

KOSOVO: THE PRICE OF NOT SOLVING

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MISSION

Futurist Institute is not a scientific institution, but it is connected to science, principally to all research and scientific projects, whose initiation and implementation pushes Serbia into the future.

Futurist Institute is created in order for those steps neither to be slowed down, nor to be backwards and in order to come closer to that which this and all countries ought to be in the future, today.

With the establishment of the Futurist Institute, we want to hurry up towards that future, with giant leaps, simultaneously preparing the entire society for what changes inevitably bring with them.

Therefore, the Futurist Institute is envisaged as, above all, think-tank organization in which on daily basis options of development and their impact on the social processes are to be elaborated.

As a result, out of such Futurist Institute, recommendations and projects for further development of Serbia are to come out.

Should we build refineries or thermal power plants, or devote ourselves to the search for new energy sources; should we invest in the production of internal combustion engines or in electrically powered engines; should artificial intelligence be developed and how; for which jobs upcoming generations are to be prepared; which type of social interactions, which system, what kind of governance will be the most appropriate in the year 2050; is there a space for Unions, political parties, NGOs within a highly automatized society, society of A.I. and how those should look like within such society; what type of business they should be engaged in; is there a computer ideology; what are and what will be the basis for the energy balance of Serbia, and further, of the complete world; which illnesses are we faced with in the upcoming thirty years; how can the prolongation of life expectancy impact the society, economy; what else do we need to prepare ourselves for; what kind of media do we need for new, virtual reality.

This is why the Futurist Institute recognizes the State as its principal partner, and it will offer the State joint project collaboration and results themselves, as a basis for initiation of new processes which should be integral part of the new development strategy. The strategy that clearly recognizes the future, all obstacles and best paths to enter such future, without fear and anxiety, with prepared answers for the challenges it is bringing.

In addition, partners of the Futurist Institute ought to be all others who do need future planning. University, scientific organizations, industry, education, medicine, digital sector, media sector, transportation, energy sector, environmental, social, etc.

It is our goal together with all of named parties to set and plan the future, to seek new paths, ways, innovate, speed-up, resolve and connect the State, society and all elements that comprise it into a joint collaboration effort with one simple goal –better future.

In so doing, the Futurist Institute has no, and needs not to have, type of claim which pushes towards idealizing self procured solutions and their imposition as the only and inevitable ones.

On the contrary, it is a starting point, the vessel which pushes and tows decision makers to that type of atmosphere, filled with various, but appropriate, proposals which enable adequate recognition and adopting good decisions.

We exist to present available options, their obstacles and dangers, as well as all the solutions.

We are here to make the society think creatively, to initiate the ongoing process of solutions finding, to present the future as a challenge, opportunity, and not as a problem, and to impose a new model, one which comprises facing the challenges, not avoiding them.

Inevitable topic we are introducing ourselves with is Kosovo and how high is the price of dealing further with it in the “borderline autism or shutting eyes to the reality” manner. Long time ago, such type of perceiving the world philosophy named Solipsism (from latin Solus meaning **Alone** and Ipse meaning **Self** – only I do exist; only my stand point is independent of the reality) and marked it as deeply wrongfull and seductive. No problem will be resolved by ignoring it. On the contrary, neglected problems are growing to the point when they cannot longer be ignored. However, at that point they are so huge that any feasible solution is not sufficient.

For us, such a problem is Kosovo. Even when we tried to resolve it, it was superficial, without going deep into it, hoping that all unplesentaries will disappear into thin air. Today, we can see they will not vanish; we have neglected it for so long that it had managed to determinatively grasp our future. Many crisis situations, wrong paths, blind roads cannot be corrected until this great burden is lifted from our path. Therefore, we believed that one institute, which will deal with the future in Serbia, firstly needs to propose what is the problem of all problems and to direct its resolvement.

Kosovo – the price of not solving

Vol.1

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A lot has been said on the Kosovo topic, from mythology which regards Kosovo as the most expensive Serbian word, therefore priceless, over pledges to the “heart of Serbia” and promises that “we shall never give it up”. By only mentioning southern Serbian provenance, emotional charge is vast, and owing to it, “the price” (financial expression of the nominal offer and demand), or “the trade” (process of exchanging goods and services) are those topics in Serbia, when linked to Kosovo, to be avoided.

At the same time, Kosovo costs today, and will cost us in the future, within all exercised scenarios, even in the one where it again would be ours. State treasury would, in that case, receive nearly two million new tax payers, possibly some of the lost assets, but at the same time a string of costs, from infrastructural to medical, educational, local, social and security related ones (according to data from the time of Former Yugoslavia, other Republics have, in the period from 1961 to 1990 provided more than USD 17 Billions for the security, out of which the Republic of Serbia has provided USD 5 Billion. Currently, according to the economists’ estimations, the Republic of Serbia is

providing annually EUR 500 million... so it is hard to foresee that according to this scenario our balances would be positive.

However, this is a highly desired outcome, the subject of other analyses, but for this analysis we focused on the price of one, highly likely outcome.

In the Theory of Chaos, extreme sensibility to initial conditions is explained with famous „Butterfly Effect“, sentence which states that flapping of the wings of a butterfly in Beijing can cause a hurricane in Florida.

In other words, every movement, everything we do, contains within it a series of often not foreseeable consequences, which are, again, inevitable.

In conducting this analysis, we dared to somewhat invert things, not touching the main concept of the cause and effect of events.

So, we have taken the assumption what would happen if nothing happens, meaning, metaphorically speaking, that all butterflies, at one moment stop flapping their wings. Simplified, we have tried to assume the price of not doing anything, which is one of the possible scenarios for Kosovo.

What doing nothing befalls, what are its consequences, what does it lead towards, what is stopped forever, and what for a definite (and which) time period, what it moves, and in which direction and what is the final outcome, for Serbia, of avoiding confrontation at any price, which awaits us anyhow in every single sequel in the topic of Kosovo.

Before that, we shall briefly, without deeper introspection into the subject, name several facts on the price of the worst-case scenario – resolution of the dispute through an armed conflict with Kosovo Albanians.

Firstly, what needs to be known is that the last war for Kosovo lasted some three months and the damage that Republic of Serbia suffered is estimated at USD 30 Billion in direct and USD 130 Billion in indirect damages.

Of course, major part of damages was caused by the bombing campaign conducted against Serbia, but as no guarantee exists that the same countries

would not in case of new armed conflict bomb Serbia again, conclusion cannot be avoided that within those estimations, one should seek the main economical price of what we would lose again.

Second estimation is the one on lives. Within the three-month long conflict in 1999, we have lost, according to official reports, approximately 2,500 civilians and 1,008 policemen and soldiers.

As much as it seems unhuman, human life is also prone to statistics and estimations, and here are some of those unpleasant figures.

Human life is, on various grounds, priceless, but stringent statistics officially estimates it in the range from EUR 300,000 – EUR 700,000. (Globally, this task is reserved mainly for insurance houses, and in that manner, in USA, insuring a human life for one year is valued at USD 50,000. On the other hand, researchers from the Stanford University claim that a year in human life is worth almost USD 130,000. We have used domestic and European estimates). If we accept that and decide on a mean value, we calculate that through proposed price of life, in the 1999 war, we have lost additional one billion and 754 million EUR. If Stanford University estimation is accepted (value of one year, times number of deceased, times lost years), the bill is far higher – nearly USD 15 Billion.

Above stated price is one without all those values that accompany a life – from lost working hours, assets owned, social and cultural role to demographic value, in the terms of loss of future generations.

If all that is added, the price is several times higher, and if figures of ammunition, fuel, logistics, medical equipment, recovery time for the wounded are added to the calculation, already mentioned material damages... it is clear that new, even three-month long war, would cost ten times more than consolidated state expenses in 2017, which amounted to EUR 16 Billion.

If we know that expenses are on par with budgetary income, and that Republic of Serbia has constant surplus, and that budget comprises GDP growth in this year, at the level of 3.5 percent, it is easily concluded that we would have to

work at least 100 years with the same savings and growth of GDP in order to earn enough money for a three-month war on Kosovo.

That period would decrease, for some ten years, if we would invest our foreign currency reserves, which are just over EUR 11 Billion, which is again, ten times lower than the total price of possible war.

That is enough on the worst-case scenario. There are two more, very abominable ones, but we also left them for another research. In the first one, which occurs if we decide to annul all current agreements, stop future ones and decline in advance any proposed solution, we would probably experience international embargo, excommunication from the international community, assets freezing, immediate blockade of donations and investments again... how much would that cost, it is impossible to say, but as a comparison, it should be mentioned that economists' estimations on embargo imposed in 1992 (whose main effect – hyperinflation - we still vividly remember) were at USD 125 Billion.

How much has, alongside that, anyone of us lost, when salaries have dropped from 1.000 German marks to 20 German marks and when everything is devaluated and devastated, from assets to jobs, it is impossible to calculate.

Within the second abominable scenario, negotiations on Kosovo are indefinitely prolonged, for years. In that case nothing economically catastrophic is happening, but instability and uncertainty as well as constant delay of admittance to the EU, for sure have an impact on flow of investments and further growth. On the other hand, during that, indefinitely long period, we would for sure, as far as Kosovo is concerned, enter a “boiled frog” mode – over time we would, unwittingly give the Albanians whatever they want, and we would not get anything, which, also we would not be able to notice.

Finally, we deal with the scenario to which this analysis is devoted. The scenario in which nothing happens...

Facts and Law

Why Resolve Kosovo Status Now

Question asked in the subtitle is an expression of the usual attitude in Serbia and is derived out of the immutability of the position, claim, that Kosovo is an integral part of the Republic of Serbia since 1912, and that it has been occupied by military force and illegally separated in the year 1999.

On that part of the territory of the Republic of Serbia, by UN Security Council resolution, based on Charter of the United Nations, Chapter VII (meaning it is compulsory to all member states), temporary civilian and military protectorate has been established, while all jurisdiction of the Serbian Authorities has been suspended on that territory.

This resolution has been accepted by and agreed with the Republic of Serbia, as a state, and it was accordingly passed, even though China, as a permanent member state of the UN Security Council had not voted for it.

Moving aside the fact that the Republic of Serbia has convalidated, by accepting the Resolution, illegality of the forced used on it, and underlining only the fact that international protectorate in Kosovo, formally as temporary, until the final conclusion has been reached, exists with the Serbian acceptance.

That final solution is not detailed in the Resolution, but only stated as an essential autonomy, with guaranteed territorial integrity of the FR Yugoslavia, whose legal successor is the Republic of Serbia.

From that, the assumption is derived that existence of said Resolution is enough of guarantee that Kosovo cannot be legally separated from Serbia, and that it should legally guard it, until circumstances arise under which it is possible to establish factual sovereignty of the Republic of Serbia, even with essential autonomy.

That understanding is widely accepted with the colloquial term “frozen conflict” with often linking of it to the analogy of Cyprus case.

The first mistake in that concept lies in the fact that conflict, illegal foreign aggression, has legally ended with the Kumanovo Agreement, and that conflict, at least legally, does not exist any more.

This leads to the fact that the commitment for “frozen conflict” is a wrong phrase and that the ones mentioning it, actually commit themselves for “frozen status”, namely keeping present status of Kosovo, as a UN Protectorate on the part of the territory of Serbia, until new, future, more favourable conditions, realities arise.

Proponents of that understanding do believe that the integrity of Serbia is indefinitely secured and protected by the existence of said Resolution, which cannot be altered without consents of China and Russia, as well as the fact that formal creation of Kosovo, as a State, would be contrary to the set of general rules and principles of the international law, such as immutability of borders, ban of use of force, etc.

Error in said calculation is that it is based on superficial and high expectations, and especially on wrong perception of the reality from 1999 until present day.

It is superficial as deeper analysis of the Cyprian crisis shows that there frozen status does exist, but only in the Northern part of Cyprus, which is factually independent, but legally recognized by only one state - Turkey, and as such is without changes since the year 1983, and most probably for years to come.

Also, proponents of “frozen conflict”, starting from wrong assumption, wrongly equalize position of Serbs in Kosovo with position of Greeks in Cyprus, which is totally wrong, especially since position of Serbs has much more similarities with the isolated position of Turks in Cyprus.

Meanwhile, other parts of the Cyprian territory have not only continued undisturbed and normal existence, but have, without obstacles (unsettled borderline and territorial dispute) been accepted to the EU, which again means that the status has changed significantly.

Let us now take a look on Kosovo reality, which is being omitted by those who, superficially, link it with the Cyprus case.

Analysis of the international statute of Kosovo, since the year 1999 till today, unambiguously show obvious, permanent and phasal coming forward in the rounding of the factual state of the Country, and alongside it, weakening of the primary scope of the international protectorate.

To that should be added significant increase of the state capacity, which was produced by the declaration of independence, after which nearly 100 countries (Kosovo claims more than, we claim less than that number) recognized Kosovo as an independent state.

Aside the fact that neither by declaration, nor by acts of recognition, Kosovo has not become, legally speaking, neither independent country, nor state, it was sufficient to factually increase number of state insignias, proclaim Kosovo Constitution, open foreign embassies in Pristina and Kosovo's across the world, etc.

In other words, number and the type of factual authorizations of the state of Kosovo constantly increase and significantly are enlarged for the past 19 years, with the tendency of further growth.

As a conclusion legally, status of Kosovo is frozen, and it is formally part of Serbian territory under international protectorate, in which Serbia has no authority.

Factually, Kosovo has over time obtained large number of State authorities, which makes it, unfortunately, not part of the Serbian territory under international protectorate, but de facto, state with disputed subjectivity and sovereignty.

Unacceptance of its status by the Republic of Serbia, and members of UN Security Council China and Russia, are preventing it from complete international subjectivity.

As big powers have no friends or foes, but only interests (Milovanovic, Palmerston), it does not deem sensible to rely the faith of the Republic of Serbia on that type of expectations, as no guarantees can be provided that

tomorrow Russia (due to Crimea or Ukraine) shall stop blocking dislvement of the protectorate, or for China (due to favourable outcome of the trade war), again not to be present during the voting time in the UN Security Council.

All aforementioned pushes for sooner rather than later resolving of the Kosovo topic, but due to sceptics, let us see whether the Republic of Serbia can linger until better circumstances, for Serbia, are reached.

Let us start from the best assumption, according to which none of the external factors changes for worse for the Republic of Serbia and all topics related to the status are frozen in their present stance.

Several important facts are obtained here, first one being that financial – economical recovery and growth of the Republic of Serbia are based on expectations exactly from those countries from which largest investments, credit lines, donations are coming, that disputed status of Kosovo shall be resolved, with all interested parties satisfied.

Other one is, that exactly those countries, our main investors not only would stop investments, but also admittance to the EU.

How much would that impact excellent economic results Serbia is reaching today - what would be stopped – in those facts lies the answer to the question how long the Republic of Serbia can wait.

Well, let us see that.

Price of stall

Economical Indicators

Aim of this document is to - in brief and based on available limited time frame needed for detailed research, but based on clear assumptions, using basic historical data - provide introspection, primarily into economic consequences of lack of long-term sustainable solution of the Kosovo issue.

Period for which certain economical parameters are foreseen is no longer than 10 years, having in mind that longer estimations bear higher margin of error.

Demographic parameters allow longer assumption period with acceptable margin of error.

For the purposes of comparison, data from the year 2001 have been used, considering that period is long enough in order to clearly identify cycles and determine legalities of the effects of economic policies on key results.

Not going much into elaborating consequences of the frozen status on the territory of Kosovo or refusal of obtaining comprehensive sustainable agreement with Kosovo Albanians, we have focused on an economic sustainability of the solution and of course on consequences on the society as a whole.

In reality, throughout the history of modern Serbia Kosovo has always represented some sort of fate of our society. It is the cradle of statehood, as well as corner stone of cultural and national Serbian identity, today inhabited with majority of the Albanian population. Conflict between two ethnic groups is almost regular, expressed with lower or higher intensity and represents the only constant in relations of the two ethnic groups in that area.

From the mid-eighties, when it slowly became evident that self-governing socialistic system is gradually desolving, ethnic tensions in the entire former Yugoslavia became severe and reached their peak during the nineties with war and breakdown of the country, and by the end of the decade with Kosovo war and Nato bombing campaign, which ended with horrific consequences for

Serbia and lack of any state control on the territory of Kosovo and Metohija, aside of small strip of land in the North of Kosovo around Kosovska Mitrovica. Even though Serbian population from the North of Kosovo in majority boycotted the Census in the year 2011, it can be accounted for that Serbian population is largely in minority with no more than 50-100 thousand people in the territory which is populated by 1.7 million inhabitants. After the pogrom in the year 2004, when it became evident what is to be the faith of the Serbian population in an orderless system, Kosovo has declared independence in the year 2008. Independence was recognized by some 100 countries, among which nearly all countries from the region and all developed countries with several exemptions, such as Spain, where refusals of recognition mainly relate to countries in which ethnic groups with strong secessionistic tendencies exist.

Political price of not resolving Kosovo issue is simple and it is seen as more or less constant misunderstanding with the EU as the key economic partner of Serbia in regard to membership in that organization. Even though prolongations and wrong solutions existed from our side in the judicial area and in the rule of law, **key stalling element is actually not resolved issue of Kosovo.**

Starting point in the analysis and grading of lack of sustainable solution in the territory of Kosovo was the issue of Serbian integration into European associations, foremost EU, as the key economical and political power on European territory.

Key determinant of the Serbian future is EU membership, having several facts in mind:

1. EU is our leading trade partner. Total foreign trade in Serbia in 2017 has been EUR 34 Billion, out of which EUR 19 Billion are imports and EUR 15 Billion are exports. **EU contribution in total foreign trade is 64%.** Export contribution is 66% while EU contributes 62% in the total import of goods.
2. EU represents block of countries from which most direct foreign investments originate. Only in the period since 2010, approximately 70% of direct foreign investments originated from EU countries.

3. Total public and private debt of Serbia amounted to EUR 26 Billion at the end of 2017. Out of this amount, financing sources from development banks and institutions such as EBRD and EIB amounted to EUR 4 Billion. On the other hand, out of balance sum of the domestic banking sector which amounted to EUR 28 Billion at the end of 2017, **70% related to the banks domiciled in the EU countries.**

4. Complete foreign non-refundable aid from EU to Serbia from 2001 to 2015, according to the data of the Delegation of EU in Serbia surpassed EUR 3 Billion, **and 75% in total non-refundable funds.**

Geopolitically and geoeconomically speaking, membership in the EU is an imperative having in mind the fact that nearly all countries in the region are EU members or on the road towards membership.

This is crucially important when discussing trade relations with countries from the region. In relations with Bosnia and Herzegovina, Montenegro, Croatia and Macedonia, the Republic of Serbia marks constant surplus for a longer period of time, while in the trade with Slovenia, Serbia marks relatively low trade deficit.

Total trade with these countries in the last year amounted to EUR 5 Billion, out of which our export to the countries of the region amounted EUR 3.5 Billion, while our import was EUR 1.8 Billion.

Table 1. Trade overview with the countries of the region

EUR MLN	BiH	Croatia	Macedonia	Slovenia	Montenegro	Total
Total Export	1,212	548	562	499	726	3,547
Total Import	516	478	208	531	51	1,783
Net Export	696	70	354	-31	675	1,764
Source: RZS, data for the year 2017.						

In the wider context, EU membership represents one of the key pillars of development, for a number of reasons.

1. By analyzing the experiences in the last 30 years, meaning from the beginning of the nineties, EU has managed to refute classical economical

setup, that capital moves from the zones of lower to the zones of higher profitability. In the case of EU, and especially in the countries which opened the membership negotiations and later became EU member countries, **inflow of capital is nearly perfectly in line with the upgrade of the institutional frame.** That basically means that stability, political and economical, foreseeable and long-term projections of long term changes and wider economic space, and not the potential profit, is seen as key assumptions of capital inflow in a certain country or region.

2. Accelerated technological development demands higher level of investments both in trade and non-trade sectors as well as in institutional infrastructure. Smaller countries, outside of economic associations such as EU, can hardly realize demanded investment rates having in mind the fact that **investors as a rule have higher appreciation for larger rather than smaller economical space**, higher level of institutional development, meaning lower costs of transaction and significant opportunities for realizing advantages from the economy of volume. This is one of the key development parameters, having in mind that economy of knowledge based on innovations and technological development represents the paradigm of modern economical system.

3. Financial intermediation has proven to be a two sided blade. Primarily, growth of financial intermediation leads to undoubted growth of all parameters in the development of economy, but structurally can be challenging, which was proven on the example of Serbia, as it foremost speeds up development of nontradeable sectors, having in mind lower risk of entry and exit and higher return of investments. However, financial intermediation is an absolutely necessary element of development, and financial institutions are highly sensible to institutional arrangement, before all of the legal system. Perceived risk of the country, as a joint denominator of various elements of the economical, political and other risks, represents one of the main variables in determination of readiness of financial institutions to invest its assets into certain country. Especially for financial institutions which bring long-term funds, knowledge and capacity for improving the institutional frame. This simultaneously avoids or diminishes the effect of hot capital, which is primarily driven with high rates of return and extremely short period of ROI, which leads to the violation of stability of the countries' financial system and significantly

leads to institutional disorganisation and maximization of social differences. These are the reasons due to which level of integration into the EU framework is, to some point, a guarantee of the quality of financial intermediation, which leads to significant quality of economic development.

4. Through the system of concentration of the capital on already developed segments of the society, capitalism is undoubtedly leading to inequality in regional development and augmentation of social differences. This is more than visible on the example of Serbia. However, EU has mechanisms and, even more importantly, funds to reduce effects of such differences. Preaccession and especially accession funds turn special attention to equal regional development, maintaining functionality of small agricultural properties and small businesses, integration and economic independence of socially endangered groups, higher inclusion of women into the business etc. These funds are limited, and **smaller peripheral countries with the lower level of development lack sufficient funds to balance out the growth and development in regional units** and in different social groups.

When we consider above mentioned factors and put them in the context of today's political decisions and their mid and long-term effects, it is necessary to correctly define the starting point.

Serbia is a country which only begins to reach Europe in most development parameters, such as GDP per capita, participation of investments in GDP, medial income, educational funds, funds for science and technological development, rate of unemployment, especially with young population, educational level of the population, and demographic characteristics of the population...

Two are the crucial constants in the last twenty years in the political life of Serbia: efforts on resolving Kosovo issue and the membership in the EU. It has proven that these two questions are interlinked in such detail that it became evident that **without reaching sustainable solution for Kosovo issue, EU membership is not possible.**

If we assume that reaching sustainable solution for Kosovo is not possible, we can assume, with definite level of certainty what are to be economical, demographic and social consequences of such future.

1. **Nothing will happen in short-term.** In the first year or two in this scenario, no changes will occur in the functioning of the economical system. Commenced investments will go on, foreign trade will not suffer larger changes, and economical growth, mainly led by investments and exports shall continue to grow at 3.5%-4.5%. In such a situation, consumption will increase due to higher income, which can additionally boost the growth.

2. **Mid-term is the period when first negative changes are expected.** While economic performance of Serbia has continued to improve during the first years of not resolving the Kosovo issue, hidden changes are the ones that will occur during the 3-5 year mid-term period.

a. Slowdown or even complete halt in negotiations on EU membership is one of the first consequences to be realized within the first year or two after failure to reach solution.

i. All preaccession funds would slowly be cancelled. According to the most important of those, IPA fund, for the period 2014-2020, Serbia is to expect approximately EUR 1.5 Billion.

ii. Credit lines by EIB and EBRD and such institutions shall be gradually lowered, new ones not approved, or those approvals will be at the significantly lower level, i.e. level compared to economic crisis period.

iii. Direct, non-refundable aid by EU will be decreased and cancelled at a rate at which membership negotiations are halted.

b. Having in mind that EU accession is one of the main foundations of supposed institutional and political stability, its halting would represent definitive signal to international institutions, foremost rating agencies, that total rating, at first due to the perception of higher political risk, should be revised, so that from current BB stable outlook, we would swiftly fall to negative outlook and consequently would be further decreased.

i. Every decrease in rating would be followed with an increase of interest rates, not only for new loans, but also for existing ones in which such a clause has been agreed.

ii. Worsening of the rating would not only lead to an increase in interest rates under which the country is borrowing funds, but in the mid-term would lead to decrease in available cheap credit lines on the international market, which would increase the price of borrowing.

1. In the two to three year period of such scenario we could easily come into the situation when the price of borrowing could reach the levels before the year 2012. Namely, strong growth of deficit in this period influenced latter increase amount of borrowed funds' interest rates to be repayed, which have until the year 2015 reached approximately EUR 1 Billion, or 11-12% of the total expenses of the country. By that, share of the costs for repaying interest rates (meaning roughly speaking average interest rate on public debt) reached 4-4,5%. If positive fiscal tendencies continue, lowering of interest rates on new loans can be expected to provide decrease of interest rate on public debt. However in worst case scenario, these tendencies can invert and we could be in a situation where interest rates on public debt are again rising.

2. This increase in interest rates would impact financing of the investments, as due to higher interest rates and lesser amount of funds in the state budget due to the higher expenses for repayment the interest rates, some investments could be unprofitable or their financing would be aggravated.

3. As in public, increase of interest rates would impact private sector, foremost loans of central banks to its local subsidiaries, which would immediately affect interest rates on domestic market, through the increase of margin.

4. It is assumed that financing of foreign currency denominated state bonds would not be jeopardized at first, but interest rates would certainly grow higher while the price of bonds would be decreasing, additionally proving decline in solidity of the financial system.

c. In parallel with above described events, it is realistic to expect that rate of investment would be gradually decreased. Regardless of good relations with countries such as Germany, Austria, Hungary or Italy, investors would deem the negative signal in relation to future EU membership as worsening of the investment climate and would for sure transfer their investments to other markets. This refers not only to investors from EU, but nearly all investors from so called West or group of developed countries including some of the Arab countries. Total amount of foreign direct investments could in the 3-5 year period decrease to the level of financial crisis, at EUR 1.5 billion from EUR 2.5 billion reached in year 2017.

i. Decrease in direct foreign investments to the economic crisis level would lead to decrease of GDP growth rate by at least 1 percentage point (based on year 2016 data) in the reference scenario, while in the worst case scenario would go to 1.5 PP.

ii. Next consequence would be the decrease of employment rate and gradual increase of unemployment. Within the 3-7 year period unemployment could reach crisis level of nearly 25%.

iii. In addition to decrease in new investments, it is possible to foresee that some of existing investors would retreat, which would additionally negatively impact GDP growth rate and could bring the system into the zone of negative growth rates. Total correlation of investments and GDP necessary for positive growth of GDP would be jeopardized as rate of investing could decrease from current 20% to 18% in reference and in worst case scenario to 15%.

iv. Decreased inflow of the foreign capital, with higher costs of financing the foreign debt would automatically lead to problems in ensuring the stability of the domestic currency and higher sensitivity to external monetary shocks. First effect would be an increase in Foreign exchange rates as lower offer of the foreign currencies must invoke increase of price of foreign currencies. Although NBS has robust foreign exchange reserves, dependent on the intensity of the shock, even if intervention diminishes foreign exchange reserves, by selling foreign currency NBS could not keep the rate stable for longer than 18 months.

v. Each increase in foreign exchange rates in an already known sequence, would lead to increase in price of imported goods, and later of domestic product, which would altogether lead to higher inflation rate. Even though inflation itself could provide certain impuls to

industrial growth that effect would be of short term and swiftly exhausted. Level of deposits in domestic currency would be drastically reduced not only in private sector but also in the industrial, and all effects of Dinarisation from the last 10 years would be diminished. There are no fiscal measures which could prevent this scenario, as disturbance would not be on an economic but on structural level, impacting financial and real sector.

vi. Decreased inflow of investments would lead to further technical delay of the industry and society primarily in capital burdened segments, and also in informational technology where we mark significant results. Somewhat lesser impact would be felt on expensive infrastructural projects, considering that countries such as Russia or China would continue funding infrastructural activities, but at higher costs of capital and possibly with higher political demands.

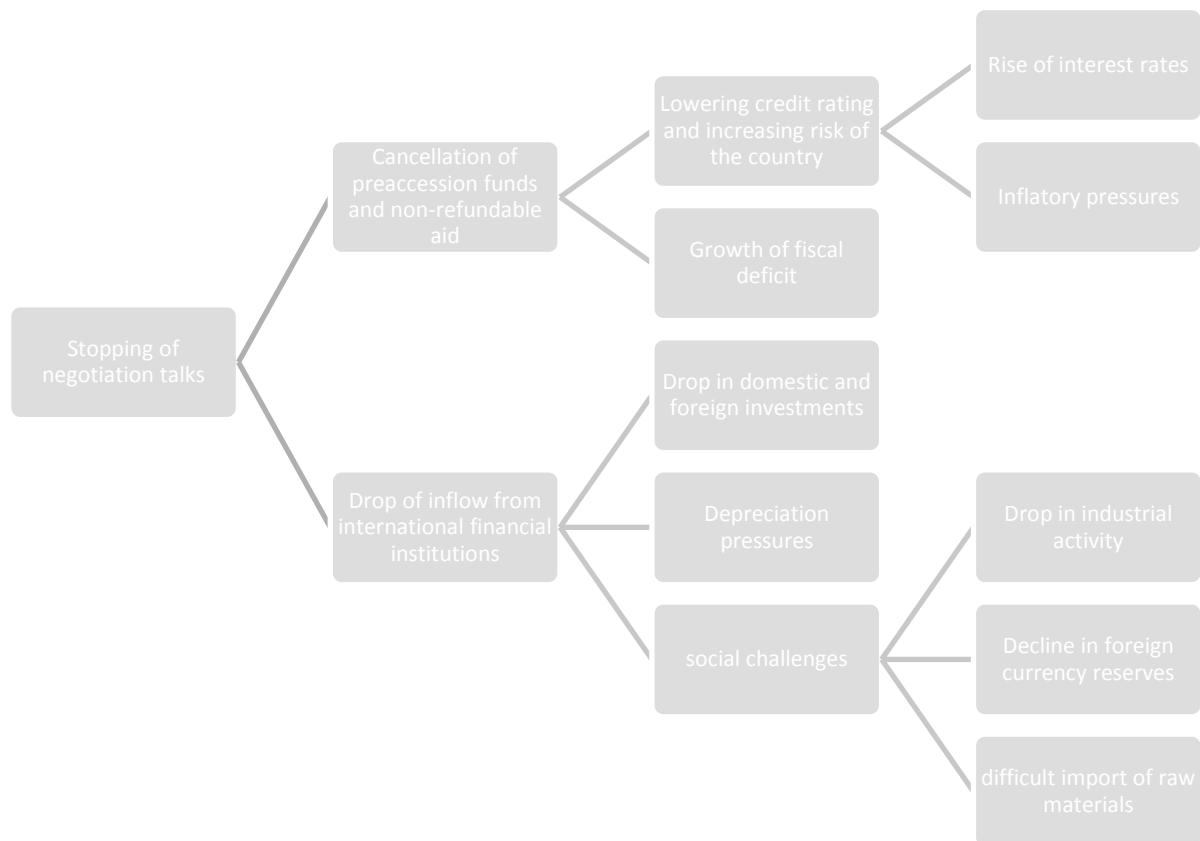
d. Effect of such negative spirale would automatically transpond to social sphere, meaning givings to social welfare and healthcare could be reduced to the level similar to the one from economic crisis, but this time without the possibility for public sector to go into new loans, having in mind already high level of public debt, which was not the case in the year 2008, because public debt was decreased drastically with write-off of the debts by Paris and London club of trustees.

i. During the course of economic crisis, significant level of social pressure was decreased with high growth rate of public debt which was predominantly used for maintaining the unrealistic level of consumption. This strategy brought the country to bankruptcy which was undoubtedly shown by the rate of consolidated budgetary deficit in the year 2012 of 6-7% in GDP which in the coming years marks a trend of decrease after conducting series of measures of fiscal consolidation. Stake of public debt in GDP reached its peak of 75% in the year 2015, followed by a decrease to 60%. In parallel with the decrease of direct foreign investments, increase in price of borrowing and not having further increase in public debt both in public and private sector, and under the assumption of the wish to keep some budgetary balance, the Government would be pressured to again put in effect savings measures for salaries and pensions in public sector, considering that these are the only two areas in which savings on the budgetary level could provide

significant results. Other option would be financing of the deficit with monetary expansion, but if the Government would exercise such action it would swiftly go into the hyperinflation which we do remember from the early nineties.

e. Political consequences of this scenario are not possible to foresee from the present standing point, but can be calculated with rise in right wing political parties, political instability, social unrest and wanderings into the foreign politics relation, in which, again, nothing would depend on us, but on relationships between big powers.

Graph 1. Overview of the possible economic effects of stopping the negotiations on EU membership in mid-term



Source: Authors

3. **Biggest changes can be expected in the long term, meaning in the 7-10 year period.** All negative trends that appeared in short and developed in mid term are reaching its peak.

- a. In an economical sense significant delay can be expected in development compared to all European countries and especially compared to neighbouring countries. While EU membership can be expected for Montenegro and Macedonia, it is somewhat harder for Bosnia and Herzegovina and Kosovo, even though such scenarios are possible. In the best case scenario, in the period 2018-2027 zero growth or negative growth can be expected, compared to 2017 levels. That would mean drastic backlog of Serbia based on all economic parameters and it would bring back Serbia to the beginning of the cycle, somewhere in the period 2001-2003 in comparison to surrounding countries. Average income could hardly surpass EUR 400, while average pension would be at EUR 220 and **by that Serbia would most probably be the poorest European country.** Domestic product per capita would not go over EUR 7.500 and Serbia would be left behind significantly compared not only to developed countries of the EU, but also to the surrounding countries in regard to all socio-economic parameters (all previous levels of development are provided in the table below for the reference scenario). In case of even further drop in investments, and related drop in consumption, which is shown in the table below within worst case scenario, where participation of 15% of investments is in GDP at the end of the period, all these parameters are more vividly negative, and by that is illustrated importance of possible retreat and decrease of investments in the country.

In the period 2018-2027 total difference in domestic product is in the range of about EUR 100 Billion (normal vs. reference) to EUR 110 Billion (normal vs. pessimistic).

That would represent total loss of GDP for this period and the price society would pay if it was not included in modern development processes. Especially huge are the differences at the end of the period,

when they are reaching EUR 20-25 Billion annually in both negative scenarios in relation to normal scenario.

Tabelle 2. Overview of basic macroeconomic series

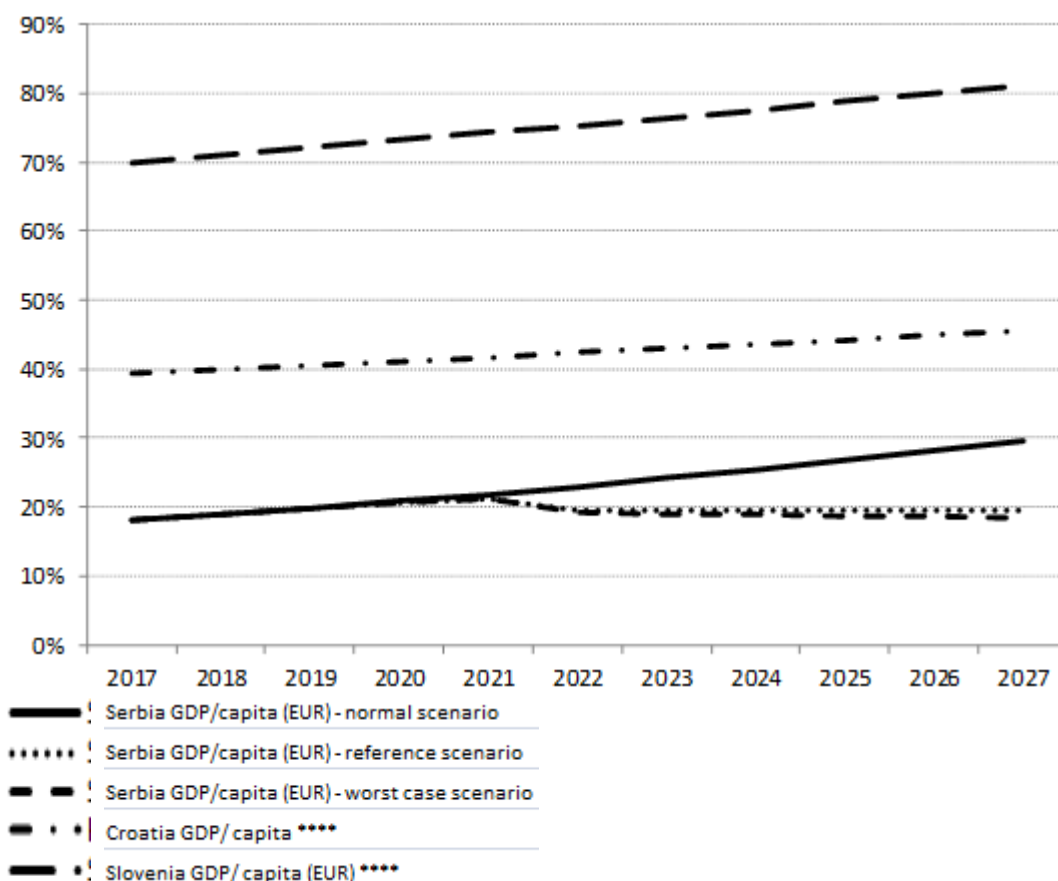
Overview of the basic macroeconomic series used in scenario - normal * vs. Reference ** and worst case *** scenario	2018	2027	Growth in the period 2017-2027	Avg Gro. Rate (CAGR) 2017- 2027
GDP nominal (EUR MLN) normal scenario	40.444	75.253	99%	7%
GDP nominal (EUR MLN) reference scenario	40.444	49.346	30%	3%
GDP nominal (EUR MLN) worst case scenario	40.444	46.931	24%	2%
Serbia GDP/capita (EUR) - normal scenario	5.811	11.402	111%	8%
Serbia GDP/capita (EUR) - reference scenario	5.811	7.477	38%	3%
Serbia GDP/capita (EUR) - worst case scenario	5.811	7.111	32%	3%
Croatia GDP/ capita ****	12.276	17530	49%	4%
Slovenia GDP/ capita (EUR) ****	21.848	31.197	49%	4%
EU28 GDP/ capita (EUR) *****	30.755	38.459	28%	3%
Serbia in % GDP/ capita EU 28 - normal scenario	19%	30%	11.6	1.1
Serbia in % GDP/ capita EU 28 - reference scenario	19%	19%	1.4	0.1
Serbia in % GDP/ capita EU 28 - worst case scenario	19%	18%	0.5	0
Croatia in % GDP/ capita EU28	40%	46%	6.2	0.6
Slovenia in % GDP/ capita EU28	71%	81%	11.1	1
Average Income (EUR) - normal scenario	440	628	48%	4%
Average Income (EUR) - reference scenario	440	397	-6%	-1%
Average Income (EUR) - worst case scenario	440	354	-17%	-2%
Average pension (EUR) - normal scenario	235	336	48%	4%
Average pension (EUR) - reference scenario	235	212	-6%	-1%
Average pension (EUR) - worst case scenario	235	189	-17%	-2%
participation of fix. investments in GDP - normal scenario	21%	25%	4.3	0.4
participation of fix. investments in GDP - reference scenario	21%	18%	-2.3	-0.2
participation of fix. investments in GDP - worst case scenario	21%	15%	-5.7	-0.5
Unemployment rate - normal scenario	15%	12%	-2.4	-0.2
Unemployment rate - reference scenario	15%	24%	9.6	0.9
Unemployment rate - worst case scenario	15%	27%	12.0	1.1
EURRSD normal scenario	119,2	130,3	10%	1%
EURRSD reference and worst case scenario	119,2	141,0	20%	2%
Inflation - normal scenario	3%	3%	34%	3%
Inflation - reference and worst case scenario	3%	4%	45%	4%
*continuation of the negotiations, average GDP growth of 4% (of potential growth rate)				
** stoppage of negotiations, average GDP growth of -1%				
***stoppage of negotiations, average GDP growth rate -1,5% (stronger negative effect of decline in investments and in consumption in relation to reference scenario)				

**** Assumption percent growth 2,5% during complete period and inflation rate of 1.5%

***** assumption 1,5% percent growth during complete period and inflation of rate of 1%

Source: RZS, Eurostat, authors estimations

Graph 2. Possible tendencies in GDP per capita in Serbia and the region in relation to European average (EU28=100)



Source: RZS, Eurostat, authors estimations

b. Pressured by negative economic and political trends, it is possible to foresee negative demographic trends, based on the negative birth rate as well as negative net migration of the population. It is possible that these negative demographic trends in smaller amount could be diminished with migrational inflow of the population of Serbian origin from neighbouring countries.

On the other hand, further strengthening of internal migrations from peripheral parts of the country to the areas around biggest cities – Belgrade, Novi Sad, Niš can be expected. Accompanied by impossibility of obtaining assets from EU funds for regional support it would lead to further widening of territorial differences.

For the purposes of this analysis in both scenarios, with stopping of negotiations and continuation of them, it is assumed that population will decrease by 40.000 annually. On the other hand, it is possible to imagine the scenario with higher outflow of population as a result of above mentioned trend, which would result in total number of inhabitants of 6-6.5 million in the next decade.

c. Divergence in relation to European standard of development (which is approximated by participation in relation to average GDP per capita for EU28) would further reflect through alienation in already weak parameters. For instance, average lifespan in Serbia is 75 years, and for comparison purposes in Slovenia it is 81. Serbian birth rate is 9.2 newborns on 1000 inhabitants, against 10 in Slovenia. Number of doctors on 1000 inhabitants is 2.5 in Serbia, while in Slovenia is 3. Mentioned gap in the area of this and related statistics in case of further economic divergence would continue to widen.

Conclusion

There is a German proverb, precise, cruel and accurate which states: “horrryfiyng end is better than endless horror”. And as much as it seems terrible, better recommendation with more precise explanation for resolving long term conflicts does not exist.

Maybe, we in Serbia refuse to acknowledge that, but the issue of Kosovo threatens to turn into a long lasting, even endless horror again.

Unstable, not fully formed state, poor, without prospective, abandoned, devastated, robbed, criminalized, dropped behind... all more than clear results of the scenario we exercised.

And that is happening at the moment where for the first time in the last 30 years we are marking progress, in nearly all areas, from economy to infrastructure, tourism, logistics, culture, security.

And it is now, when we have done more than ever in reaching the EU.

Political rating of all of that is of course different, for some it is small, and they want more, for others it is a lot and they would want less, but nobody can disagree with the fact that things in Serbia are moving.

Because of that, presently the most important political decision, to be reached by consensus, has to be the continuation of that movement, comprising all political differencies of the options involved, which must and need to exist, but not to halt that move.

Because the cancellation of these processes and another stopping, delay of the resolving of the Kosovo issue will not only keep Serbia in place but return it far away into the past.

New hyperinflations, devastation of the industry and infrastructure, general criminalization, huge unemployment, swift decline of the standard of living, mass decrease in wealth, crumbling decay of healthcare, education, social

welfare, are not, as we have shown, figments of imagination but highly realistic outcome.

And yes, catastrophe and horror are the topics.

And as the final consequence vanishing of the state and eventually, complete loss of population of one ethnic group.

We can use the example of Kosovo to realize how some questions are more biological than political, no matter how we see or present them.

Official census data showed that in the year 1921 Kosovo inhabited 288.000 Albanians and 114.000 Serbs. In the year 1991 the number of Albanians was 1.600.000, and Serbs – 194.000.

They have grown more than five times, while we have not even doubled.

This maybe be the key reason for politics to go into the resolving of the Kosovo issue, as with these trends, very soon there will not be an issue to resolve or anyone to resolve it for.

Neither in Serbia, nor in Kosovo.

Therefore, as much as the ending today seems horryfiyng, we have to, time and time again, remember that endless horror is a far worse option.

And that for everything, even the one that seems most expensive, price exists which must be paid. As every delay does not decrease, but again and again increase the price.

Special aspect of that price is something that creates main pillar of every progress, and that is the faith in its own society. Before Bruseels talks in the year 2011, even 70% of the surveyed thought that the country is not on the right path.

Changing that picture to worse, going back to old habits, diminishing the faith both in society and in itself and personal survival, development, progress in that society would push Serbia farther back than in any worst estimate.

People that do not believe in their own country, do not want to live or work in it and it becomes burden they want to free themselves of.

How big outflow of the population would be, after wars, embargo, tests with various models, because of the passing of the last opportunity for life in normal conditions, foreseeable surroundings freed from stress and anxiety, it is impossible to count, but the word „exodus” is not far from the truth.

Who would after that in Serbia turn off the lights, it is the least important question.

Light, for sure, would not exist.

Part of all of that, scenarios in which nothing happens and the price is rising, we have tried to present in this analysis.

Each appendix, further talks, new data can only help, and not only we are ready to hear them, but we call all that have data, argumented opinions, propositions to include themselves in the process we have commenced.