Intelligence Report

DCI Interagency Balkan Task Force

21 July 1995

Serbia: UN Sanctions Hobble the Economy

UN sanctions have helped push the Serbian economy into its current depression, and the long-lasting damage from sanctions and economic mismanagement offers Belgrade little chance to recover for years to come. According to official statistics, Serbia's economic output has plummeted 55 percent since 1989. About 40 percentage points of the decline have come since the UN slapped a trade embargo and asset freeze on Serbia and Montenegro in May 1992.

- *National Bank of Yugoslavia Governor Dragoslav Avramovic's statements to the press this month imply a 90-percent fall in imports, based on prewar statistics.*
- *Although smuggling, savings, and emigrant remittances have kept consumption higher than official GDP data suggest, these sources of funds have only softened the plunge in living standards for most of the Serbian populace.*

Serbs Feel the Pinch

UN sanctions remain a significant drag on economic activity in Serbia and Montenegro. With limited access to ships, barges, trains, and trucks, Serbia cannot conduct its traditional trade in raw materials, industrial inputs, and finished products. Although smuggling in small boats and motor vehicles supplies some goods to Serbian markets, bulk commodities and industrial machinery are difficult to ship into Serbia.

- National Bank of Yugoslavia Governor Avramovic bragged to reporters this month that Serbia imports $1 billion a year despite UN sanctions. In 1991, Serbia bought $12.5 billion from suppliers from other Yugoslav republics and abroad, according to official statistics.
- Serbia pays a premium for smuggled imports and must pay bribes to export, making it difficult for firms to profit from foreign trade.
- Belgrade has lost access to loans from international financial institutions and up to $1.6 billion in frozen assets, according to the press.

- Capital flight has further constricted Serbia's access to funds—an outflow that emigrant remittances are unlikely to have made up. [redacted]

Serbian Trade Minister Djordje Siradovic told the press this month that UN sanctions have thrown half the labor force onto the dole and impoverished the country's middle class. Serbian statistics indicate GDP has plummeted 55 percent from the 1989 level, the year Serbia began its economic slide. About 40 percentage points of the decline occurred after the UN imposed a trade embargo and an asset freeze on Serbia and Montenegro in May 1992.

- According to official statistics, almost 1 million workers are on "compulsory holiday" and another 750,000 are unemployed. Although 1 million still have jobs, many of the unemployed and laid-off probably work in the black and gray markets, suggesting a somewhat higher level of output than statistics indicate.

- Although smuggling, savings, and emigrant remittances soften the decline in output, Serbia probably is the poorest country in Europe. [redacted]

Unemployment has added to Belgrade's budget deficit, the proximate cause of the 100-percent annual inflation that dogs the economy. Laid-off workers and the unemployed receive about two-thirds of the salaries they earned when working, according to Serbian law.

- Although press reports indicate delays of several months in meeting these payments, government officials are loath to cut the size of the payments for fear of triggering social unrest.

- Many working in the gray and black markets do not report their employment to avoid losing jobless benefits and to evade income taxes. [redacted]

Economic Mismanagement Magnifies the Impact

Serbian economists outside the government point out that sanctions have only exacerbated the greater damage done by the breakup of the former Yugoslavia, the outbreak of war, chronic inflation, and the survival of Communist-era economic management. Aleksandra Posarac of the independent Institute of Economic Sciences in Belgrade told journalists this month that sanctions give the government a scapegoat for the country's economic woes.

This intelligence report was prepared at the request of Leon Fuerth, Assistant to the Vice President for National Security Affairs, by [redacted] Office of European Analysis. Comments and queries are welcome and may be directed to Chief, DCI Interagency Balkan Task Force, at [redacted]

- Serbia's hyperinflation—which peaked at 313 million percent *a month* in January 1994—wiped out the savings of pensioners and the middle class. Belgrade's efforts the blame sanctions have had only partial success, according to the US Embassy.

- Before the breakup of Yugoslavia, about half of Serbia's production was sold to other Yugoslav republics and to customers abroad. [redacted]

Serbia is the only East European country with greater state control over the economy than in 1989, and it has taken steps recently to increase this control further. Even before Yugoslavia broke apart, Serbia lagged Slovenia and Croatia on economic reform, particularly privatization, banking and financial reforms, tax policy, and foreign investment laws.

- Belgrade introduced price controls for many consumer goods this year, and the state's key role in buying grain to smuggle to foreign purchasers has tightened its grip on the farm sector.

- Belgrade is considering the conversion of "socially owned" enterprises—ostensibly managed by the workers—into state-controlled entities, according to the US Embassy. Moreover, the ruling Socialist Party reportedly is reasserting its control over several small socially owned companies.

- Serbia's state-owned industries are increasingly inefficient and uncompetitive in world markets, but the government subsidizes their payrolls to keep unemployment from rising.

- Financial support to large enterprises comes from commercial banks, which Belgrade has pressured to provide debt-for-equity swaps and easy credit. Consequently, many banks are saddled with nonperforming loans and liquidity problems [redacted] nominal loan rates range up to 800 percent at an annual rate. [redacted]

Gloomy Economic Prospects, Even After Sanctions

The economic outlook for Serbia and Montenegro is likely to remain bleak as long as sanctions stay in effect and even beyond.

- The independent Institute for Economic Sciences told the US Embassy in Belgrade that industrial production this year is declining 1.2 percent a month and that industry is likely to exhaust its working capital by the end of 1995.

- Inflation is reportedly rising at an average 6-percent monthly rate and probably will accelerate as the government prints money to finance its deficit.

- Banks are charging loan-shark rates because industry's nonperforming loans have created a shortage of funds. [redacted] banks are offering loans at annual rates of up to 790 percent. [redacted]

The economy probably will face a long recovery after UN sanctions are lifted, unless Serbia receives massive inflows of foreign capital as assistance or investment.

- Industry Minister Oskar Fodor told journalists this week that depletion of capital and the inability to keep up with technology makes the survival of the chemical, steel, shipbuilding, and railroad car industries doubtful when they again face competition from abroad. These industries have accounted for 6 percent of Serbian GDP.

- Last month, Central Bank Governor Dragoslav Avramovic told a press conference that Serbia needs $6 billion over two to three years to bring its electric power, telecommunications, water, and road networks back to 1989 standards.

- Increasing government control of the economy is likely to make Serbia less appealing as a location for investment than other East European countries that are transforming into market economies.

- Posarac believes the economy will grow about 20 percent in the year after sanctions are lifted but will take 10-20 years to regain the 1989 level. [redacted]

Although the private sector has grown substantially under sanctions with the expansion of gray and black markets, much of this activity is dominated by organized crime, which will try to stay in business after sanctions end. The pervasiveness of organized crime in the Serbian economy will impede the efficient functioning of the private sector and deter foreign investment.

- Many small businesses profit from the premium prices they can charge for smuggled goods, but they are unlikely to be able to compete once prices drop to world market levels. [redacted]