</sup> Instead, many in this camp call for investing heavily into government-controlled sections of Donbas while limiting contact with the statelets to legal support and relocation programs for Ukrainian citizens living there who want to leave – essentially allowing the ship to sink, while helping some to escape.<sup>197</sup> Under this paradigm, reintegration, if it takes place at all, would happen only after the balance of power between Russia and Ukraine has shifted sufficiently that Ukraine could dictate the terms of Donbas’s return.

Such an approach would not work. At best, it might mean integration of the statelets’ economies with Russia’s under an uneasy peace. More likely, it would continue the trends of the past years: a slow-burn war that no side is working all that hard to end, further decline of the statelets’ economies and infrastructure, and yet more departures of working-age residents to Russia and the EU. Then, if Kyiv did one day reintegrate these territories, it might well find a level of demographic and economic devastation against which today’s picture would pale.<sup>198</sup>

This concern may be pressing for those who advocate putting off reintegration. Some of these people, whether due to painful wartime experiences or pre-existing prejudices, view the statelets as places where virtually nothing of cultural, economic, political or demographic value remains.<sup>199</sup> But allowing these sometimes embittered voices to guide national policy is a recipe for protracted conflict, further immiseration and deepening resentment – the fruits of which Ukraine would reap if and when reunification occurs.

Kyiv can and should aim higher. Its goals should be to ease humanitarian suffering and to shape the conditions on both sides of the line of separation in a way that

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<sup>196</sup> “Переварит ли Украина Донбасс?” [Can Ukraine digest Donbas?], *Zerkalo Nedeli*, 25 February 2020; “Эксперты указали на угрозы быстрой реинтеграции ОРДЛО”, *Zerkalo Nedeli*, 26 February 2020; “Тест на совместимость” [Compatibility Test], *Zerkalo Nedeli*, 9 November 2019. For a diaspora perspective, see Alexander J. Motyl, “It’s time for Ukraine to let the Donbass go”, *Foreign Policy*, 6 December 2019.

<sup>197</sup> Crisis Group interviews, former Samopomich member, Kyiv, March 2019; former deputy governor of Donetsk oblast, November 2019. See also the Holos party’s policy proposal, “Голос розуму: стратегія холодної деокупації” [The Voice of Reason: A Strategy for Cold De-occupation], February 2020.

<sup>198</sup> See Milakovsky, “The Wartime Donbas Economy: Can It Be Saved?”, op. cit.

<sup>199</sup> In a November 2019 dialogue meeting, a young pro-Western activist who had fled the region in 2014 said, citing the region’s pre-war cultural and economic landscape, that Donbas’s future role should be to serve as “a museum of what should not be”. Crisis Group observation, Svyatohirsk, November 2019. See also “Асеев: Думаю, оккупированный Донбасс потерян, и чем быстрее мы начнем вести общественный дискурс в этом направлении, тем будет лучше” [Aseev: I think occupied Donbas is lost, and the sooner we start taking the public conversation in this direction, the better], *gordonua.com*, 2 March 2020. Stanislav Aseev, who suffered torture at the hands of DPR security services, was offered but turned down a role as Ukrainian government representative to the Minsk process in early 2020. In the article cited, he calls for resettling the areas now under D/LPR control with “people with pro-Ukrainian views” if and when these areas return to Kyiv’s jurisdiction.



would make reintegration both economically viable and politically palatable for residents throughout Donbas. In order to pursue these goals, it will ultimately have to help rebuild an economy that works for residents of both separatist- and government-held Donbas – a major and long-term undertaking that will almost certainly require outside help. In order to make it feasible, Kyiv could take several steps, some relatively modest, to help get things moving in the right direction. Some of these steps will require working with de facto authorities, which, even if they resist the notion of reintegration, may be drawn to ideas that can help strengthen the struggling D/LPR economies.

#### A. *Three Steps*

To start with, Kyiv can throw an economic lifeline to the desperate pensioners living in separatist-controlled territory who have not been able to collect their Ukrainian pensions. Helping them gain the access they have been denied could be a way to re-forge broken ties between these individuals (and their families) and Kyiv, while at the same time putting the Ukrainian government on the right side of the 2018 Supreme Court judgment and mooting the possibility of cases going before the European Court of Human Rights. The financial and political costs would of course be significant, but international financial institutions like the World Bank could help with at least the former by providing financial and technical support for restoring pensions to all eligible citizens and paying back debts.<sup>200</sup>

Secondly, Kyiv can take certain measures to build trust with those on the break-away side of the line who worry that reintegration would spell legal peril. Crisis Group's research indicates that even rank-and-file civil servants working in the de facto authorities' administrations see themselves as potentially exposed to prosecution should the breakaway territories return to Ukrainian control. While it may be premature for Kyiv to announce a full-blown transitional justice plan that would apply in the event of reintegration, it could at least pass legislation affirming its commitment to certain basic principles – including that it has no intention of proceeding legally against persons who have not been complicit in major transgressions (eg, gross human rights abuses) – in order to help quiet those concerns.

Thirdly, to begin fostering social and economic cohesion across the line of separation, Kyiv and the de facto republics, with Russian support, should encourage legal cross-line trade once pandemic restrictions are lifted. Ideally, a further easing of

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<sup>200</sup> The World Bank supports governments to reform pensions and social insurance policies to improve coverage for vulnerable groups and promote fiscal sustainability through a combination of technical analysis and concessional loans (for additional background, see the World Bank's 2012–2022 Social Protection and Labor Strategy “Resilience, Equity and Opportunity”). Notably, the World Bank currently supports pension and social insurance programs in Ukraine, including some related to Donbas. In April 2020, the bank approved \$150 million in loans to expand social assistance for low-income families in Ukraine, including through the Hand of Help initiative targeting those internally displaced by the Donbas conflict. In June 2020, the bank announced the first of two economic recovery loans to Ukraine, indicating that the second would strengthen pension benefits for the elderly. See “World Bank Steps up Support to Ukraine to Help Protect Poorest, Most Vulnerable”, press release, World Bank, 30 April 2020; and “World Bank approves \$350 million loan to support reforms for economic recovery in Ukraine”, press release, World Bank, 26 June 2020.

restrictions, to be negotiated in the Minsk format, atop the measures implemented in late 2019 would encourage small traders to move agricultural and other goods legally. De facto authorities have not facilitated this easing in the past, with the DPR, for example, retaining an 100kg limit on items shipped in from government-controlled territory, with lower maximum weights for specific food products, after Kyiv lifted its weight limitations on items going both ways.<sup>201</sup> Yet they have good reason to cooperate: even if the easing produces benefits for Kyiv (including by improving perceptions of it in the east), expanded access to affordable, high-quality Ukrainian goods in the statelets would provide relief to household budgets. Entrepreneurs on both sides of the line also stand to gain.

Such steps should go hand in hand with improved cross-line freedom of movement for civilians. Greater mobility will be particularly salient in Luhansk oblast, where the planned addition of new motor crossings at both Zolote and Shchastya by 10 November will create important channels for trade and traffic over the line.

On both sides of the line, residents' concerns about the prospect of expanded trade will have to be addressed. Kyiv needs to be sensitive to worries among some front-line dwellers that relaxed trade restrictions will lead large businesses to move in and squeeze out local traders and small farmers.<sup>202</sup> Ukraine could consider incentives (if not requirements) for firms engaged in cross-line shipping to hire locals for certain functions.

Others worry that procedures for trade may remain murky even if trade itself is encouraged, giving unscrupulous officials more opportunities for harassment and bribe taking. Some Shchastya residents, for example, look to the culture of bribery that has arisen at the Stanytsia Luhanska crossing and fear that an open motor crossing will bring the same, or worse, to their town.<sup>203</sup>

Another problem is that in order to operate freely on both sides, firms would almost certainly need to be registered not just with Ukrainian authorities but with de facto authorities as well. While such dual registration is illegal in Ukraine, many firms already function with it, subjecting owners and staff not just to bribe solicitation but detention and ill treatment by security and law enforcement personnel on both sides of the line.<sup>204</sup>

To ensure that expanded trade does not backfire, then, government and de facto authorities would have to find solutions to legal conundrums including registration

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<sup>201</sup> "На КПВВ Донбасса теперь новые правила" [There are new rules now at the Donbas entry-exit points], *vpl.in.ua*, 1 December 2019.

<sup>202</sup> Thus far, this anxiety is particularly felt in Donetsk oblast, which has four motor crossings, in contrast to Luhansk, where the motor crossings are still plans on the drawing board. Crisis Group interviews, aid worker, Lysychansk, October 2019; Brian Milakovsky, development expert, Kyiv, October 2019.

<sup>203</sup> Crisis Group interviews, international expert on socio-economic effects of conflict, Kyiv, November 2019; Shchastya residents, January 2019; Sarah Lain, Centre for Humanitarian Dialogue, February 2019.

<sup>204</sup> To cite just one example, a Luhansk resident spoke of a friend whose business had dual registration in Kharkiv and Luhansk. "On both sides [...] they say in no uncertain terms that he's an enemy accomplice. The SBU [Ukrainian security services] detained him for a week. In Luhansk they buried his product by the tonne. The bribes go without saying. He's decided to sell everything because he's developed a bunch of health problems". Crisis Group correspondence, August 2020.

issues, develop clear crossing procedures and communicate these effectively to would-be traders, local authorities, and law enforcement and security organs. These substantial challenges help explain why policymakers in Kyiv are divided as to whether cross-line trade should happen at all.<sup>205</sup>

### B. *A Bigger Jump*

A more difficult step forward, and one that would force Kyiv and the de facto authorities to seek common ground, is to explore unravelling the effects of the 2017 blockade and reinvigorating cross-line industrial trade. This idea has a practical and political logic that all sides should at least seriously consider.<sup>206</sup>

For one thing, a compromise that would allow resumption of the cross-line coal trade could work to the mutual benefit of Kyiv, the separatists and Moscow. While Ukraine's energy consumption patterns have changed dramatically in the past few years, anthracite still plays an important role. In early 2019, Ukraine's energy ministry reported that anthracite usage had fallen from 10.5 million tonnes in 2016 to 3.9 million in 2018. The then-minister promised that Kyiv would soon wean itself off anthracite altogether.<sup>207</sup> But it has yet to do so, and the country still requires anthracite for five of Ukraine's thirteen thermoelectric power stations.<sup>208</sup>

At the same time, the anthracite mines in de facto controlled territory have struggled to find alternative customers for their output, which a coal-saturated Russia does not want. Indeed, as discussed above, much of the coal that Ukraine imports from Russia in recent years is rumoured to be from the statelets but re-labelled to obscure its origins. Adjusting the system so that industrial concerns in separatist-held territory can ship directly to Ukrainian entities across the front line could help the former unload their product, and the latter meet their needs, while displacing shadowy and seemingly illegal export schemes. From Moscow's perspective, a move that helps make the statelets more economically self-sufficient should also be a plus.

But even if all sides stand to gain something from resumed trade in anthracite, the benefits of such an arrangement would not, by themselves, be likely to sway Kyiv. Although the trade ban had its share of critics in Kyiv when it was imposed in 2017 – some argued that it legalised what had essentially been a vigilante blockade, severed important cross-line ties and diminished the government's leverage over the separatists – there is less support for that view today, particularly in view of the statelets'

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<sup>205</sup> Crisis Group telephone interview, Kyiv official, July 2020.

<sup>206</sup> The discussion that follows borrows heavily from Brian Milakovsky, "Trade or Blockade? Economic Relations with Uncontrolled Territories in Moldova and Ukraine", Wilson Center, March 2020.

<sup>207</sup> "Украина с 2016 года сократила потребление антрацита втрое" [Ukraine has reduced its anthracite consumption three-fold since 2016], *Unian*, 18 January 2019. Crisis Group interview, Ihor Nasalyk, Kyiv, March 2019.

<sup>208</sup> Ukrainian imports of ostensibly Russian anthracite grew more than five-fold in the year following the blockade, making up approximately 83 per cent of all anthracite imports in the first six months of 2019. Serhiy Holovnev, "Сколько угля импортировала Украина в первой половине 2019 года" [How much coal did Ukraine import in the first half of 2019?], *Business Sensor*, 27 August 2019; Elena Holubeva, "Пчелиные укусы: кому будет 'больно' от решения Кабмина запретить использовать газ на ТЭС" [Bee stings: who will feel the 'pain' from the Cabinet's decision to ban the use of gas at TES], *112.ua*, 19 June 2020.

“nationalisation” of industrial assets. When, after Zelenskyy took office in May 2019, Russia and the D/LPR reportedly began to raise the issue of lifting the blockade in meetings of the Minsk Trilateral Contact Group, they received a provisional answer.<sup>209</sup> Kyiv’s chief envoy for Minsk negotiations, former President Leonid Kuchma, suggested in June 2019 that the government was willing to entertain the possibility with conditions, but that industrial assets seized in 2017 would have to be returned to their owners’ control before Kyiv would agree to allow pre-blockade levels of trade to resume.<sup>210</sup>

Such a deal might be difficult to strike but it may not be beyond reach.<sup>211</sup> For Moscow and the de facto authorities, in addition to unlocking the resumption of cross-border trade to the benefit of the D/LPR’s struggling economies, it would offer the chance to place the seized assets into hands that would likely manage them better than the entity that the latter authorities created for that purpose, Vneshtorgservis, and possibly save them from further decline. For the owners who lost control of these assets, it would be a form of restitution. For Kyiv, it would be a chance to rescue from continuing degradation an industrial infrastructure that at some point could well become its responsibility.

But while there may be shared interests in such a deal, there are also substantial practical and political impediments. For one thing, as Kyiv officials point out, the costs and difficulties for the legal owners to reassert control of the seized assets have increased over time because of the extent to which the interim managers have allowed some to fall into disrepair and because of the high level of out-migration from the statelets. As Kuchma said in July 2019, some of the previous owners “don’t want them back, because they’ve fallen into such a state over this time. And also the workers, the management – where are they going to find them? [Owners] say, take them off our hands”.<sup>212</sup> Still, comments from individuals close to Akhmetov convey his enduring eagerness to resume control of at least some assets.<sup>213</sup> The fact that Kuchma openly considered the proposal moreover suggests that at least some business circles would be in favour.

The notion of resuming trade with the east has also become increasingly politicised in Kyiv, with supporters of the Poroshenko administration and other Zelenskyy opponents equating trade resumption with surrender or even terrorist finance – the latter ostensibly on the grounds that cross-line trade would put money in the hands of separatist rebels. After Kuchma suggested an openness to a deal in 2019, Ihor Lutsenko, the outgoing prosecutor general, whom Zelenskyy had asked to resign in

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<sup>209</sup> Crisis Group interviews, international security expert, February 2020; expert on Minsk Trilateral Contact Group, June 2020.

<sup>210</sup> “Кучма призвал провести аудит предприятий, которых может коснуться снятие блокады” [Kuchma calls for audit of entities that may be affected by lifting of blockade], *Strana*, 6 June 2019.

<sup>211</sup> Several respected analysts have put forth proposals for how to resume industrial ties and give a boost to languishing assets currently in de facto hands without provoking an unmanageable political backlash, or, as analyst Brian Milakovsky put it, help Kyiv to “sail between the status quo Scylla of industrial collapse and the Charybdis of capitulation”. Milakovsky, “Trade or Blockade? Economic Relations with Uncontrolled Territories in Moldova and Ukraine”, op. cit.

<sup>212</sup> “Кучма призвал провести аудит предприятий, которых может коснуться снятие блокады”, op. cit.

<sup>213</sup> Crisis Group interviews, Akhmetov spokesperson, Kyiv, January and October 2019.

his inaugural address, opened a criminal case into “actions taken with the aim of providing financial or material support to a terrorist group”.<sup>214</sup>

Additionally, there is the question of whether the asset owners would now be required to pay some form of duty to the de facto authorities, which would almost certainly be a dealbreaker for Kyiv. Here the answer might be for the de facto authorities to extend the tax holiday they granted Vneshtorgservis to the owners so that the latter are not required to make direct payments to those authorities (which critics might characterise as support for a “terrorist” entity as Lutsenko did). Instead, the owners could pick up responsibility for “social payments” that VTS previously pledged to make via de facto ministries to support education, medical services and other social goods. The owners could agree that as the assets generate higher revenues with renewed cross-line trade, the payments will increase.<sup>215</sup>

To the extent it helps matters to proceed in this direction in measured steps, economist Oleksandr Kushch has suggested a number of pilot zones where Ukrainian entities might begin to resume control of their assets, including the coal and steel hubs of Anthracite in Luhansk oblast and Yenakievo-Makeevka in Donetsk.<sup>216</sup>

Even if it takes great pains to design a politically palatable approach, however, Kyiv will require a deft touch to build support for it domestically. While some evidence suggests support for a loosening of the blockade among the oligarchs, the same groups that led the vigilante blockade in 2017 could well rally in opposition to its dismantling.<sup>217</sup> Semen Semenchenko, a key figure in that protest, has suggested that any attempt to restore cross-line industrial trade would meet an even fiercer response than that which launched the blockade.<sup>218</sup> Other critics say they would also vehemently oppose restoration, even if the statelets enjoy no tax gains, on the grounds that doing so would support anti-Ukrainian constituencies.<sup>219</sup>

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<sup>214</sup> Facebook post, Yuri Lutsenko [Юрій Луценко], 7 June 2019. In a mirror-image reaction, a DPR official suggested that Kuchma’s demand that Kyiv regain jurisdiction over industrial assets amounted to an invitation for the self-declared republics to “sponsor military action against ourselves”. “В ДНР раскритиковали условие Луценко по возобновлению торговых отношений” [DPR criticises Lutsenko’s condition for renewing trade relations], RIA, 6 June 2019.

<sup>215</sup> Milakovsky, “Trade or Blockade? Economic Relations with Uncontrolled Territories in Moldova and Ukraine”, op. cit.

<sup>216</sup> Crisis Group interview, Oleksandr Kushch, Kyiv, February 2019.

<sup>217</sup> Milakovsky notes that “the Opposition Bloc [which is associated with Akhmetov] submitted a bill in the Verkhovna Rada to lift the economic blockade. [Musa] Magomedov, [director of the Avdiivka coke plant and a deputy from the Opposition Bloc], explains that it would be part of a step-by-step process that begins with successful pullback of forces. The bill has little chance of passage since it did not emerge from the Servant of the People parliamentary supermajority, and because the likelihood of bilateral troop pullback has faded after recent deadly artillery attacks on Ukrainian positions. But such a gesture from the political force of the oligarch most impacted by ‘nationalization’ suggests that there is behind-the-scenes positioning for economic liberalization, although the short bill includes no mention of how seized enterprises will be returned to their legal owners. The optimal arena for this discussion is probably not Ukraine’s parliament, but the economic sub-group in Minsk”. Milakovsky, “Trade or Blockade?”, op. cit.

<sup>218</sup> Crisis Group interview, Semen Semenchenko, lead participant in 2016-2017 blockade, Kyiv, October 2019.

<sup>219</sup> Crisis Group interview, former volunteer fighter and Fantom member, December 2019.

Kyiv will also need to address legitimate concerns that the reinvigoration of cross-line coal trade is taking the country in the wrong direction when it comes to clean energy. Members of Kyiv's opposition are likely to cite these concerns, in some instances out of their own commitment to the environment and in others to bolster their position against restoring ties.<sup>220</sup> Absent a clear plan on Kyiv's part to shift away from coal use in the coming decades, they will have a strong case. It helps their argument that several early 2020 policy decisions maintain a clear role for both anthracite and gas coal in Ukraine's energy grid, meaning that revival of cross-line trade could end up looking like part of a broader strategic choice to stick with dirty but readily available fuel.<sup>221</sup>

If a deal were reached, one measure that could help address this political and environmental dilemma would be for Kyiv to announce a phased unwinding of the previous state subsidies that made the mines and factories economically attractive for their owners. This approach would provide a short-term boost to the region's economy while encouraging the gradual closure of unprofitable and environmentally harmful enterprises. It could also help with the optics of transferring these assets back to their oligarch owners – who are often vilified on both sides of the front line – by making clear that there is a limit to how long the assets will be conduits for state funds to pass into their pockets.

More broadly, whether or not the sides reinstate some cross-line industrial trade, Kyiv needs to offer a clear strategy to move away from coal production and use. It will need to address both acute environmental and public health concerns, such as the consequences of mine neglect and flooding, and the long-term goal of reducing carbon emissions. It will also need to show respect for those whose communities have depended on and served the coal industry for generations. National leaders should make every effort to involve these communities in planning for the future, pushing back against some reformers' depictions of them as impediments to, rather than partners in, positive change.<sup>222</sup>

### C. *Modernisation*

Finally, while steps such as these can help Kyiv mitigate the human and economic costs of the continuing conflict, and set the stage for a more successful reintegration when a political settlement is ultimately reached, they leave open many questions about how the government will help the Donbas economy modernise and thrive.

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<sup>220</sup> See, for example, Facebook posts by Holos parliamentarian Lesia Vasylenko.

<sup>221</sup> Kyiv took several steps to reduce reliance on energy imports in the first half of 2020: the introduction of 65 per cent import tariffs on Russian coal, and mandating of coal, rather than imported gas, as the primary fuel for thermoelectric plants. The new tariffs only cover gas coal, not anthracite, while the order on power stations leaves open the possibility of their running on anthracite. So, despite coal's dubious long-term viability and Kyiv's efforts to switch to gas coal, anthracite retains a central role. "Прем'єр-міністр України Шмигаль Д.А.", Telegram post, Ukrainian Prime Minister D.A. Shmyhal, 17 June 2020; "Кабінет Міністрів України, Постанова від 18 березня 2020 р. N. 261" [Cabinet of Ministers of Ukraine, Order No. 261, 18 March 2020].

<sup>222</sup> Crisis Group interviews, assistant to President Poroshenko, Kyiv, April 2018; economic policy expert, National Institute of Strategic Studies, Kyiv, December 2019; expert in cross-line dialogue, Kyiv, October 2019.

Ultimately, it will fall to Kyiv to convene experts, seek investor input and engage the public to develop different visions for the future of a reintegrated and economically viable Donbas. As they do so, parties with a stake in the conflict's peaceful resolution should bolster these efforts by assuring Kyiv of their financial and political support when the time comes to implement the most promising of these visions and to bring this period of regional division to a close.

On the issue of financial support, one question is the role that Russia might play. Russian interlocutors have reportedly spoken of a willingness to financially back the rebuilding of Donbas, once a political settlement is reached.<sup>223</sup> Kyiv may have reason to be sceptical about whether Russia would be a constructive partner in such efforts – it may expect that Moscow would try to undermine reintegration and in any case would not be generous with its money. While it need not shed this scepticism absent a reason to do so, it should welcome both open and discreet exchanges on the subject through the Minsk Trilateral Contact Group and the Normandy Format, recognising that Russian funding will almost certainly be insufficient, and testing how it might be possible to guard against concerns that Russia's participation could work against successful reintegration.

Another possible source of funds that has widespread support among Ukrainian experts would involve creating a consortium of international and domestic investors.<sup>224</sup> As a potential step in that direction in October 2019, Zelenskyy announced the creation of “an International Partnership Support Fund for the reconstruction and future reintegration of Donbas” that will be used “to support economic recovery and peacebuilding in Ukraine”.<sup>225</sup> In theory, the fund's scope is broad and long-term; in practice, experts say plans and goals are underdeveloped. They report few high-level discussions about how to facilitate holistic economic recovery for Donbas residents on both sides of the front line.<sup>226</sup> Donors should urge Kyiv to think more comprehensively. They should offer contributions tied to incentives to use the funds to promote renewal of cross-line economic ties, rather than consolidating the current divide. Both donors and the Ukrainian government could offer benefits to investors throughout the country willing to be involved, thus also increasing Ukrainian entrepreneurs' stake in a successful Donbas.

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<sup>223</sup> Crisis Group interviews, spokesman for prominent businessman, Kyiv, February 2019; security official, Kyiv, December 2019.

<sup>224</sup> Crisis Group interviews, D-TEK staff member, Kyiv, October 2019; experts at National Institute for Strategic Studies, Kyiv, October/November 2019.

<sup>225</sup> “President announced the launch of the International Partnership Support Fund for the reconstruction and future reintegration of Donbas”, President of Ukraine official website, 29 October 2019.

<sup>226</sup> Crisis Group interviews, experts at National Institute for Strategic Studies, Kyiv, October/November 2019; former deputy governor of Donetsk oblast, Kyiv, December 2019.

## **VII. Conclusion**

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The effects of combat and partition have decimated the Donbas region's economy on both sides of the front line, weakened Ukraine's and siphoned funds out of Russia's. Although illegal and semi-legal trade, together with Ukrainian and Russian subsidies, have helped residents make ends meet, they have produced few genuine economic winners. The result is a stalemate. Kyiv has increased the war's cost to Moscow by placing Donbas's upkeep on its shoulders, but Moscow has complicated Kyiv's task of eventually reintegrating the region, by both posing as its patron and allowing the corrosion of what remained of its industries.

There is a better way. Kyiv can begin to re-forge social and economic ties that have frayed through a series of measured steps (some in conjunction with Moscow and the de facto authorities) to support alienated pensioners in separatist territory, assure workers that they will be at no risk of prosecution in a reunified Ukraine, resume cross-border trade in goods, and cautiously explore a deal that will lift the 2017 blockade. Looking to the future, and working with partners and adversaries alike, Kyiv should commit to the task of envisioning and enabling a rebuilt, more economically viable, post-conflict Donbas, which promises more for its residents than the fraught status quo. In so doing, it may help to bring peace that much closer.

**Kyiv/Brussels, 3 September 2020**



Appendix A: Map of Donbas Conflict Zone



## Appendix B: About the International Crisis Group

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The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 120 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries or regions at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international, regional and national decision-takers. Crisis Group also publishes *CrisisWatch*, a monthly early-warning bulletin, providing a succinct regular update on the state of play in up to 80 situations of conflict or potential conflict around the world.

Crisis Group's reports are distributed widely by email and made available simultaneously on its website, [www.crisisgroup.org](http://www.crisisgroup.org). Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board of Trustees – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policymakers around the world. Crisis Group is co-chaired by President & CEO of the Fiore Group and Founder of the Radcliffe Foundation, Frank Giustra, as well as by former UN Deputy Secretary-General and Administrator of the United Nations Development Programme (UNDP), Lord (Mark) Malloch-Brown.

Crisis Group's President & CEO, Robert Malley, took up the post on 1 January 2018. Malley was formerly Crisis Group's Middle East and North Africa Program Director and most recently was a Special Assistant to former U.S. President Barack Obama as well as Senior Adviser to the President for the Counter-ISIL Campaign, and White House Coordinator for the Middle East, North Africa and the Gulf region. Previously, he served as President Bill Clinton's Special Assistant for Israeli-Palestinian Affairs.

Crisis Group's international headquarters is in Brussels, and the organisation has offices in seven other locations: Bogotá, Dakar, Istanbul, Nairobi, London, New York, and Washington, DC. It has presences in the following locations: Abuja, Addis Ababa, Bahrain, Baku, Bangkok, Beirut, Caracas, Gaza City, Guatemala City, Jerusalem, Johannesburg, Juba, Kabul, Kiev, Manila, Mexico City, Moscow, Seoul, Tbilisi, Toronto, Tripoli, Tunis, and Yangon.

Crisis Group receives financial support from a wide range of governments, foundations, and private sources. Currently Crisis Group holds relationships with the following governmental departments and agencies: Australian Department of Foreign Affairs and Trade, Austrian Development Agency, Danish Ministry of Foreign Affairs, Dutch Ministry of Foreign Affairs, European Union Emergency Trust Fund for Africa, European Union Instrument contributing to Stability and Peace, Finnish Ministry of Foreign Affairs, French Development Agency, French Ministry of Europe and Foreign Affairs, Global Affairs Canada, Iceland Ministry for Foreign Affairs, Irish Department of Foreign Affairs and Trade, the Principality of Liechtenstein Ministry of Foreign Affairs, Luxembourg Ministry of Foreign and European Affairs, Norwegian Ministry of Foreign Affairs, Qatar Ministry of Foreign Affairs, Swedish Ministry of Foreign Affairs, Swiss Federal Department of Foreign Affairs, UK Department for International Development, and the World Bank.

Crisis Group also holds relationships with the following foundations: Carnegie Corporation of New York, Global Challenges Foundation, Henry Luce Foundation, John D. and Catherine T. MacArthur Foundation, Open Society Foundations, Ploughshares Fund, Robert Bosch Stiftung, and Rockefeller Brothers Fund.

**September 2020**

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## Appendix C: Reports and Briefings on Europe and Central Asia since 2017

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### Special Reports and Briefings

*Counter-terrorism Pitfalls: What the U.S. Fight against ISIS and al-Qaeda Should Avoid*, Special Report N°3, 22 March 2017.

*Council of Despair? The Fragmentation of UN Diplomacy*, Special Briefing N°1, 30 April 2019.

*Seven Opportunities for the UN in 2019-2020*, Special Briefing N°2, 12 September 2019.

*Seven Priorities for the New EU High Representative*, Special Briefing N°3, 12 December 2019.

*COVID-19 and Conflict: Seven Trends to Watch*, Special Briefing N°4, 24 March 2020 (also available in French and Spanish).

### Russia/North Caucasus

*Patriotic Mobilisation in Russia*, Europe Report N°251, 4 July 2018.

*The COVID-19 Challenge in Post-Soviet Breakaway Statelets*, Europe Briefing N°89, 7 May 2020.

### South Caucasus

*Nagorno-Karabakh's Gathering War Clouds*, Europe Report N°244, 1 June 2017.

*Abkhazia and South Ossetia: Time to Talk Trade*, Europe Report N°249, 24 May 2018 (also available in Russian).

*Digging out of Deadlock in Nagorno-Karabakh*, Europe Report N°255, 20 December 2019 (also available in Russian).

*Preventing a Bloody Harvest on the Armenia-Azerbaijan State Border*, Europe Report N°259, 24 July 2020.

### Ukraine

*Can Peacekeepers Break the Deadlock in Ukraine?*, Europe Report N°246, 15 December 2017.

*Ukraine: Will the Centre Hold?*, Europe Report N°247, 21 December 2017.

*"Nobody Wants Us": The Alienated Civilians of Eastern Ukraine*, Europe Report N°252, 1 October 2018 (also available in Ukrainian).

*Rebels without a Cause: Russia's Proxies in Eastern Ukraine*, Europe Report N°254, 16 July 2019 (also available in Ukrainian and Russian).

*Peace in Ukraine I: A European War*, Europe Report N°256, 28 April 2020 (also available in Russian and Ukrainian).

*Peace in Ukraine (II): A New Approach to Disengagement*, Europe Report N°260, 3 August 2020.

### Turkey

*Managing Turkey's PKK Conflict: The Case of Nusaybin*, Europe Report N°243, 2 May 2017 (also available in Turkish).

*Turkey's Syrian Refugees: Defusing Metropolitan Tensions*, Europe Report N°248, 29 January 2018 (also available in Turkish).

*Turkey's Election Reinvigorates Debate over Kurdish Demands*, Europe Briefing N°88, 13 June 2018.

*Russia and Turkey in the Black Sea and the South Caucasus*, Europe Report N°250, 28 June 2018.

*Mitigating Risks for Syrian Refugee Youth in Turkey's Şanlıurfa*, Europe Report N°253, 11 February 2019.

*Turkey Wades into Libya's Troubled Waters*, Europe Report N°257, 30 April 2020 (also available in Arabic and Turkish).

*Calibrating the Response: Turkey's ISIS Returnees*, Europe Report N°258, 29 June 2020 (also available in Turkish).

### Central Asia

*Uzbekistan: The Hundred Days*, Europe and Central Asia Report N°242, 15 March 2017.

*Central Asia's Silk Road Rivalries*, Europe and Central Asia Report N°245, 27 July 2017 (also available in Chinese and Russian).

*The Rising Risks of Misrule in Tajikistan*, Europe and Central Asia Briefing N°86, 9 October 2017 (also available in Russian).

*Rivals for Authority in Tajikistan's Gorno-Badakhshan*, Europe and Central Asia Briefing N°87, 14 March 2018 (also available in Russian).

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