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Ukraine Refugees: From Temporary Protection to Encouraging Return to Support the Ukrainian Economy

KEY MESSAGES

- **War of attrition. President Trump's promises of a quick end to the war are unlikely to come true. German and European policy must shift from providing temporary protection to supporting a productive return to support the Ukrainian economy**
- **At present many Ukrainian refugees still require substantial financial support from their host country. This is particularly the case in Germany, with the fiscal cost sapping popular support for Ukraine**
- **Ukraine needs people to strengthen its economy, including the ramping up of domestic production of weapons and machinery. A productive return thus yields a double dividend**
- **German and European enterprises should be encouraged to start producing in Ukraine by providing them with a guarantee against bomb damage. European FDI in Ukraine, in particular by German SMEs, could provide returning refugees with productive jobs**
- **Encouraging the productive return of refugees would also make sense in the unlikely event of a near-term cessation of hostilities**

ADAPTING POLICY TO THE PERSPECTIVE OF A LONG WAR OF ATTRITION

After Russia launched a full-scale invasion of Ukraine on February 24, 2022, millions of Ukrainians found refuge in the European Union. Germany and Poland hosted more than one million refugees each. After three years of war, and with no end in sight, despite promised attempts by US President Trump, the initial plan to provide temporary homes to Ukrainians needs to be revisited as the war of attrition calls for more durable solutions.

Indeed, President Zelenskyy repeatedly emphasized that Ukraine needs its people back to support the war effort as well as to ensure that the country is not depopulated after the war. These needs are urgent. Many businesses report shortages of labor as a key limiting factor. The population is projected to decline from more than 40 million before the war to approximately 31 million in 2034.

FISCAL PRESSURES

At the same time, fiscal pressures mount on governments, thus igniting public discussions, especially in Germany, regarding the high cost of supporting the refugees. The German federal government alone spends about EUR 9–10 billion annually to support Ukrainian refugees, and more spending is financed by lower levels of government ("Länder" and local authorities).

Official data suggest that 1.3 million Ukrainian citizens live in Germany, of which 730,000 are of working age (two-thirds women); 119,000 have "normal" jobs (paying social security) and another 37,000 have so-called "mini-jobs." These statistics indicate two key facts. First, Ukrainian refugees in Germany have a low employment rate, of around 25 percent, compared to 50–60 percent for those from Iraq and other Middle Eastern source countries. This is partially due to the prevalence of women among the Ukrainian refugee population. Male refugees generally have a higher employment rate. Among the Ukrainian refugees, especially those of working age, women naturally dominate (about 70 percent), which is the opposite of most other source countries. Second, employment rates for Ukrainian refugees are higher elsewhere in the EU, at more than 60 percent in Poland, Czechia, and other countries hosting large populations of Ukrainians. Third, a large part of the non-working population of the refugees relies on the German social security system. A German newspaper reports on an internal report from the Bundestag that a single Ukrainian can count on about EUR 950 per month ("Bürgergeld" plus rent support). A single mother with one child gets probably closer to EUR 1,300 per month, or approximately EUR 15,000 per year. By comparison, in Austria a single person gets around EUR 420 per month, in Italy and France between EUR 300 and 400 per month, implying about EUR 4,000–5,000 per year. The language barrier and German labor market regulations obviously play a role in low employment rates, but the generous support also blunts incentives to get a job (and find daycare for children).

The relatively high employment rates of Ukrainian refugees in other EU countries has come at a cost: many Ukrainians are highly skilled, but have had to accept low-skilled, unstable (and relatively low-paid) jobs. The German strategy aims first at providing

Ukrainians with the necessary language skills and then matching their skills to German requirements so that they can aspire to more stable high-skilled jobs. But both processes have taken a lot of time because of the limited availability of language courses and general rigidities of the German labor market. Unfortunately, these problems continue, which explains why the employment rate of Ukrainian refugees is increasing only very slowly in Germany.

At any rate, the increasing needs for manpower (or rather womanpower, as a majority of Ukrainian refugees are female) to support the war effort at home warrants a strategic rethink. The new approach should be based on the recognition that Ukraine needs people and Germany needs to control costs. Of course, humanitarian considerations have primacy, but we would argue that there is a possibility here to hit two birds with one stone.

THE UKRAINIAN LABOR MARKET

The Ukrainian labor market reflects the ongoing shift to a war economy. This shift is still ongoing and because of the war, labor market statistics are sparse and unreliable. But some basic facts can be deduced from various proxy measures. First, work.ua, a major online aggregator of job vacancies in Ukraine, reports that the average wage for a job posting in July 2024 is UAH 20,500 per month, which is close to EUR 500 per month. Taking into account lower prices in Ukraine, the real purchasing power might be similar to aid in Germany.

Wages have been rapidly increasing (real wages are projected to increase by 8 percent in 2024) as businesses struggle to attract workers. Second, the National Bank of Ukraine estimates the unemployment rate at about 16 percent in mid-2024 (for comparison, the rate was at approximately 29 percent in the early months of the full-scale invasion). There is also a large regional variation in employment rates, with western Ukraine doing significantly better than eastern Ukraine. Third, employment rates for internally displaced people (IDPs) are significantly lower (~44 percent) than the national average (~55 percent), thus suggesting considerable difficulties in integrating IDPs.

All these facts together indicate large frictions in Ukraine's labor market. This should not be surprising. The war has severely damaged infrastructure and severed many ties between suppliers. Ramping up production for the war effort requires different skills than those of a peacetime economy. As domestic production of military material increases, more jobs will need to be filled in Ukraine.

The incentives to work remain intact in Ukraine. A mother with a child that had to flee the eastern part of the country receives about UAH 10,000 (~EUR 220) per month from the Ukrainian government and international agencies, in addition to a housing subsidy. This is less than a Ukrainian wage.

If a similar household moves from Germany to Ukraine, the mother will have a much lower income if she relies on local public aid, even if the gap is reduced by at least a factor of two when adjusted for cost-of-living differences. However, if she were to obtain a job, especially one with a foreign company, which generally pay higher wages, she might even be marginally better off. Provided there are jobs at home, refugees might thus no longer face a high disincentive to return. At the same time, the German government would save about EUR 10,000 on an annual basis, thus freeing up considerable resources that may be used to help refugees in their reinsertion and Ukraine in other ways.

HEIMWEH

Returning to one's motherland is not a decision made purely on financial grounds. The ifo Institute has since 2022 regularly polled Ukrainian refugees in Germany about their intentions to return or stay. Initially about two-thirds wanted to return when it is safe. This percentage has since fallen to about 50 percent. This means that there is still a significant proportion of refugees that would return when they consider it safe. The result of the polling also revealed that what matters is not so much the severity of bombing at the local level but the overall situation, since local difficulties redirect return but do not deter it. The key issue is thus to find ways to make return more attractive, at least to those areas of Ukraine considered relatively more secure.

A NEW APPROACH: SUPPORT FOR REINSERTION INSTEAD OF SOCIAL TRANSFERS

Encouraging return can be achieved by shifting from social transfers to support for reinsertion in Ukraine ("Wiedereingliederungshilfe statt Bürgergeld") to incentivize Ukrainians to return home and by providing support for German enterprises that invest in safer parts of Ukraine. Shifting toward support for reinsertion and investment in Ukraine would yield a double dividend inasmuch as Ukraine's economy grows and expenditure for social support in Germany is no longer needed.

The German government could thus offer Ukrainian refugees support for reinsertion. Returning home after a long absence, especially if their home-

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town has been destroyed, will be a difficult process in many cases. Support for reinsertion in the form of a couple of monthly payments would thus be entirely appropriate. But the return will benefit Ukraine only if the returnee has a realistic chance of finding a job. This is where the second pillar comes in.

German industry, including the "Mittelstand," is interested in producing in Ukraine. For example, Leoni Wiring Systems UA GmbH employed more than 7,000 workers in western Ukraine before the war. In 2023, Bayer committed to invest EUR 60 million in Pochuiky, Ukraine. Any investment in Ukraine faces two problems: war risk and the lack of qualified German-speaking personnel. War risk will remain a problem for a long time. It might not be an insurmountable obstacle for a large multinational company like Bayer. But a Mittelstand firm cannot shoulder this risk alone. It does not make sense to wait for a peace settlement before starting to rebuild the Ukrainian manufacturing sector. Some form of war insurance will have to be provided by either German or EU sources (e. g., KfW or EIB). Direct risk of destruction is in any case limited for small factories located at some distance from the front.

The lack of qualified German-speaking personnel could be alleviated if the German government were willing to support a combination of training courses and relocation aid. The large number of refugees that have gone through at least some German language training should provide a large pool for such a program.

The German government should thus create a new program under which it provides German enterprises with a package of insurance coverage and financing for the training of Ukrainians living at present in Germany who would be offered a job in the new factories in Ukraine. Linking relocation to a job in Ukraine would ensure that the return does not constitute a burden for Ukrainian public finances that are already under enormous strain.

Concerns about security and housing are tightly intertwined. As of May 2024, more than 8.6 percent of Ukraine's housing stock was destroyed, mostly in the eastern part of the country. A massive influx of IDPs increased housing prices in western Ukraine, where there has been relatively little destruction, but smaller towns in this region remain affordable. Investment in this region can hit two birds with one stone. First, vacant homes can house returnees. Second, the logic of the war favors either decentralization of production or fortified clusters of production. The latter is appropriate for steel mills and similar large-scale production processes. The former is better suited for small and medium enterprises, i. e., operations of German Mittelstand companies, and thus can be targeted and scaled by the program we describe above.

STRATEGIC CONSIDERATIONS

This program can provide longer-term benefits for Ukraine too. Western Ukraine was historically less developed than other parts of the country. But the center of Ukraine's economic gravity has been shifting to the west as most of the heavy industry in the east has been destroyed and EU membership beckons.

Fostering a combination of return and investment from the EU, especially from small or medium-sized enterprises, can accelerate the integration of Ukraine into the European economy. History also suggests that areas with a strong presence of small and medium-sized enterprises are more resilient to economic shocks and thus potentially provide a more durable model of economic development. The rise of Italy's Veneto region is an inspiring success story.

In summary, while the reconstruction of Ukraine is often envisioned to happen after the war, we believe that rebuilding the Ukrainian manufacturing sector should commence now. This process will not only increase the capacity of Ukraine to resist Russian aggression, but also plant the seeds of Ukraine's future integration into the European Union. The tragedy of Ukrainian refugees may be turned into an opportunity to build economic ties and make Europe stronger. Our proposal to direct funds to investment and refugee reinsertion into Ukraine is a step in this direction.

POLICY CONCLUSIONS

When Russia started a full-scale invasion of Ukraine in 2022, Europe provided shelter for millions of refugees. The perspective then was to provide temporary support in a sudden emergency. With the war now one of attrition, policy must look at the longer run. Here, the key issue is to strengthen the Ukrainian economy. The country needs the potential productive capacity of these refugees. But a combination of financial support in EU countries and limited job opportunities at home does not encourage refugees to return home. We propose a package of measures that provides refugees with incentives to return for and businesses with support for investment in Ukraine to create the job opportunities that returning refugees need.

This approach should be seen in the wider picture of the stronger European support for Ukraine needed given the uncertainty about US policy. The package we propose should be seen a part and parcel of the EU's overall Ukraine policy, which has to encompass not only continuing financial and military support but also measures to strengthen the long-term economic potential of Ukraine.