DCI Interagency Balkan Task Force
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*Serbia: Coping With Sanctions*

## Summary

Sanctions have accelerated the downward spiral of Serbia's economy, but have yet to impose sufficient hardships on local consumers needed to spark a groundswell of anti-regime sentiment. Supplies appear to be adequate to get through the winter and the Milosevic regime is anticipating that sanctions will be lifted before reserves of hard currency, food, fuel, and public tolerance run out. [redacted]

Sanctions have generated substantial adjustments in the Serbian economy. Belgrade has been forced to:

-- draw on strategic commodity reserves to assure critical supplies of food and fuel for the population;

-- curtail severely investment in infrastructure and modernization, resulting in a steady deterioration of the country's already inefficient industrial base, and transport and telecommunications systems;

-- print money to pay laid-off workers, fueling hyperinflation;

-- periodically shut down large segments of industry for lack of imported inputs and to conserve supplies;

-- draw down nearly 70 percent of its official hard currency reserves during 1992. [redacted]

The Milosevic regime realizes that these measures will do long-term damage to Serbia's economy, but accepts that as the price of pursuing its military and political goals. A Serb official, [redacted] admits that each month of sanctions delays

[redacted]

economic recovery by two months. We have not seen indications, however, that Belgrade is prepared to hold out for the long term by, for example, preparing plans to build an autarkic economy.

**Introduction**

Serbian consumers are grumbling from inconvenience and falling real incomes, but they show no signs of approaching the end of their patience. Food supplies are adequate, in part because the surplus that was traditionally exported is now being consumed domestically. Energy stocks, the other key to surviving this winter, are also in fairly good supply thanks to a surge in smuggled oil imports in September and October. Belgrade's open tolerance of black market activities, the heavily redundant workforce, and inflated inventories of the pre-war Serbian economy have also helped cushion the effects on market supply and revenue.

**Industry's Fortunes Mixed**

Sanctions have had a more marked effect on factory output. Shortages of imported raw materials and semi-manufactures almost certainly were instrumental in last year's reported 25 percent decline in industrial production. Much of this production, however, is not vital to meeting basic domestic needs. Official data also indicate that Serbia's exports totaled nearly $2.5 billion in 1992, nearly 50 percent below the previous year's level. Imports, on the other hand, dropped almost 40 percent.

The textile and metal industries--major sources of employment and hard currency for Belgrade--have been the hardest hit. Excess capacity and high import dependence have reduced textile production by up to 35 percent since May, and up to 100,000 workers may have been put on paid leave as a result, according to press reports. Metalworking output has fallen by nearly half since the imposition of sanctions, while iron and steel production is down by up to 40 percent. This sector alone may have laid off 500,000 workers, according to Serbian press reports.

-- For example, Zastava, Serbia's largest vehicle manufacturer has reportedly shut down several times since the initial imposition of sanctions in June. According to Serbian press reports, Zastava has laid off 60 percent of its 48,000 employees. To stave off worse trouble, the government has offered loans to pay off company debt and help the firm diversify production. Several subsidiaries that have already shifted production are expected to continue operations at least for the next several months.

Despite the decline in industrial output, Serbia retains access to enough raw materials for limited production. [redacted], Serbia's major steel, aluminum, and copper plants are still operating near pre-sanctions levels. Firms throughout the Belgrade area, including light metal manufacturers and food processors, also continue to run. The major petrochemical plant at Pancevo, which was operating throughout the summer when demand for fertilizers was highest, has ceased operations temporarily as fuel stocks are directed towards producing heat. [redacted]

[redacted] some firms have reaped windfalls by using sanctions as a pretext for developing more efficient operating procedures, while others are exploiting their new positions as monopolistic producers without import competition.

-- In early January 1993, for example, [redacted] sanctions have given [redacted] the opportunity--prohibited before the embargo--to restructure factories, lay-off redundant workers, reduce high "socialist level" inventories and otherwise dramatically increase industry efficiency, [redacted].

-- [redacted] the electronics industry is doing quite well. Producers of components, such as a factory in Nis, are working double shifts to meet demand, and factories producing consumer electronics continue to operate, albeit at a reduced level, using smuggled raw materials.

-- Zmaj, the FRY's only producer of specialized farm equipment, increased production 4 percent in 1992 to meet domestic demand for goods cut off by sanctions, according to Serbian press reports.

-- At a recent convention, agricultural producers from all over Serbia were upbeat because the decline in competing food imports more than compensated for the falloff in export earnings.

-- Manufacturers of consumer durable goods, however, are producing at significantly reduced levels, staying in business through reliance on smuggled raw materials. The absence of cheaper imports, however, does allow these firms to charge higher prices. [redacted]

Other major industries, such as construction and trading, have survived sanctions by focusing operations abroad. Firms in these sectors rely on third country operations--allowed under sanctions--for transfers of both money and material. [redacted]

[redacted] two Serbian firms with operations worldwide, Energoprojekt and Genex, use contacts in such far flung places as Pakistan, Mongolia, and South Africa to secure essential imports. [redacted] Energoprojekt [redacted] receives 80 tons of diesel fuel monthly from its Russian subsidiary, [redacted]

**Energy Supplies: Adequate For Now**

We estimate that Serbia has sufficient reserves of oil--the most critical import affected by sanctions--to last several months at the current reduced consumption rate. [redacted] government stockpiles have been high since October, and at no time have Serb stocks fallen below 50 percent. Belgrade's ability to increase gasoline supplies in the runup to the 20 December election and bring down prices, supports this claim. [redacted]

The supply of heating oil appears to be tight, while stocks of coal and firewood are adequate, [redacted] Serbia is nearly self-sufficient in coal production and electricity generation. During a cold snap in early January, however, electrical "brownouts" occurred in Belgrade, due mainly to overloading of the city's electrical grid as more people used electric heaters. Households dependent on natural gas--piped in from Russia via Ukraine and Hungary--are apparently the most affected. Apartment temperatures dropped into the 50s on the coldest days, and heat is being turned off after 8:00 PM. Schools have also delayed opening an extra week after the holidays to conserve heating oil. [redacted]

There are signs that Belgrade is looking ahead to renewed shortages. Serbia probably imported less oil in December compared to October and November primarily due to tightening of the UN embargo. Many private gasoline stations were closed down in late December, and four to five hour lines have reappeared, [redacted] In addition, official dinar prices for oil, coal, gas, and electricity have been raised substantially since the end of December. For those willing to pay for gasoline in foreign exchange, an accompanying devaluation of the dinar offset most, if not all, of the latest price increase. Hard currency prices for gasoline, now around $3-$4 per gallon, are down by two-thirds from September. The situation may be eased temporarily by recent oil deliveries; a Russian tanker unloaded up to 165,000 barrels of fuel oil in the Montenegrin port of Bar on 24 January, [redacted], while five convoys of Serbian barges carrying up to 340,000 barrels reached Serbian territorial waters over the past week. [redacted]

[redacted] unleaded gasoline and diesel fuel are hard to come by, but Belgrade city officials believe black marketeers may be withholding some supplies to force up prices, [redacted]

[redacted] High stock levels, domestic production of 21,000 to 24,000 barrels per day--[redacted]-and some continued oil imports, however, will probably allow Belgrade to meet its basic needs for the next several months. [redacted]

**Agricultural Output Down But Food Supplies Adequate**

Serbian officials are predicting that grain production for 1992 will be 40 percent lower than in the previous year as a result of summer droughts and diesel shortages, according to press reports. Belgrade should still have enough stocks to meet the needs of the populace; in normal years Serbia exported up to 30 percent of its output. In addition, the carryover from the boom harvest of 1991 provides a buffer stock for the coming year. [redacted], market supplies of bread, meat, potatoes and other staples are plentiful and undiminished from several months ago. Meat production for 1992 was forecast to remain at the previous year's level, and should continue to cover domestic needs. There are spot shortages in stores of items such as sugar, cooking oil, and detergent, but these are probably the result of consumer hoarding. [redacted]

## Providing for the Consumer

Serbians are accustomed to periodic shortages, occasional long lines to make purchases, cold houses in the winter, and brownouts, the frequent result of Serbia's chronic economic inefficiency. At the same time, however, several factors have helped Serbs cope. We estimate that nearly $2 billion in hard currency is in private hands. Remittances from relatives and workers abroad will bring in possibly another $2 billion. Holders of hard currency currently have little difficulty buying on the black market those goods that are in short supply at official prices. Historic ties to the countryside also provide many Serbs access to foodstuffs. [redacted]

High prices, however, apparently are becoming a growing burden for consumers. Necessities such as food and energy are absorbing a large share of household income. The Serbian press reports that the cost of living has risen five times faster than wages while [redacted] retail trade fell by 60 percent. Indeed, the abundance of goods on shelves probably represents in many cases the slow turnover of inventories. [redacted] very few consumers in Belgrade can afford the imported luxury goods which are on display in the capital. [redacted]

## Outlook

Over the next three months, sanctions will further squeeze the economy, but we believe that they will not reduce living standards below the public's endurance level. Industries and individuals will continue to draw on stockpiles of raw materials, hard currency, fuel, and food to get through the winter and to deal with the latest embargo restrictions. Only a prolonged determination by the West to impose even tighter sanctions--including a freeze on financial assets held by private Serb interests and the imposition of penalties on sanctions violators--would offer any prospect of forcing Belgrade to make significant political concessions. The Milosevic regime probably appreciates this, but hopes for a growing disenchantment with the embargo among its neighbors and laxer enforcement to ease its isolation. Even maintaining the current level of sanctions will, over time, deprive Belgrade of the capital and equipment needed for Serbia to assume Yugoslavia's former role as an important exporter of arms, agricultural goods, and low-technology industrial goods.

**Appendix A**

## Official Serbian Statistics for 1992

As official figures show, the sanctions have had a significant effect on the normal functioning of the Serbian economy, although official estimates give an a somewhat inaccurate picture of conditions in the FRY due to exclusion of black market activities. Serbia may also be intentionally presenting a bleaker picture to bolster its requests for exclusions from the embargo and to play down the effectiveness of sanctions evasion.

- **GNP** down 26 percent
- **Industrial production** fell 24 percent
- **Retail Trade** down approximately 45 to 60 percent
- **Trade:** exports - \$2.5 billion, down 46 percent<br>imports - \$3.9 billion, down 30 to 40 percent
- **Unemployment:** approximately 800,000 workers have been laid-off or 30 percent of the workforce. This does not include and additional 700,000 people who may be completely unemployed.
- **Firm Closures:** 11,500 firms are insolvent
- **Inflation:** December monthly 48 percent<br>Average annual approximately 19,000 percent.

Sanctions have virtually halted investment seriously damaging Serbia's long term ability to modernize its dated industries and recover from the economic effects of the war such as the high unemployment and inflation.

**Appendix B**

## UN Sanctions Against Serbia and Montenegro: A Timeline

Economic and political sanctions against the rump Yugoslavia were imposed in late May 1992 under UN Security Council Resolution 757.

-- The resolution prohibits all countries from importing goods from Serbia and Montenegro. It also prohibits exports with the exception of humanitarian goods--medical supplies and authorized foodstuffs--approved on a case-by-case basis by the Security Council Sanctions Committee.

-- In addition, Resolution 757 restricts Serb and Montenegrin diplomatic staffing, aircraft operations, and financial transactions. [redacted]

From June through September the UN sanctions against Serbia and Montenegro, while taking a toll on the economy, were not as effective as they could have been because of significant leakages. Some signs of economic dislocation--such as decreased production and rising unemployment--had appeared, but sanctions had not caused extreme hardship.

-- During this time, we estimate that Serbia was probably receiving a substantial portion of its pre-sanctions level of oil imports of 65,000 barrels per day. [redacted]

The period of late September through mid November could be described as a boom time for Serbia and Montenegro as companies learned to exploit the loopholes in the sanctions.

-- During late October and early November, for example, close to 550,000 barrels of oil products were delivered to the Montenegrin port of Bar alone. [redacted]

UNSC Resolution 787 was adopted on 16 November to partially close two key loopholes in the sanctions against Serbia and Montenegro.

-- The new resolution authorized the interdiction of vessels, suspected of violating sanctions, in the Adriatic Sea. NATO and WEU forces there have reportedly boarded close to 200 ships to date. The riparian states are to stop illicit shipments via the Danube River.

-- UNSC 787 also banned the transit shipment of certain strategic commodities through Serbia or Montenegro unless authorized on a case-by-case basis by the Security Council Sanctions Committee. These commodities include crude oil, petroleum products, coal, energy-related equipment, iron, steel, other metals, chemicals, rubber, tires, vehicles, aircraft and motors. [redacted]

**Appendix C**

## Exports Still Continue

Exports in 1992 were down nearly 50 percent and imports down 40 percent from the previous year, according to official statistics, but Serbia's industries continue to earn needed export revenue crucial towards the functioning of the country's pervasive black market. Despite the UN embargo and the drop in domestic production, Serbian exports in 1992--primarily to developed countries and Eastern Europe--reached nearly $2.5 billion and imports were $3.9 billion. From June to November exports fell approximately 19 percent and imports rose 21 percent. Although imports from the developed countries declined from 1991 to 1992, just under half of all trade was still being conducted with these countries. Imports from Eastern Europe remained relatively stable, according to official statistics, and consisted largely of capital and intermediate goods, rather than the consumer goods permitted under UN sanctions. [redacted]

[redacted] firms have negotiated trade deals involving a wide variety of non-energy goods:

-- Fertilizer, other chemicals, and raw materials for the metallurgical and textile sectors account for most of Serbian import deals being discussed.

-- Metallurgical products, textiles, and agricultural goods account for the largest share of Serbian export attempts. [redacted]

[redacted] may indicate that fewer deals are being pursued, and consequently, future shipments may decline. [redacted] following the tightening of sanctions in mid-November, the number of foreign firms negotiating deals with Yugoslav firms declined by half. [redacted]

**Appendix D**

## Financing Sanctions Diversion

A highly developed financial network is also helping Serbian firms continue to conduct business with foreign partners, and providing the hard currency individuals need to buy goods on the black market. We estimate that around $2 billion is being held by individuals and companies in foreign accounts. Serbians are bringing hard currency from Austria and Hungary supplied by relatives working in Western Europe into Serbia, and, according to press reports, possibly drawing off of accounts in Swiss and German branch banks in parts of Croatia. The Milosevic regime, in turn, is tapping into these privately held hard-currency stocks by allowing some private banks, such as Dafiment and Yugoskandik, to offer exceptionally high interest rates on hard currency accounts to attract depositors, by leasing gas stations and stores which are permitted to accept hard currency, and by maintaining links with a variety of hard currency dealers and foreign exchange banks, all with strong political connections to the current establishment.

Only a small portion of the money these institutions take in is kept in Serbia. The rest is moved by courier to offshore banking safe havens such as Cyprus, where the money is kept in the personal accounts of Cypriot citizens or of Serbs operating under aliases. Serbian firms, likewise, keep most of their income in foreign accounts where local banking laws frequently continue to permit Serbian subsidiaries access to their accounts to conduct business not directly involving Serbia.