

Position of the Republic of Serbia in the Context of Russia-Ukraine Conflict - Economic Consequences of (not) Imposing Sanctions on Russia

Mihajlo Djukic, Research Associate, Institute of Economic Sciences, Belgrade, Republic of Serbia, e-mail: mihajlo.djukic@gmail.com

Background – the overall picture

Since the Crimea annexation in 2014, the EU has applied economic and trade sanctions to the Russian Federation, aiming to punish Russia for its invasion of Ukraine. Initially, sanctions targeted individuals and organizations involved in violating Ukraine's sovereignty. However, as the conflict started spreading, especially after the full-scale invasion in February 2022, the EU amended the first package of sanctions several times, targeting Russian economic potential in energy, defense, finances, travelling, etc. By February the 25th, ten sanction packages were adopted, gradually tightening the space for economic collaboration between Russia and the Western world. The EU imposed sanctions against Belarus¹ and Iran² as well. Although the overall aim of sanctions is to impose damage to the Russian economy, thus reducing its capacity to continue the aggression³, the EU approach also considered the global economic position of other countries regarding their relationships with Russia and the EU itself, given its energy dependence on Russia. Consequently, the sanctions have not targeted the Russian export of food and agriculture products to global markets since the EU assessed that it would dramatically hit global food security. Overflights and other types of transport in case of humanitarian support are also allowed. As per the latest EUROSTAT data (third quarter 2022), Russia is still one the leading EU suppliers of oil and gas, accounting for 14.4% and 15% of petroleum oil and natural gas, respectively⁴. Despite of harsh narrative, the EU approach against Russia is still relatively soft, allowing specific economic collaboration patterns. EU officials reported sanctions were effectively causing the Russian GDP to decline by 2.2% in 2022. In contrast, the Russian government expected a 3% growth before the conflict. However, World Bank forecasts from April 2022 estimated an 11% decline. Although the EU and USA are essential trade partners, accounting for more than 46% of the overall Russian export⁵, sanctions have been imposed by countries which account for around one-third of the global population⁶. This fact enabled the Russian economy slowly to adapt to the new circumstances. Moreover, sanctions' effectiveness was additionally reduced by the fact that international companies are not obliged to suspend their operations in Russia, considering potential economic damage which might arise. As per Evenett and Pisani (2022), only 8.5% of the EU and G7 companies had divested at least one of their Russian subsidiaries.⁷

¹ Traditional ally of the Russian Federation.

² Iran provided support by selling military equipment (e.g. drones).

³ <https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/sanctions-against-russia-explained/>.

⁴ https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_imports_of_energy_products_-_recent_developments&oldid=558719#Share_of_energy_products_in_total_EU_imports.

⁵ <https://www.trademap.org/>.

⁶ <https://www.wilsoncenter.org/blog-post/countries-have-sanctioned-russia>.

⁷ Evenett, S., & Pisani, N. (2022). Less than Nine Percent of Western Firms Have Divested from Russia. Available at SSRN 4322502.

Western Balkans context

Western Balkan countries, being under the status of candidates or potential candidates for EU membership, are also expected to align with the common EU foreign and security policy. Namely, EU Parliament resolutions⁸ adopted in March and April 2022 called on Western Balkan countries to align with sanctions as it is formally required following the EU negotiation framework⁹ (in the case of Serbia and Montenegro), Stabilization and Association Agreements for the countries that have not started negotiation process yet¹⁰ (Albania and North Macedonia). Bosnia and Herzegovina and Kosovo*¹¹ are not formally obliged to align with EU foreign policy since not being under the candidate status yet. Their position against the Russian-Ukraine conflict has been closely monitored, and alignment with EU policy is highly encouraged. However, the EU still needs concrete mechanisms to force Western Balkan countries to pursue complete harmonization as this still depends on the political commitment of their governments. While other Western Balkan countries showed certain levels of political comply with EU foreign policy, the political situation in Serbia is, for various reasons, more complex. Serbia and 139 other countries favor the UN Resolution condemning Russian aggression. However, further steps which could indicate eventual alignment to the common foreign and security policy (CFSP) were outside the agenda. Such a policy of balancing East and West provoked the EU officials' adverse reactions, finally putting pressure on Serbia to choose the side¹². Within this paper, we aim to shed more light on issues and dilemmas Serbian officials are facing being exposed (not) to impose sanctions on the Russian Federation and related economic consequences. The purpose of the following elaboration is not to provide rationale or justification for any decision eventually being made in the future but to present potential financial implications and risks. In the following sections, we explain factors that make the Serbian case so complex compared to other countries from an economic and geopolitical perspective. Additionally, the leading collaboration patterns between Serbia and the EU/Russia have been briefly analyzed over the last decade. The final section summarizes economic consequences and essential factors that should be considered having a potential impact on the financial outcomes under any possible scenarios.

Why are Serbian officials hesitating to impose sanctions on the Russian Federation?

Unlike is the case with other Western Balkan countries, the Serbian position against sanctions is relatively different given its rather complex relationships with Russia. Firstly, the Serbian energy sector depends on gas and oil supplies, including related imports from Russia. Around 20% of the gas consumption is produced in Serbia. The remaining 80% is exclusively imported from Russia through Gazprom, which controls the Balkan gas stream pipeline. Russia accounts for approximately 18% of the imported oil, the second largest Serbian partner after Iraq. Secondly, coupled with China, Russia is an important ally supporting the Serbian side in protecting its sovereignty regarding the Kosovo* issue. The role of Russia is crucial, given its veto option within the UN Security Council. Finally, Russia enjoys the public sympathies of Serbian citizens. As per

⁸ https://www.europarl.europa.eu/doceo/document/TA-9-2022-0121_EN.html.

⁹ Stasiukevych, I. and Malovec, M. (2022). EU sanctions against Russia: alignment of the EU enlargement countries. Available at [https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/639327/EXPO_IDA\(2022\)639327_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/639327/EXPO_IDA(2022)639327_EN.pdf).

¹⁰ Albania and North Macedonia have officially started accession negotiations in July 2022.

¹¹ This designation is without prejudice to positions on status and is in line with UNSC 1244 and the ICJ Opinion on the Kosovo Declaration of Independence.

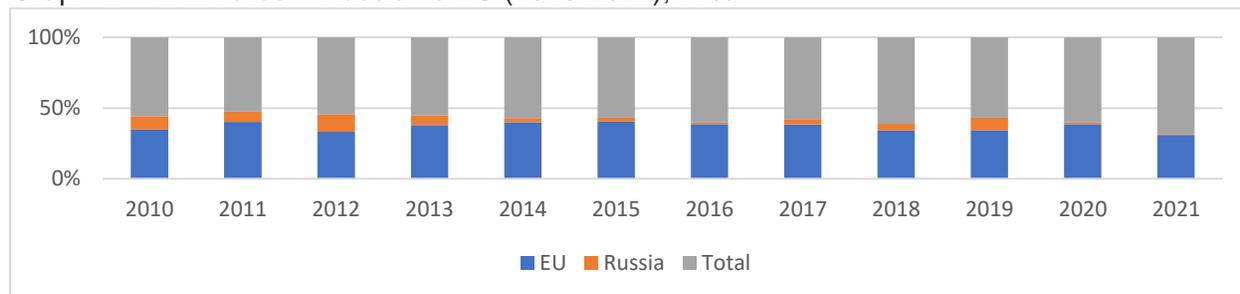
¹² <https://www.theguardian.com/world/2022/nov/01/serbia-must-choose-between-eu-and-russia-says-germany>

the latest public opinion surveys, only 8% of Serbian citizens support imposing sanctions on Russia¹³. NALED survey on business sentiment shows that 60% of business entities believe that imposing sanctions on Russia would have negative consequences through energy shortages, price increases and supply chain disruptions¹⁴. For the above reasons, Serbia carefully monitors the conflict in Ukraine, avoiding confrontations with Russia by imposing sanctions.

Analysis of economic collaboration between Serbia and the EU/Russia

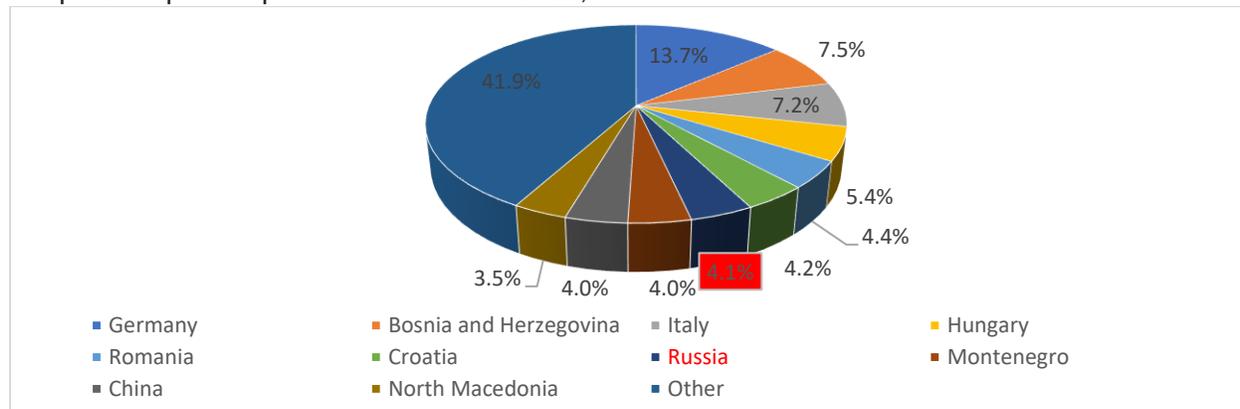
Diving into statistical data, the EU is by far the most significant economic partner of Serbia if foreign direct investments and overall trade are considered. Over 2010-2021, the EU accounted for 64% of the total FDI attracted, significantly higher than any other group of countries, including Russia, which participated with around 9% (Graph 1). EU countries were also main trade partners. Among the top 10 export destinations in 2022 (Graph 2), Russia is ranked 7th (4.1%), while 5 out of 10 are EU members, with Germany being the 1st (13.7% of the total exports). As for imports, China leads with 12.1%, followed by Germany (11.4%) and Russia (7.5%) (Graph 3).

Graph 1. FDI inwards – Russia vs EU (2010-2021), in %



Source: National Bank of Serbia

Graph 2. Top 10 export destinations in 2022, in %

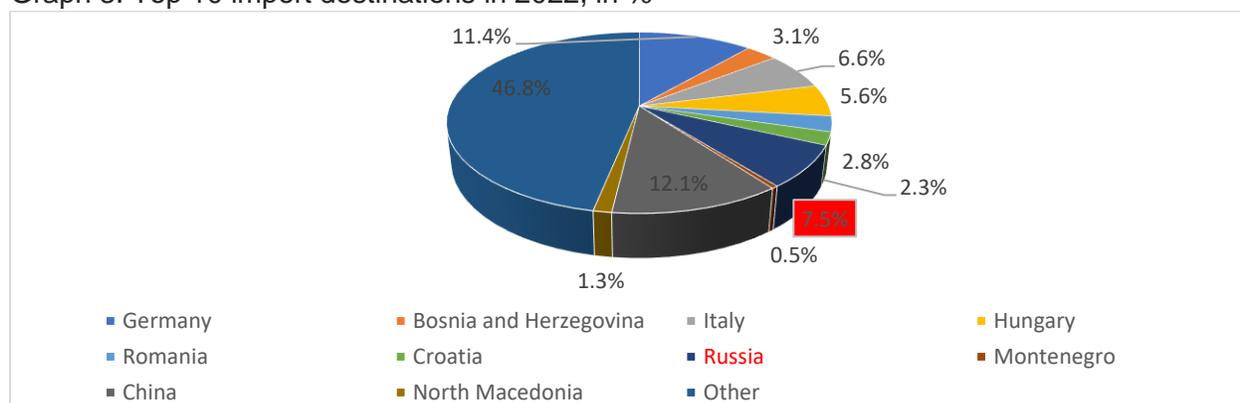


Source: Statistical Office of the RS

¹³ A telephone survey was conducted over the January 5 – 15, 2023, representative sample of 1,050 adult citizens. More details: <http://www.nspm.rs/istrazivanja-javnog-mnjenja/srbija-januar-2023-sns-na-391-odsto.-za-ulazak-srbije-u-eu-355-protiv-477.-protiv-sankcija-rusiji-801-odsto-gradjana-a-podrzava-82-odsto.html>.

¹⁴ Rancic, J. and Stojanovic, B. (2022). The impact of the armed conflict in Ukraine on doing business in Serbia, NALED. More details: <https://naled.rs/htdocs/Files/09623/Impact-of-Ukraine-crisis-on-doing-business-in-Serbia.pdf>.

Graph 3. Top 10 import destinations in 2022, in %



Source: Statistical Office of the RS

From the narrow economic perspective, the standard methodology of economic cost-benefit analysis suggests that the Serbian authorities should introduce sanctions on the Russian Federation if and only if expected costs imposed on Serbia by the European Union (EU) for not aligning with CFSP outweigh the potential benefits which Serbia can derive from its economic cooperation with the Russian Federation in medium to long term. In other words, the Serbian government must define and measure the following decision-making criteria: a) what are the maximum economic losses of possible EU restrictive measures taken against Serbia for not aligning with its CFSP framework; b) how probable is the implementation of each defined policy measure under a) by the European authorities? Given the policy inputs outlined in a) and b), the authorities in Serbia can calculate how much, on average, the Serbian society can lose for not adhering to the official EU foreign policy agenda. The same approach can be used to measure how much, on average, Serbia could lose/benefit from potential economic cooperation between the Republic of Serbia and the Russian Federation.

According to the Policy Department for External Relations of the Directorate General for External Policies of the Union¹⁵, for the 2021-2027 period, the EU has provided financial support of EUR 14.2 billion under the Instrument for Pre-Accession Assistance (IPA) program for Türkiye and Western Balkan economies (Albania, Bosnia & Herzegovina, Kosovo*, Montenegro, North Macedonia and Serbia). These numbers are, on average, in line with the EUR 1.5 billion of IPA II funds Serbia received from the EU between 2014 and 2020¹⁶. However, using the IPA funds is conditional on the “progressive alignment with the Union’s CFSP, in particular on issues where major common interests are at stake, such as restrictive measures”, according to the recital 8 of the IPA III regulation.

Previous economic collaboration analysis (FDI and external trade) suggests that the Serbian government has no rationale to sacrifice cooperation with the EU if forced to choose between the EU and Russia. However, energy collaboration with Russia and geopolitical factors slightly blur the picture. The benefits of the approximately EUR 3.5 billion IPA funds between 2014 and 2027 mentioned above are matched mainly by the favourable natural gas import prices from the Russian Federation from mid-2012 to mid-2025. In particular, according to Vuk Vuksanovic from

¹⁵ Stasiukevych, I. and Malovec, M. (2022). EU sanctions against Russia: alignment of the EU enlargement countries. Available at [https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/639327/EXPO_IDA\(2022\)639327_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/IDAN/2022/639327/EXPO_IDA(2022)639327_EN.pdf).

¹⁶ Astrov et al. (2022). Overshadowed by War and Sanctions. wiiw Spring 2022 Forecast Report. Available at <https://wiiw.ac.at/overshadowed-by-war-and-sanctions-dlp-6138.pdf>.

Belgrade Centre for Security Policy (BCSP), between mid-2012 and mid-2022, the Serbian economy imported natural gas from Russia for 270 \$ per 1000 m³, while the Serbian media outlet Danas reports that between mid-2022 and mid-2025, the average price of imported natural gas from Russia will be around 400 \$ per 1000 m³ for the first 2.2 billion m³ of natural gas consumed and about 800 \$ per 1000 m³ for the additional 800 000 m³. The subsidized natural gas prices mentioned above are considerably lower than the average natural gas market price paid by the EU between 2012 and 2023¹⁷, although the collaboration has been often criticized for the lack of transparency and involvement of mediation companies which eventually caused Serbia to pay even higher gas prices compared to its neighbours¹⁸.

Concluding remarks

A narrow economic perspective shows that the EU is a more significant financial partner for Serbia. Thus, if not aligning with CFSP causes imposing severe restrictive measures on Serbia with respect to value chain integration and international trade, the Serbian government would have no economic rationale to stay on the same path. Even if benefiting from obtaining gas and oil at lower prices, as has been the case so far, the opportunity costs of losing financial injections related to capital inflows, foreign direct investments and IPA funds seem too high to be neglected. Using a more dynamic EU accession policy as a foreign policy instrument would make the situation even more apparent, increasing foregone economic benefits related to access to more generous EU funds and involvement into global value chains. Nevertheless, it should be noted that the status quo policy is still a preferable short-term option for the Serbian government, weighing the potential economic damage of disrupted energy financial arrangements with Russia on one side and the vague European perspective and the fact that the EU integration process has been almost frozen over the last couple of years on the other (Djukic, 2022)¹⁹. On the other hand, in the medium to long term, status quo seems extremely unfavourable since it could leave Serbia in the EU neighbourhood for years falling into quite isolation without reasonable alternatives.

¹⁷ The natural gas market price between the 1st of July 2012 and the 1st of January 2023 averaged 406.7 \$ per 1000 m³. More precisely, between the 1st of July 2012 and the 1st of July 2022, the aforementioned price averaged 353 \$ per 1000 m³ and 1493 \$ per 1000 m³ for the subperiod 01.07.2022-01.01.2023. For details, visit [https://fred.stlouisfed.org/series/PNGASEUUSD#Global price of Natural gas, EU \(PNGASEUUSD#\) | FRED | St. Louis Fed \(stlouisfed.org\)](https://fred.stlouisfed.org/series/PNGASEUUSD#Global%20price%20of%20Natural%20gas,%20EU%20(PNGASEUUSD#)|FRED|St.LouisFed(stlouisfed.org)).

¹⁸ <https://serbia-energy.eu/serbia-the-story-of-jugorosgas-company-that-mediates-in-the-supply-of-gas-with-russia/>

¹⁹ Djukic, M. (2022). Stuck in the Middle with EU - Serbian Accession to the European Union, Current State and Future Perspectives, EMERICs project; Available at: <https://www.emerics.org:446/issueFileDownload.es?brdctsNo=317309&brdctsFileNo=81508>