

**Republic of Serbia**

**MINISTRY OF INTERNATIONAL ECONOMIC RELATIONS**

**DEPARTMENT FOR FOREIGN INVESTMENT**

**STRATEGY FOR ENCOURAGING AND DEVELOPING  
FOREIGN INVESTMENT**

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## 1 INTRODUCTION

The purpose of the Strategy for Encouraging and Developing Foreign Investment (Strategy) is to address a number of key challenges facing Serbia and the need to attract new investment in the productive sectors to address national priorities of value added export development and provision of additional sustainable employment opportunities.

Foreign Direct Investment (FDI) is only one element, although internationally an increasingly important component, towards addressing a country's overall economic development goals and is designed to complement important national strategies on the development of the Small and Medium Enterprises (SME) sector, public sector reforms, modernization of education and infrastructural development. The benefits arising from the attraction and retention of increased levels of foreign direct investment in the country provides governments with the economic flexibility and strength to effect modernization and improvements in all other areas.

Serbia has not been able to attract larger and continual inflow of foreign private investment due to a poor business environment. Nothing can contribute more to the improvement of business environment than the enhancing of economic freedom and improving the rule of law. State involvement in the economy should be minimized; a very moderate state activism may give results after some improvements in the rules of the market game are undertaken. These are the reasons why the Strategy is aiming towards the improvement of the economic freedom and the rule of law. The improvement of economic freedom means - in negative sense - the removal of barriers and the force in doing business, i.e. the withdrawal of the government from the economy, and – in positive sense – providing a wider field for business activities (including lower administrative costs). The function of enhancing the rule of law is to decrease regulation, to make regulation transparent and to make the behavior of actors predictable.

Measures proposed include improvement of investment climate through acceleration of reform programmes and strengthening of institutional capacities at national, municipal and agency levels, development of improved linkages with the private sector at national and municipal levels to address competitiveness issues, development of an internal awareness campaign aimed at municipalities and utility providers and a focussed external investment promotion strategy.

Institutional strengthening with the establishment of new state functions in the market economy conditions should lead to development of market institutions, labour market, liberalization, deregulation, privatization and inflow of capital from international market. This will be the result of building and functioning of economic system focused on market economy, market institutions and mechanisms in the function of market liberalization and encouraging competitiveness.

The attraction and retention of foreign direct investment is a key objective in many countries as it is well recognised that FDI has the important potential to create incremental and sustainable jobs, increase exports, transfer technology and business knowledge, enhance competitiveness, boost overall productivity and ultimately reduce poverty through overall economic growth and development.

The creation of a favourable climate for investment, both foreign and domestic, is a major challenge for all countries as increased globalisation and competitive business pressures provides the framework and need for continuous improvement in both the overall enabling environment for business and company performance. Governments have a key role at the macro level in providing stability and in improving the overall environment for business whilst competitive market pressures are demanding continuous improvement in efficiencies and increased flexibility and effectiveness by company management.

Whilst significant progress has been made in Serbia since 2000 in creating stability at the macroeconomic level coupled with legislative improvements in many areas, it is recognized and acknowledged that this process of reform must be accelerated and that a significant increase in new foreign investment must be attracted to improve export capability and competitiveness and to create increased employment opportunities.

The results of the delayed start to the general economic reform and modernisation programmes are evidenced by:

- The relatively low levels of foreign investment attracted to Serbia in comparison with neighbouring countries,
- The bulk of the new foreign investment has occurred in the purchase of companies and assets with a domestic market focus under the privatisation programme,
- A small number of companies have made new business investments to address international markets,
- Limited development work has been undertaken and there is limited internal understanding of the needs of modern competitive industry and the potential benefits from FDI,
- The low level of exports and the continued dependence on international support and private remittances from abroad to support Government programmes confirm this overall low level of investment,
- Limited institutional capacity and undeveloped mechanisms in place to support investors in the implementation of their plans.

This poor economic outcome of this lack of new investment in the productive sectors of the economy is clearly demonstrated in the relative decline in both overall GDP and GDP per capita in Serbia until 2000, after which the economic growth has stabilized. This contrasts with general improvements in most neighbouring economies and significant improvements in some countries which have modernised their legislation and regulations, provided local supports to facilitate investors and implemented proactive investor support and promotion strategies. Countries in the region that have modernised and provided administrative stability have successfully attracted a significant level of new export oriented foreign investment.

The priority objective of the Strategy for is to address these weaknesses and to create a favourable climate and framework for **the attraction, retention and expansion of internationally competitive and export oriented foreign investment to complement the development of SME sector and ongoing new investments under the privatization programme.** A main thrust of the Strategy is to accelerate improvements in the business environment in Serbia for the benefit of all investors.

The Strategy is presented in the context:

a) That Serbia has moved forward significantly in the development of its relationship with the European Union and the international community and is moving forward on a process of reform to upgrade its legislative and administrative structures to European standards

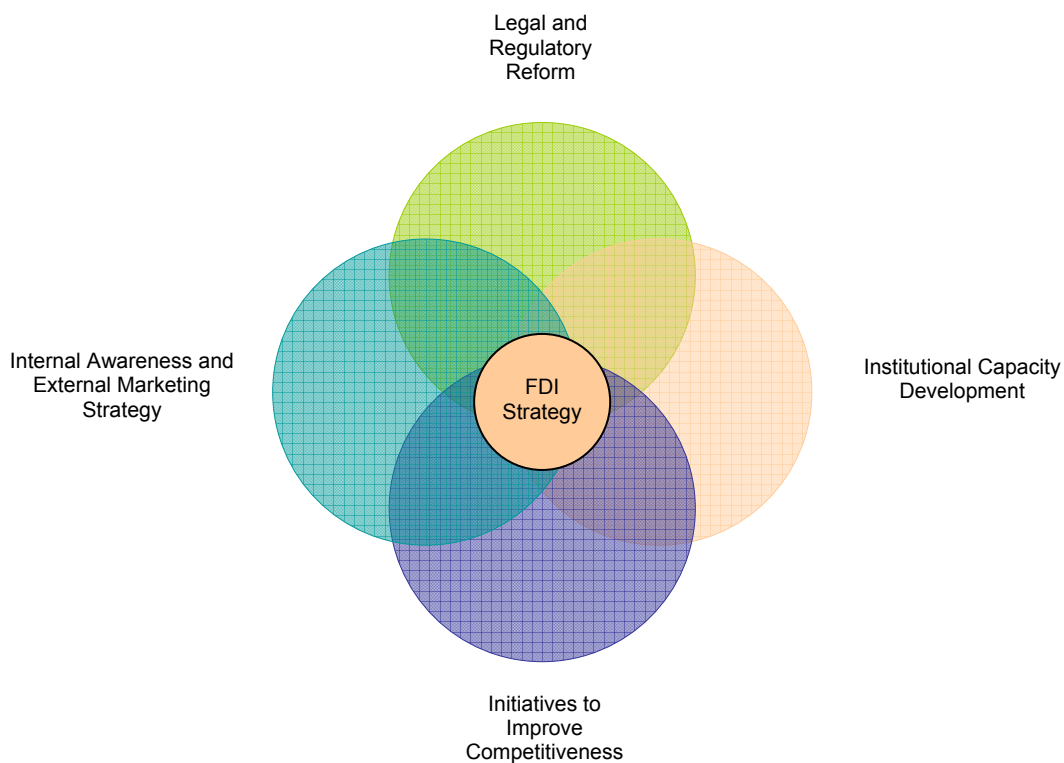
b) Serbia has the potential to regain its prominent position as a key regional gateway and base for the development of international trade and is seeking to generate significant level of new employment opportunities through increased private sector driven production, trade and investment.

c) Government is committed to further acceleration of this legislative reform programme coupled with further initiatives and supporting actions to strengthen institutional capacity, address competitiveness issues and develop improved internal awareness and external marketing to facilitate and support investors in the profitable implementation of their investment plans.

The Strategy is focussed on achieving significant progress under 4 broad high-level headings which are elaborated and detailed in Chapter 7 with clear objectives, measures and actions by a range of Government Ministries, agencies and municipalities with envisaged significant private sector and cooperating partner support and participation.

- 1. Legal and regulatory reform.**
- 2. Strengthening of institutional capacity and development of partnership processes to facilitate business development at national and municipal level.**
- 3. Actions and initiatives for improvement of competitiveness.**
- 4. Development of internal awareness campaigns and focused international marketing strategy.**

General approach to implementation of the Strategy and the interdependence of the above 4 main pillars is illustrated below.



The major recognized barriers to FDI<sup>1</sup> in Serbia are:

- Legislative issues:
  - Land ownership and access to land issues
  - Need for significant improvements and modernisation of court system
  - Need for a wide range of legislative reforms
  - Need for reform of construction laws and building regulations
  - Non competitive and uncertain fee and levy structures

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<sup>1</sup> In literature, different expressions are used for foreign direct investment. Forthright foreign investment is the most appropriate expression in Serbian language.

- Limited institutional capacity for implementation of reforms and for strategic planning and marketing,
  - Need for prioritising investor related issues amongst a wide range of administrative and regulatory bodies
  - Need for prioritising capacity building on investment promotion, strategic planning and policy development
  - Priority need to improve administration of construction permits through development of One-stop-shop principles
  - Need to maximise participation of private sector and educational authorities in overall reform processes
- Slow pace of reforms, infrastructural deficiencies and limited access to competitiveness enhancing measures,
  - The necessity of quick reforms, initiation of modern regulatory environment and privatisation of major utilities
  - Need to address development of industrial and technology parks
  - Need to improve access and reduce cost of access to accreditation, quality, certification and other international standards
- Need for both internal awareness and sensitivity programmes on investor needs and development of focussed national investment promotion programme.

Action plans to address these issues are documented in greater detail in the report and will be developed and implemented on the principles of high level Government commitment, improved cooperation between all levels of government, active participation of private sector and donors with the key objective of accelerating reforms and progress in a relatively short period.

The overall goals of the Strategy include:

- Increase the number and value of new investments in the productive sectors of the economy,
- Facilitate and support investors to accelerate the implementation of their planned investments in the country,
- Encourage and facilitate existing investors to deepen their involvement in the country and to maximize the level of internationally competitive local value added within the economy.

By emphasizing the importance of investment in production sectors the Strategy does not neglect global increase of services sector; Production sectors that are addressed in the Strategy should be viewed in broader sense, which includes service sectors that essentially have production character; In terms of that, services sector is often defined as “services industry”.

This Strategy is presented in the context and on the understanding and acceptance that:

- The current industrial base within Serbia is operating at a fraction of the levels of 1989 and has significant gaps in terms of overall competitiveness,
- The restructuring and privatization stage of the major state and socially owned enterprises will not generate the required levels of new employment or exports and in the short term will result in job losses,
- The SME sector based on historical and current trends will fail to generate either increased employment or tangible exports at the levels required.

It has been shown internationally that new foreign investment has played a major role in revitalization of many economies and addressed key national needs of employment creation and export development. Countries adopting a restrictive view on FDI, with the exception of a few natural resource rich areas, have not grown and prospered.

Governments worldwide have recognised these benefits and are adopting pro-investor policies and seeking to improve their investment environment in recognition of demonstrated benefits from FDI.

- A strong export led contribution to economic growth,
- Intensive growth in employment opportunities,
- Positive impact on influencing regulatory change, human resource and management development,
- Key driver of business friendly infrastructure,
- Key source of new technology, skills, management and business know-how, global orientation and a breeding ground for entrepreneurship,
- Ultimately, substantial incremental tax revenues to facilitate new infrastructure developments and social expenditures.

A strategic and focused approach is essential and will be reflected in action plans with an emphasis on:

- Recognition of reality of competition.
- Focus on countries, sectors and companies where Serbia can build competitive advantage.
- Establishment of the building blocks to target investors and to facilitate investors.
- Need to be innovative and visionary.
- Need to build image to reflect improved reality on the ground.

Actions under the 4 main pillars of the Strategy will support existing investors both foreign and domestic, new Greenfield FDI investment and public/private partnership (concessions) through effecting improvements in the overall environment for business and building on identified key strengths.

These key strengths include:

- Key regional position and preferential access to key markets to East and West,
- People strengths and capabilities – good quality educational system, good language skills including excellent English-speaking capabilities in key age groups,
- Industrial/research tradition and background in engineering/production skills.
- Natural and human resources, comparative advantages for agricultural and wood production that is competitive in terms of quality and price,
- Lower cost salaries for skilled and qualified workers and management.

Whilst investment in all sectors of the economy is required and welcomed, the following sectors have been identified as potential key contributors with some comparative competitive advantage in Serbia:

- Agribusiness: food and drink – focused on production of organics, products with geographic origin, traditional production of high quality specialty foods (application of autochthonous and traditional technologies), conventional production and processing of high quality food for mass consumption,
- Auto-Components: focused on sub-supplier companies to new car plants and lorry/heavy plant manufacturers,
- Banking and Financial Services,
- Engineering: specialist turnkey, design, services, etc.,
- Furniture: primarily wood furniture based on craft skills and timber supply,
- ICT: products and services focused on opportunities in software, back office services, call centres, initiatives based on strengths of university/research centres,
- Pharmaceuticals/health care/clinical research and Chemical Industry,
- Public/private partnerships: energy / telecoms / infrastructure / metals, mining and exploration / transportation nodes and regional distribution centres,
- Textiles: focused on short run, CMT and branded clothing and specialist markets,
- Tourism.

The above sectors are highlighted for the following reasons:

- Potential for creation of significant numbers of new, sustainable, jobs,
- FDI projects in a number of these sectors can provide a regional spread in the country,
- Projects in these sectors can generate significant new exports,
- Potential to provide substantial linkage opportunities for domestic companies and to attract foreign sub-suppliers and service providers,
- The sectors are growing globally,
- Greenfield FDI into these sectors is occurring in SEE,
- Sectors have potential to develop industry clusters and foster niche competitive advantage.

In addition, further liberalization of key utility sectors and the development of a programme of public/private partnership are envisaged as both investment opportunities and key building blocks of a revived investment environment.

These actions focussing on effecting improvements in the business development environment and providing the building blocks for FDI attraction, facilitation and support resulting in increased levels of foreign direct investment and exports over the short, medium and longer terms:

- Measures to improve the investment climate to attract FDI based on current main advantages of cost competitiveness, language skills, qualified personnel and local raw materials – impact in period 2006-2008,
- Measures to attract higher levels of FDI in the medium term in sectors where knowledge, skills and overall efficiencies are the factors that determine competitive advantage, building on initiatives in the educational, infrastructure and overall competitiveness areas – impact in period 2009-2011,
- Measures by which FDI can contribute to significantly increased levels of value added and improved regional development in the country – impact in period 2012-2015.

## **VISION – a 10 Year Perspective:**

*“A prosperous Serbia with low unemployment rate, a standard of living on the level higher than recent EU entrant countries, fast increase and a trebling of GDP per capita”.*

The above vision will be achieved through development of favourable climate and framework for attracting, keeping and expanding internationally competitive and export oriented Greenfield foreign investments.

## 1.1 Need for Greenfield FDI

There are a number of key high level challenges facing the economic development of the country. They call for systematic approach and consistent implementation of the adopted measures:

- High and rising unemployment and further pressures on employment levels arising from necessary restructuring of major utilities,
- Significant trade deficit with imports exceeding exports by a factor of 3<sup>2</sup>,
- Significant structural and competitiveness issues facing the industrial base of Serbia with output between 1989 and 2000 showing a decline of 50%, whilst the traditionally productive exporting sectors of metal processing, machinery and equipment, finished textiles, footwear and leather goods are operating at less than 25% of 1989 levels<sup>3</sup>. There is no evidence of significant changes in industrial output in the 4 year period to 2004,
- Late start to the reform and modernization process and progress cannot be expected without significant new investments in competitive modern industrial, agricultural and service sectors,
- Limited understanding of the key potential benefits of new foreign investment at many levels within society,
- Acknowledged severe gaps in institutional capacity to implement and manage reform and modernization process arising from the delayed start.

Developing countries, emerging economies and countries in transition increasingly see FDI as a source of economic development and modernisation, income growth and employment. Countries have sought to maximise the benefits of foreign ownership presence in the domestic economy and to increase the level of new foreign owned investment in their country through a series of policy and promotional initiatives.

The spin-off benefits from increased levels of FDI include:

- Triggering of technology transfer and spill over into the domestic economy,
- Assisting the development of human capital and management capability,
- Contribution to international trade integration,
- Help in creation of a more competitive environment,
- Enhancement of enterprise development.

SME Development and Entrepreneurship Strategy and this Strategy are complementary to each other: they are two different, but interconnected aspects for development of private sector in Serbia. Therefore, the preconditions influencing the success of FDI are the same or similar to those necessary for development of SME, as follows:

- Encouraging legal and taxation policy,
- Focus on sectors in which Serbia has competitive advantage,
- International competitiveness ensured through modern infrastructure (transportation, electric energy, telecommunications), trained and skilled labour, investment in research and development, quality control and certificates,
- Developed financial system lead by market requirements,
- Efficient and transparent state and local administration.

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<sup>2</sup> See Tables 1 and 1A for comparative exporting activities in the country and the region

<sup>3</sup> See Table 2

SME Strategy and Strategy for Encouraging and Developing foreign investment support each other and have synergy effects:

- Strong SME network and rich offer of business services would make Serbia more attractive for FDI and ensure benefits for foreign investors,
- Capacity of SME to meet foreign investors' needs would increase employment rate in Serbia and add value to economy,
- In some cases, SME would influence increase of FDI through cooperation, subcontracting, franchise and transfer of technologies.

Example: the survey conducted by *The Ernst and Young Investment Monitor* shows that small investments, that is, investments engaging less than 200 people, make around 50% of all FDI in Europe.

The challenge underpinning the overall Strategy is to optimise operating conditions for private sector driven internationally competitive business development within the country, to maximise both the inflow of new FDI into the country and the level of value added activities undertaken by both foreign and Serbian owned small business in the country.

One of objective for Serbia is to accelerate programmes of support to improve SME capability in terms of capacity, quality and accreditation.

FDI assists in:

- Integration into the global economy by engendering foreign trade flows,
- Development of international networks of related enterprises,
- Establishment of vertical linkages between local suppliers and MNEs,
- New investment by international companies often triggers further business opportunity and investment both by existing foreign suppliers and new domestic companies,
- International companies as part of their quality assurance programmes often introduce support programmes for domestic companies to improve quality of goods and services through technical assistance, training and information and accreditation programmes.

FDI is recognized for its contribution to human resource development:

- A direct positive impact stems from both the increased level of training generally provided by new companies and the demonstration effect of demand for increased specific skills,
- Frequently as the new FDI company becomes established and embedded in the country there is increased localisation of senior management positions with consequent broadening of management experience,
- FDI influences development in general education as the availability of a skilled educated work force is of the utmost importance in creating a favourable environment for FDI.

Furthermore, FDI facilitates the smooth implementation of international trade and national policies, raises productivity and competitive levels and improves standards and overall efficiencies. Serbia is moving towards full membership of international and regional bodies and is well positioned to benefit quickly from new FDI because of its rich industrial traditions and general high quality of education.

## 1.2 High Level Objectives

High level objectives of the Strategy are focused on attraction of a significant level of foreign investment in the productive sectors to:

- Develop exporting – internationally competitive – industrial, service and agro-industry capacity and capability,
- Address current problem that the bulk of current capacity is obsolete for modern production and markets because of lack of investment for many years,
- Create sustainable employment opportunities,
- Stimulate reform programme, address trade deficit and achieve convergence in development with EU states,
- Maximise the level of internationally competitive value-added within the economy.

## 1.3 International Principles

The main preconditions for attracting new foreign investment include:

- Acceleration of economic reform programmes, modernization of legislation and improvements in the administration of legislation and regulations,
- Increased awareness at public and official levels of the competitive needs of investors and a broader understanding of the benefits that arise from the presence of modern internationally competitive industrial undertakings,
- Development of focused and evolving plan to address barriers,
- Development of initiatives to improve the competitive environment for investors,
- Development of a strong sense of partnership and unity of vision between government at all levels and the private sector,
- Development of a focused marketing programme to identify, interest and attract foreign investors.

These principles are articulated in many publications by World Bank institutions, OECD, Investment Compact for Southeast Europe<sup>4</sup> and other international agencies.

## 1.4 Key Barriers to FDI

Major recognized barriers to FDI in Serbia are:

- Legislative issues e.g. complicity concerning land-ownership and non-market prices for the land usage, non-specialised court systems,
- Lack of special court departments dealing with specific legal areas,
- Infrastructural deficiencies in comparison with neighbouring countries,
- Slow pace of reforms, arising from delayed start, in comparison with competitors and general poor quality of implementation,
- Limited institutional capacity for strategic planning and marketing and adoption of medium and longer term view,
- No focussed national investment promotion programme against a background of a perceived negative investment climate.

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<sup>4</sup> Initiative for improvement of investment environment under the auspices of SEE Stability Pact

## 1.5 Primary Measures to Achieve Goals

For the successful implementation of the Strategy it is recognized by government that:

- The present policy mix and institutional capability is not adequate to provide the framework for the required levels of employment growth and increased levels of export development,
- There is a need to accelerate and fast track the reform process, to develop as a matter of urgency improved institutional capacity in a number of key ministries and institutions and to promote and publicize the successful outcome of the EU feasibility study,
- There is need to address a wide range of issues impacting on the cost and competitiveness of doing business in Serbia,
- There is a need to strengthen and enhance the principles of partnership between government ministries, municipalities and the private sector in the implementation of measures to achieve the desired outcomes,
- There is need to develop a focus on key companies and sectors where Serbia has or may have the capability to develop potential international competitive advantage,
- There is a need to develop a focus and prioritization in selected international markets to maximize usage of financial and personnel resources and create a positive impact,
- There is a need to focus resources and achieve measurable results in a number of key areas to address investor concerns in terms of the perceived risks of investing in Serbia.

Serbia faces strong competitive pressures to the achievement of its goals as most key competitor countries have made more significant advances in terms of overall economic reforms over the past 15 years and many already have an established base of foreign investors.

Most neighbouring countries have strong established Investment Promotion Agencies with both marketing and sectoral expertise. Many countries have developed industrial sites and parks available for new investors to locate their plants. Mechanisms have been developed in most countries for the provision of land and services by both private and municipal authorities and all countries are offering incentives. This impact is measured and reflected in both overall increased levels of FDI, lower levels of unemployment, higher levels of export activity and various other measures of economic development.

The challenge for Serbia is to position itself as a credible and profitable location for FDI based on:

- An approved pre-accession EU country with the benefits of tariff and duty-free access and regional trade agreements in place,
- Credible and accelerating programme of modernisation of its infrastructure, administration and legal system in place,
- Key gateway position to Western European, Eastern European and Middle East markets,
- Strengths of its industrial tradition, an educated workforce with acknowledged better foreign language skills than most competitor countries.

The Strategy is focussed on achieving significant progress under 4 broad high-level pillars which are elaborated and detailed in Chapter 7 with clear objectives, measures and actions by a range of Government Ministries, agencies and municipalities with envisaged significant private sector and cooperating partner support and participation.

- 1. Legal and regulatory reform.**
- 2. Strengthening of institutional capacity and development of partnership processes to facilitate business development at national and municipal level.**
- 3. Actions and initiatives for improvement of competitiveness.**
- 4. Development of internal awareness campaigns and focused international marketing strategy.**

In this situation, whilst the Strategy is focussing on effecting improvements in the investment climate over the short, medium and longer terms, the need for prioritization and urgent actions on a wide range of issues is self evident. This is reflected in the Action plan on the modernisation of the legal and regulatory environment, the proposals for improved liaison between the municipalities, utilities and national government, an emphasis on improving access to land and infrastructure for industry and modern export oriented business services and development of partnership and improved liaison between private sector and government in driving the modernisation process at institutional and infrastructural levels. In this process, development of partnership and connections between the private sector and Government is of crucial importance.

## **2 KEY INTERNAL ECONOMIC AND BUSINESS DEVELOPMENT ISSUES**

### **2.1 Key Strengths**

There are positive and encouraging signs that Serbia is in a strong position to capitalise on its development potential over the next five to ten years, that it can achieve strong economic growth on a sustainable basis and improve the living standards of its citizens, while substantially advancing its transformation into a competitive and well functioning market economy.

Serbia is perceived as a friendly and improving environment for foreign investors, with an investment law that compares favourably with similar laws in other countries. Under the Foreign Investment Law of 2002, foreign persons may, on their own or with a local partner, establish an enterprise or a subsidiary; buy shares or stakes in an existing enterprise; acquire other property rights in an enterprise; or be granted a concession for the exploitation of natural resources, production plant or capacity as well as infrastructure or communication facilities. There is an ongoing programme of legislative and regulatory reform with the objective of achieving harmonization of all laws and regulations with the standards of the European Union.

The overall macroeconomic and business development environment has improved steadily over the past 5 years with the government enacting significant levels of new legislation, stabilizing the annual budget, reaching formal agreements with international community on debt and budgetary support issues and making significant progress with its privatization programme.

Key strengths as recognized in many investor and comparative analysis surveys are highlighted in the following table:

**SERBIA – KEY STRENGTHS**

- **People strengths and capabilities: competitive workforce (skilled, relatively inexpensive, English speaking and with a traditional external exposure).**
- **Central location in Southeast Europe and good market access via EU accession process, regional free trade agreements and a free trade agreement with Russia<sup>5</sup>.**
- **Lower cost salaries particularly for qualified and trainable workers**
- **Industrial/research tradition and background in engineering/production skills.**
- **Natural resources and good preconditions for agriculture and forestry (food and wood products).**
- **Improved and improving investment climate.**

There is increasing evidence of international and local agreement on the level of progress achieved with the pace and direction of the overall economic reform programmes as shown by:

- Successful outcome to EU accession feasibility exercise and commencement of EU accession discussions,
- Renewal of World Bank /IMF credit supports to 2007,
- Positive review of legislative reform progress by the OECD – Investment Compact for South East Europe for 2004,
- World Bank Report on World Business for 2005, listing 155 countries. According to this report Serbia and Montenegro has achieved most successful results in improvement of business environment,
- European Bank for Reconstruction and Development 2005 Report on Transitions in the Countries. According to this report Serbia and Montenegro was the most successful reform country in 2005,
- Increased dialogue and support between government and private sector from existing foreign investors and business groups as set out in annual White Book published by the Foreign Investors Council (FIC).

The positive attitude and proactive involvement of business and private sector organizations is an important component of the overall business environment. The Serbian Chamber of Commerce is the largest business association and partners with government with a goal of improving the country's competitiveness, raising productivity and exports. Other important business associations include the Union of Employers, Federation of Serbian Entrepreneurs, "Privrednik" Serbian Business Club and the FIC.

The FIC has played a key role on behalf of its members in ongoing dialogue with government on identifying and prioritising key initiatives to improve the overall environment for business development in the country. It publishes an annual White Book on the investment climate and sees itself as a partner with government and the civil service in highlighting initiatives for attention and formally documenting progress on an annual basis. FIC members also participate in a number of national bodies including the American Chamber of Commerce in Serbia and Montenegro, other countries' business associations such as the Israeli Business Forum, Greek-Serbian initiatives for partnership, Italy in Belgrade business manifesto and the Association of German investors. These national associations are also active policy advocates and government partners in improving Serbia's investment climate.

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<sup>5</sup> Instead of signing bilateral agreements on free trade, it is much better to sign one multilateral agreement for the entire region. This would create single market of SEE.

## 2.2 Weaknesses

The major weaknesses within the economy can be traced to the decade of internal conflict and the resultant international isolation in the 1990's. At the start of the 1990's Serbia was more advanced industrially and technologically than many of its neighbouring countries and many of its companies operated competitively in the international marketplace.

The outcome of this period of international isolation has resulted in a lack of modernization across many sectors of industry and a resultant lack of international competitiveness, the emigration of many skilled and qualified workers and an overall 10-year delay in the initiation of its privatization programme and its programme of reform on the legal and regulatory environment.

Actually, the main problem is the competitiveness of Serbia (the rules of the game), and this should be the concern of the government. The competitiveness of firms should be left to firms themselves.

Notwithstanding the significant improvements effected over the past 5 years, the economic performance of Serbia is poor on a number of key indicators:

- Significant trade deficit with consequent reliance on borrowings and external private remittances,
- Employment levels and numbers of people gainfully employed in productive internationally competitive industry and services are low by international standards, although still better than in many neighbouring countries,
- Lack of overall competitiveness through lack of investment, delayed start to the privatisation process and failure to facilitate the development of modern industrial and agribusiness competitive clusters,
- Poor external image, perceptions of political instability and lack of a focused marketing and investment promotional programme<sup>6</sup>.

This is reflected in structural and institutional weaknesses and the slow pace of public sector reform resulting in:

- Weaknesses in the overall legal and regulatory environment,
- Weaknesses in administrative structures and inconsistent application of regulations,
- Poor, although improving ratings by a number of private sector international monitoring companies.

The following tables critically show that Serbia ranks very poorly in comparison with neighbouring countries.

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<sup>6</sup> Trade deficit, unemployment level and poor external image are things that do not directly interest (foreign) investors. They are rather interested in the quality of the business environment and not much impressed with the political uncertainties.

### Growth Competitiveness Index (GCI) Rankings and 2003/2004 Comparisons <sup>7</sup> - Selected Countries -

Country	GCI 2004 rank	GCI 2003 rank
Slovenia	33	31
Hungary	39	33
Czech Republic	40	39
Slovak Republic	43	43
Bulgaria	59	64
Poland	60	45
Croatia	61	53
Romania	63	75
Bosnia and Herzegovina	81	-
Macedonia	84	81
<b>Serbia and Montenegro</b>	<b>89</b>	<b>77</b>

This growth competitive index shows a worsening of the situation between 2003 and 2004 is derived from 3 pillar indices including:

#### Public Institutions Index <sup>8</sup>

Country	Rank
Slovenia	31
Hungary	37
Slovak Republic	49
Czech Republic	51
Bulgaria	56
Romania	74
Croatia	76
Bosnia and Herzegovina	78
Poland	80
<b>Serbia and Montenegro</b>	<b>85</b>
Macedonia	92

#### Macroeconomic Environment Index <sup>9</sup>

Country	Rank
Slovenia	39
Czech Republic	41
Poland	51
Slovak Republic	54
Hungary	55
Croatia	59
Bulgaria	60
Romania	71
Macedonia	77
Bosnia and Herzegovina	85
<b>Serbia and Montenegro</b>	<b>102</b>

<sup>7</sup> Source: The World Economic Forum – Global Competitiveness Report 2004 on a scale of 1 to 104

<sup>8</sup> Source: The World Economic Forum – Global Competitiveness Report 2004 on a scale of 1 to 104

<sup>9</sup> Source: The World Economic Forum – Global Competitiveness Report 2004 on a scale of 1 to 104

### Technology Index <sup>10</sup>

Country	Rank
Czech Republic	19
Slovenia	26
Slovak Republic	28
Hungary	29
Poland	45
Croatia	46
Romania	47
Bulgaria	59
<b>Serbia and Montenegro</b>	<b>75</b>
Macedonia	76
Bosnia and Herzegovina	82

These tables underpin the fact that Serbia has started late in its reform process and from a very weak base in comparison with most competitor countries for new investment. These 3 pillars of the Growth Competitiveness Index are given particular attention in the design and implementation of a strategy to make the country more competitive and attractive for new FDI activity.

It is recognized that this will require an emphasized prioritization on legislative reform to improve the business environment, a wide range of supports to address competitiveness issues and a significant strengthening of the institutional capacity to address internal regulatory and external marketing issues.

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<sup>10</sup> Source: The World Economic Forum – Global Competitiveness Report 2004 on a scale of 1 to 104

### 3 FOREIGN DIRECT INVESTMENT IN SERBIA AND COMPARATIVE ANALYSES

#### 3.1 Greenfield and Privatization

Not all foreign investments are of the equal importance. Foreign investments may stem from some non-market fund (WB, EBRD, EIB, etc.) and they may stem from the private sources. Non-market funds are similar in the investment efficiency to the state investment. Private foreign investments are very efficient. Non-market funds invest according to political priorities (donations, credits for concrete projects), private investors according their chances to get profit. For these reasons, it is important that statistics reflects these two types of foreign investments.

Private foreign investment should be further distinguished into Greenfield, Brownfield, Classical sale off<sup>11</sup>, Joint Ventures, Reinvestment, Portfolio investment and Realisation of investment obligations from the privatization process.

The principal types of FDI, excluding forms of classical sale of (mergers, acquisitions and privatization) are classified as follows:

- *Greenfield* – where a foreign company establishes a facility on a new site or building,
- *Brownfield* – where a foreign company establishes a facility in a building or site that was previously used for production or other activities and has some infrastructure already provided; assets from bankruptcy procedures could be bought for new investment,
- *Joint Venture* – where a foreign company takes a significant stake in a newly-formed domestic company.

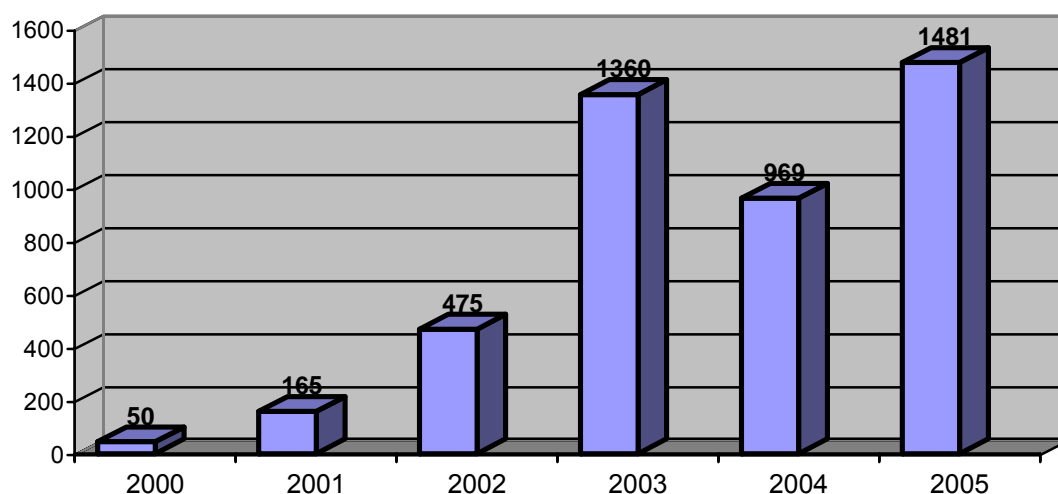
Public private partnership (PPP) is a modification of the above joint venture definition where a public authority (national/municipal/utility) enters into a partnership arrangement with a private sector company to plan, implement and manage, under formal terms, a defined activity or facility.

To date the bulk of the new foreign investment into Serbia, like other countries in the region, has come under the privatization programme. The delayed start on the privatization programme is highlighted by the following figure on inflows (excluding inflows from portfolio investments), whilst the bulk of privatisation activity was undertaken in other countries during the global boom foreign investment period of the second half of the 1990's.

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<sup>11</sup> Classical sale off is an operation when private owners (or states) are selling companies, or their stake in companies. In the case of state doing a sell off, the process is called privatization.

**FDI IN SERBIA IN MILLION US\$, 2000-2005 - Annual Inflow** <sup>12</sup>



Whilst privatisation receipts in 2005 almost reach the \$1.5 bn figure, mainly from bank sales, even this low overall level by regional comparison is not sustainable in the medium term from privatization. In order to attract significant level of new Greenfield foreign investment, the country should focus on encouragement of Public Private Partnership, infrastructure improvement and strengthening the competitiveness.

The overall level of privatization activity since 2002 as established from the records of the Privatization Agency is set out in an appendix. This appendix details the recorded annual flow of investments under the various methods and is summarized in the following table. <sup>13</sup>

2002 – 2005	Offered Total	Sold Total	Success (%)	Sales Proceeds	Investment Program	Social Program
<b>Tenders</b>	96	54	56%	908,736	737,541	271,955
<b>Auctions</b>	1,608	1,254	78%	602,095	160,785	
<b>Tenders + Auctions</b>	1,704	1,308	77%	1,510,831	898,326	271,955
<b>Capital Market</b>	773	523	68%	325,838	5,902	
<b>Total</b>	2,477	1,831	74%	1,836,669	904,227	271,955

It should be noted that some firms, plants and banks operating in Serbia were owned by foreign companies even before the sell-off (like Mobtel, Delta Bank-Banca Intesa). When these entities are sold, money goes to the accounts of foreign owners and this can not be counted as the Serbian FDI.

Nearly all Tender capital inflows originate from foreign investors, whereas Auction capital inflows are predominantly domestic. In terms of origin of the capital, privatization inflows that come through the capital market are balanced. Foreign buyers are usually transnational companies (TNCs) - Philip Morris, Interbrew, Lukoil, Holcim, US Steel, Alpha Bank, Lafarge, Carlsberg, Titan, Henkel, BAT, Galaxy Tire&Wheel, etc.

<sup>12</sup> Source: National Bank of Serbia

<sup>13</sup> See Table 3 for more details (Source: Privatization Agency of the Republic of Serbia)

It seems that many foreign companies assessed the overall investment climate in Serbia to be relatively immune to political uncertainty and therefore waived a significant part of the noise that comes from Serbian political scene. Issues of unresolved political status shall not inevitably hold back the economic development of the country. There are examples of countries with long-term disputes and unresolved statutory issues, like South Korea, Taiwan, Cyprus and Israel, which have developed superior business environment and which are among the most successful economies in the world in last decades.

#### SECTORAL REVIEW OF PRIVATIZED COMPANIES (UP TO MARCH 5, 2006)<sup>14</sup>

SECTOR	Number of Privatized Companies
Processing and Mining Industry	521
Construction	183
Trade	178
Agriculture and Fishery	104
Financial Intermediary Services	100
Handcraft	89
Hotels and Restaurants	78
Transportation and Connectivity	61
Education and Culture	12
Housing and Utility Services	7
Water Resource Management	6
Social and Political Organizations	4
Health and Social Work	1
<b>Total</b>	<b>1,344</b>

Looking at the above numbers, investors are mostly interested in the **processing industry**, and then in **trade** and **construction** companies. Up to the end of January 2006 the Agency has initiated cancellations of additional 194 contracts due to lack of fulfilment of contractual obligations by investor companies and legally cancelled 74 awarded contracts.

The question is why significant numbers of investors are not in a position to fulfil contractual investment and social programmes or additionally invest and expand their business activities. Since huge amounts of money had already been spent on purchasing companies through the privatization programme, in order to ensure return and growth of invested capital one would say that investors have naturally had an interest to additionally invest in the company they have bought (mostly in material and new equipment) and implement social programmes to lower the number of employees. All these would have provided the adequate return and fertilization of the total capital they have invested.

Unsuccessful privatizations (or lack of post-privatization investment) could be justified by facts that buyers' plans were too ambitious and/or that initially a wrong judgment was made in regard to the purchased company's assessed condition and its market capabilities. One of the reasons, after all, is that new owners are not provided with "after-care" services and support (this generally pertains to all investors) neither by the Privatization Agency nor by the other relevant institution, such as SIEPA. Reasons for the lack of "after-care" services are:

- Lack of a direct and clear competency of a relevant institution,
- Lack of a required authority of a relevant institution, especially towards local self-governments,
- Lack and/or inadequate human and financial resources.

<sup>14</sup> Source: Privatization Agency of the Republic of Serbia

Looking at the course of the privatization programme, numbers of offered and sold companies as well as the value of privatization inflows (proceeds) are peaking in 2003. The 2004 decrease is a consequence of political instability during the end-2003/beginning 2004. Also, during 2003 some of the most attractive enterprises were sold which resulted in high proceeds (tobacco industry, several good companies from food processing and brewing industries and an oil industry retailer).

With intention to speed up the privatization process in 2005, the Government of Serbia proposed and the Parliament adopted the changes and amendments of relevant laws (Privatization, Privatization Agency and Share Fund). The Privatization Agency competencies were expanded and it can now take up the role of a Bankruptcy Manager if a company's Bankruptcy Council assigns such duties to it - in accordance with the law regulating the bankruptcy procedure. There are some thoughts which say that changes in Share fund law and Privatization agency law undermine property rights, enhance already large influence of bureaucrats over firms, concentrate the power of bureaucrats and keep in play the conflict of interest (Privatization agency prepares firms for sale, sales them and monitors the sale process).

The important change in the Law on Privatization pertains to the fact that debts of companies in the privatization process would be written-off by the state (debts are those that they have towards Funds and other public enterprises) and in such way make them more attractive to potential investors. The debt would, later on, be remunerated from proceeds of a privatized company. These measures should provide faster privatization pace of larger and companies heavily in debt which employ most of the excess workforce. These are the enterprises belonging to the so-called "Group 67" and their successful privatization would mean a success of the overall privatization process in Serbia.

It has to be decided what to do with social ownership enterprises that have already been offered for sale twice – re-evaluate and offer them for sale again or privatize them through a bankruptcy procedure. At the moment, majority of companies that are offered on tenders are usually not very attractive, but this trend should be "refreshed" by sale offerings of non-core businesses of public enterprises. Changes and amendments to the Law on Securities and other Financial Instruments have been adopted for the purpose of better regulation on the securities market. It is necessary to enact the Law on Investment Funds as soon as possible so that operations of investment funds that already heavily participate in the privatization process could be properly regulated and made more public in order to avoid suspicions in proper operating of their businesses (deadline for the Law on Investment Funds: March 2006).

During 2005 privatization inflows surpassed the best record of 2003. During 2005 privatization inflows are mainly tied to privatization of banks. Banking sector is very attractive to foreign investors regardless of the increased competition, at least in terms of having additional players on the Serbian market. Main reason for attractiveness of the Serbian banking market: interest rates are high, that is – the perceived risk of doing business is high whereas the real risk is significantly lower (Serbia is the country that has the highest rate of returned loans from operations with citizens). Privatization of the remaining banks to renowned foreign banks shall lead to increased competitiveness on the market and thus to lowering interest rates. Consolidation of the banking sector (through mergers and acquisitions between the market players) should be expected.

The law stipulates completion of the privatization process by 2007 with an exception of public and state-owned enterprises. The deadline must be met as the existence of both socially and privately owned enterprises leads to de-valuation of socially owned capital, i.e. illegal overflow of the capital towards the private sector. The same applies to public enterprises. Those enterprises are to see organizational and status preparations for the

privatization process. It is necessary for these companies to consolidate and lower their operational costs. This is why it's essential that the Government, i.e. responsible ministries, develop The Public Enterprises Restructuring Strategy by end-2005 (the energy sector has advanced on this topic). Reduction of workforce for 10% in these enterprises has been announced as well as in the public administration. Social programmes would be funded from the so-called "Transition fund". Additional resources for this fund shall be provided through the restructuring process of public enterprises, i.e. by selling parts of an enterprise that are a non-core business.

The overall inflows of FDI as recorded by National Bank of Serbia include both privatization and greenfield FDI investments. These current FDI statistics are based on capital transfer record-keeping maintained by the National Bank of Serbia, based on data obtained from banks and registered as FDI inflows only when banks mark the payment with 557 Code (foreign investment). Inflows are recorded when payment is carried out, regardless the contracted liabilities.

These records provide a review of total foreign investment inflows from one year to another as well as a comparison of foreign investment inflows in Serbia with inflows in other countries. However, these data allow analytical foreign investment monitoring only by country of payment (as it is presented in the Table below), which in many cases is not a real country of origin of invested capital. The Table presents the Netherlands as the country from which most FDI inflows came to Serbia; In fact, the investments are made from sister-companies of the companies originating elsewhere. The companies from USA dominate in terms of investment realized through own companies. However, these data do not allow analytical monitoring of FDI (by country of origin, by sectors, by region, etc.), so it is essential to improve foreign investment statistics and find the best available methodology for collecting foreign investment data<sup>15</sup>.

**Direct Foreign Investment by Countries of Payment (000 \$)  
2000-November 2005<sup>16</sup>**

No.	Country	FDI Inflows
1	Netherlands	794,442
2	Austria	425,037
3	Germany	408,308
4	Greece	365,531
5	Slovenia	238,790
6	Great Britain	170,020
7	Cyprus	161,537
8	France	154,180
9	Switzerland	100,190
10	Luxemburg	79,236
11	USA	76,871
12	Croatia	74,848
13	Italy	61,182

<sup>15</sup> In order to improve foreign investment statistics a Working Group consisting of the representatives of the Ministry of International Economic Relations, the National Bank of Serbia, the Agency for Business Registries and the Statistical Office of the Republic of Serbia was formed on July 13<sup>th</sup>, 2005.

<sup>16</sup> Date on inflows made by non-residents. See Table 5. Source: National Bank of Serbia

Privatization Agency keeps records on inflows from sale of enterprises through privatization process and contracted liabilities based on investment and social program. It keeps separate records on inflows from foreign buyers, that is, contracts concluded with non-resident legal/and natural persons. Data on privatization inflows recorded by Privatization Agency do not include inflows from contracts that were later terminated. On the other hand, the investment liabilities that have been once recorded and liabilities related to social programs are often violated, especially in terms of deadlines.<sup>17</sup>

The consequence of the aforementioned is absence of precise and updated evidence on inflows from privatization. If these data were reliable, inflows from privatisation could be deducted from total annual FDI inflows and give the figure on annual Greenfield FDI.

Taking into account very small number of Greenfield projects of high value (except Ball Packaging Investment of 75 million euros) it can be estimated that Greenfield FDI investments in Serbia after 2000 never exceeded \$150 million per year<sup>18</sup>. This is definitely far from development needs of Serbia and therefore dissatisfactory. The low level of foreign Greenfield investment must clearly be increased as there is little domestic capacity for investment and privatization receipts will decline once the next tranche of major companies are restructured and sold. The country is thus clearly reliant for modernization and development, employment creation and export generation on significantly increasing the level of new foreign direct Greenfield investments and on creating an environment whereby existing companies are encouraged and facilitated to reinvest in higher value added activity.

Private investors that bought state-owned firms in previous years in many cases do not respect their contractual obligations related to the social and investment programs (as broadly reported in the media). This does not come at surprise. If investors feel further investment reasonable, they will conduct it, if they do not, one can not force them by law to do that. If nevertheless the state establishes such an obligation, investors will defect, and leave the state with the options: either to react, and reverse previous privatization, what sends a bad message to other potential and actual investors, or to turn a blind eye and ignore it. The former would discourage already low level of investment, the later would undermine the state credibility. Social programs and investment obligations should be removed from the privatization law, leaving the transaction cost as the only criterion. So, what is needed here is to establish the factual rather than promised state of affairs concerning FDIs.

Very important is to find out the amount of the green-field investment, because that is the best indication about the quality of a business environment. Privatization revenues are a very misleading indicator, since private investors may come for reasons other than attractive business conditions. In the classical case, they buy market with firms, and than get extra rents because the market is monopolized or even closed. The best examples of that in Serbia are the sales of the tobacco industries (DIV and DIN), but there are others as well. Other reasons may be poor competition and/or protected market, costly real estate owned by firms undergoing privatization (even some in other sense worthless firms possess attractive buildings at good locations), etc.

When one day the privatization wave comes to an end, the green-field and portfolio investments are going to be the only FDIs. The level of the FDIs will depend exclusively on the quality of business environment.

Although investments of the private Serbian firms outside Serbia are still relatively small they are very useful and desirable. In the first move this represents an outflow of capital, but thereafter there is a gain from the investments.

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<sup>17</sup> This is often a reason for termination of contracts.

<sup>18</sup> Source: Free Market Centre, Belgrade

Only 13-16% of Serbian GDP goes into investment, which is just a half of the investment level in successful transitional countries. Serbia will hardly face a strong increase in FDI before domestic investments significantly increase. Domestic entrepreneurs are first to test the quality of business environment.

Domestic investments are as a rule higher than direct foreign investment and therefore are very important. Share of domestic investment in GDP in 2003 in the Republic of Serbia was 14.1% and in 2004, 19.2%<sup>19</sup>. FDI in 2003 were \$1.36 billion (average exchange rate at 53.98 dinars) and its share in GDP was 7.1, while in 2004, FDI was \$966 million (average exchange rate at 58.38 dinars) making 4.3% of GDP (estimated value).

## 3.2 Comparative Analyses

### 3.2.1 Contemporary Trends

#### Global trends

The 1990's were a period of significant growth in global FDI movement caused by increased globalization, boom in South East Asia in the mid 1990's and increased movement under privatization programmes into the countries of Eastern Europe. The bulk of new foreign investment flows into the more developed economies of the world and is driven by major competitive challenges facing companies: pace of technological development, global restructuring and improved logistics and information flows.

Global FDI flows declined sharply over the 3 years to 2003 in the context of a world economic slowdown, and fell by more than 40% in 2001 in comparison with 2000. This followed steady growth in global movements of FDI since 1991 and very significant increases in 1999 and 2000.<sup>20</sup> These figures reflect major factors:

- The slowing of economic activity in the early years of this decade in major industrial economies.
- A sharp decrease in their stock market activity in the post dot com boom era.
- The tiny success levels achieved to date in Serbia in comparison with other countries in Central and Eastern Europe.

The World Investment Report for 2004<sup>21</sup> showed that these adverse global trends were reversing and that pickup was occurring particularly into Asia, Central and Eastern Europe. It also showed the increasing importance of China as a major location for new foreign investment continues and that it has assumed dominant position as a preferred location for a wide range of industrial sectors with significant implications for Serbia and other countries.

#### Trends in Central and Eastern Europe

The EU accession countries and the rest of central and Eastern Europe account for over one third of all foreign investment projects into Europe and this trend is expected to continue.<sup>22</sup> The growing trend of FDI moving further east will continue in next two to three years and the EU accession countries and the rest of Central and Eastern Europe are estimated to account for up to 40% of all investment projects into Europe.

A significant proportion of new investment to Europe in the back office, data centre, logistics and Greenfield manufacturing areas is predicted to occur in Central and Eastern Europe.<sup>23</sup>

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<sup>19</sup> Source: Statistical Office of the Republic of Serbia

<sup>20</sup> See Table 4

<sup>21</sup> World Investment Report 2004

<sup>22</sup> See Table 6

<sup>23</sup> See Table 7

Serbia with its acknowledged strengths in language capabilities, key regional location, educational and technical capabilities and policy and operational improvements is positioning itself proactively to address opportunities in these areas.

### Concentration of Investment

FDI in CEE continues to be highly concentrated by country – Poland, Czech Republic, Hungary and Slovakia – that have attracted significant levels of new foreign investment in addition to virtual completion of their privatisation programmes by 2000.<sup>24</sup>

The exponential growth in value of FDI inward stock in Czech Republic (which has grown from US\$ 7.4m in 1995 to US\$56,4m in 2004) and in Hungary (from US\$ 11.3m in 1995 to US\$60.3m in 2004) contrast with the very low figure achieved in Serbia of \$3.9m in 2004.<sup>25</sup>

### Impact of FDI

This growth in the scale of new investment (FDI inflows as a percentage of GDP) is significantly linked with changes in a number of the key economic indicators including levels of overall GDP and GDP per capita. These tables, based on United Nations and WIIW publications are included in detail in the appendices and their segments are highlighted below.

**FDI INFLOW AS % OF GDP, GDP/CAPITA US\$ – SELECTED COUNTRIES**

	1990	1995	2000	2004
<b>Croatia</b>				
FDI inflow % GDP	n/a	0.6	5.9	3.5
GDP/capita	5485	4029	4090	7557
<b>Czech Republic</b>				
FDI inflow % GDP	n/a	4.9	9.7	4.1
GDP/capita	3594	5349	5425	10462
<b>Hungary</b>				
FDI inflow % GDP	n/a	10.7	6.0	4.6
GDP/capita	3484	4325	4565	9908
<b>Romania</b>				
FDI inflow % GDP	n/a	1.2	2.9	8.7
GDP/capita	1648	1564	1647	3358
<b>Bulgaria</b>				
FDI inflow % GDP	n/a	0.7	8.0	11.7
GDP/capita	2377	1580	1576	3137
<b>Serbia and Montenegro</b>				
FDI inflow % GDP	n/a	-	0.6	5.3
GDP/capita	2706	1412	1044	2813
<b>Slovakia</b>				
FDI inflow % GDP	n/a	1.3	9.5	3.1
GDP/capita	3103	3617	3764	6019

In contrast, Ireland (acknowledged as an international success story in terms of the attraction of FDI based on focused strategies) has seen GDP per capita growth from \$13,458 in 1990 to \$24,808 in 2002 and \$44,521 in 2004.<sup>26</sup>

<sup>24</sup> See Table 8

<sup>25</sup> See Table 8

<sup>26</sup> See Table 12

## Importance of Access to EU

Romania and Bulgaria as EU accession countries have seen the value and volume of FDI grow significantly in the past 5 years, highlighting the earlier pace of privatization achieved, the value placed by investors on the necessary legislative reforms achieved and the increased market opportunities inherent in EU membership (see the following table<sup>27</sup>).

	1995	2000	2001	2002	2003	2004
Romania	419	1037	1157	1144	1562	5174
Bulgaria	90	1002	813	905	1419	2488
Serbia and Montenegro	-	50	165	475	1360	966

In Romania, privatization has attracted some manufacturing Greenfield investments focused primarily on a low wages competitive advantage. Retail, wholesale and services focusing on the large domestic market have also been major components of FDI in Romania.

Bulgaria, with more limited manufacturing success has boomed in construction activity focusing on the development of a mass tourism market. These two countries continue to increase the flow of FDI whilst in contrast the level of FDI into Serbia declined between 2003 and 2004 to less than \$1 billion.

## Main Sources of Investment

Companies based in Germany, Netherlands and France were main investors in the new EU states and Candidate Countries (CCs) during the period over the past 15 years. These figures include international companies, American and Japanese mainly, which were expanding a European presence by moving eastwards.

## Competitive Issues

There is also evidence of investment movement from these countries to other lower cost environments. Hungary has lost a number of 1990's investments to lower cost economies in the past few years due to increased wage and inflationary pressures and is now seeking to establish itself as a location for higher value added activities. The intensive competitive pressures for new car plants is further evidence of this trend after the earlier successes of Czech Republic.

The competition for new FDI is global and rapid developments in technology and advances in logistics, coupled with a global need for reduced costs in most sectors of industry, is heightening this competition and raising the in-country standards and expectations of investors. Serbia is faced with a considerable catching-up situation on other countries in its immediate region. Whilst this gap is recognised in overall government statements and strategies, there is a need to adopt a more proactive and accelerated focused approach and commitment of additional resources on initiatives to improve the enabling environment.

It is of special importance to create conditions for efficient application of innovative results in economy, in order to reduce the time period from the discovery of innovation to its commercialization, to the level dictated by world market.

Innovation and scientific/research activities are the flywheel of overall technological development of one country. Only new knowledge and technologies based on inventive and innovative development, and applied in production process of creating new products and services, can increase the overall competitiveness of Serbia in the world dimension.

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<sup>27</sup> Source: WIIW US\$mil – Annual FDI Inflows

In spite of increased resources allocated for research and development after 2000, the resources that are currently allocated are insufficient (1.34% of GDP in 2003)<sup>28</sup>. In 2003, allocations from the budget and funds were 0.36% of GDP and 0.32% of GDP in 2004<sup>29</sup>, showing the decline of budget allocations and increase of allocations from the private sector. Positive trend can be noticed comparing the situation in 2000 with 2003, when the allocations from private sector were tripled. Nevertheless, private sector should be further motivated to focus and invest in this sector, bearing in mind the role of research and development in increasing productivity and changing the overall structure of economy in one country.

*The Law on Innovations* stipulates establishment of the Fund for Innovations, in order to ensure financial resources for innovative activities. Along the time, the Fund for Innovations can turn into Shareholders Company and open the space for private capital (including foreign investment) for investing its activities. The law stipulates the need for adoption of incentives for legal and natural persons that use modern technologies, create and sell innovative products and services, implement patents or financially support development of innovative activities.

Serbia has badly used the chance to attract more FDIs after 8 transition countries entered the EU. Investors left the EU newcomers for basically two reasons. First, newcomers were obliged to accept the costly EU regulation that imposes costs and cuts benefits from doing business. Second, accession countries were obliged to remove so called vertical subsidies, again a net loss to investors. Until the EU integration of Serbia, the chance to attract more investors from the EU25 still exists. It is however not realistic that FDIs will continue to grow in the eight CEEC countries. They fell sharply after 2000-2001. from ca € 35 billion to € 11.1 billion in 2003 and 2004. Even larger decline in FDIs is registered in the EU25.<sup>30</sup> With the probable accession of Bulgaria and Romania in 2007/2008. there is a new chance for Serbia to get more investors leaving two countries. FDIs in the two countries totaled in \$ 7 billion in 2004, and they are expected to reach \$ 9 billion in 2005. In general, the EU25+2 loses competition for FDIs with the Far East, China, India, the U.S. and emerging market

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<sup>28</sup> Source: Statistical Office of the Republic of Serbia

<sup>29</sup> Source: Ministry of Science and Environmental Protection

<sup>30</sup> Total FDIs in the EU25 fell from 2002. to 2003. from € 424,2 billion to € 357,5 billion, and it fell again in 2004. compared with 2003. to € 189,8 billion. The FDIs in the ten newcomers from 2004. fell in 2003. compared with 2002. from € 24,5 billion to € 11,1 billion, and it has recovered slightly in 2004. to € 15,3 billion. However, this is just a half of its peak in 2000th of about €30 billion.

Comparing 2002. with 2003, the FDIs rose in EU15 in Belgium, Greece, Austria and Portugal. By comparing 2003. with 2004., the FDIs rose in the EU15 in Greece, Finland and UK.

What concerns the 10 newcomers, FDIs rose in 2003. compared to 2002. just in Estonia. Comparing 2004. to 2003, they rose in the Czech Republic, Cyprus, Latvia, Lithuania, Hungary, Poland and Slovenia. See Table 13.

### 3.2.2 Regional Comparison

The significant low positioning of Serbia in terms of the attraction of FDI is confirmed by the following table<sup>31</sup>:

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
Country Population (million)	7.49	7.8	4.44	21.73	5.4	1.35
FDI inflow 2004 US\$bn	0.97	1.609	1.1	5.1	1	0.9
Total FDI Stocks (US\$ billion) end-2004	3	6.6	12.4	18.2	12.2	9.4
FDI Stock per Capita (US\$) end-2004	402.7	846	2792	837	2592	6962

Further detailed analysis, underpinning the importance of FDI in overall economic development is highlighted by the following table on GDP per capita, real GDP growth rate, inflation and unemployment levels and the importance of exports in overall GDP (see Table 14 below<sup>32</sup>).

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
GDP per Capita (US\$) 2004	2972	3120	7660	3190	6156	7930
Real GDP Growth Rate (2003/2004)	9.3%	5.5%	3.7%	8%	4.9%	6.2%
Inflation Rate 2004	13.7%	6.1%	2.1%	11.9%	8%	3%
Unemployment Rate, 2004	18.5% <sup>33</sup>	12%	18.2%	6.3%	16%	9.7%
Total Export (% OF GDP), 2003	14.4% <sup>34</sup>	37.3	21.9	37.3	65.5	49.9

Serbia has the lowest GDP per capita, highest inflation, highest unemployment level and lowest proportion of exports as % of GDP, and the differences are also extremely high between Serbia and the better performing countries.

The gravity of the situation is accentuated by the fact that 15 years ago Serbia was ahead of most of these neighbouring countries on general economic development indicators. These figures underpin the necessity for a dramatic improvement on a number of fronts.

This major barrier underlined by this survey<sup>35</sup> relates to the land issue and the fact that Serbia lags well behind its neighbours in terms of the adoption of the basic restitution laws and that land title legislation is considerably less modern than other countries. This is reflected in the fact that in Serbia the issue of new investment in industrial parks (a key facilitator for general FDI) and other property developments (a major driver for FDI in Bulgaria as an example) is well behind other countries.

<sup>31</sup> Source: Various. See Table 14.

<sup>32</sup> Source: Various. See Table 14

<sup>33</sup> According to ILO Methodology

<sup>34</sup> Source: Ministry of Science and Environmental Protection

<sup>35</sup> Table 14

In addition, proper town and industrial planning is very undeveloped in Serbia and the issue of construction permits is a source of considerable uncertainty and anxiety for all investors. This confirms that the basic building blocks for FDI are not in place at present and this Strategy seeks to prioritise a number of measures to address this situation.

The creation of a favourable environment for investments, both foreign and domestic, is a major challenge for all countries. Competition for attracting FDI is increasing world-wide particularly for countries lacking a major domestic market or significant natural physical resources to entice investors to invest in their country

### **3.2.3 Comparative Advantages of Serbia**

#### **Language skills**

Serbia is top ranked (42%) in comparison with other countries concerning the percentage of population speaking the English language.

This compares with the following rankings – Estonia with 30%, Romania 16% and Bulgaria and Croatia 14% English.<sup>36</sup>

#### **Comparatively Low Salaries**

Croatia has the most expensive labour cost in Euros per month (920), followed by Slovakia (889) and Estonia (614). However, Serbia (333) has a higher labour cost than Romania (260) and Bulgaria (196).

The above figures are based on the average monthly cost that an investor had to pay per employee in 2004, which includes average gross salary plus social contribution paid by employer.

It is proposed to examine this social contributions scheme as the present system effectively involves very high charges for better skilled and higher paid employees.<sup>37</sup>

#### **Central Regional Location**

Whilst the key central location of Serbia positions the country well for trade both to the East and West, the road rail and river infrastructure needs development to maximise this potential to develop as a central location for trade and industry. The telecommunications network similarly needs upgrading to address the potential in the ICT product and services sector.

#### **Comparative Tax Incentives and Tax Credits**<sup>38</sup>

##### Tax rates

From the analysis, many countries are using low rates of taxation and taxation allowances as a form of incentive.

Many types of incentives are available, ranging from low rates of corporate tax, to special incentives for job creation in disadvantaged areas or incentives for investing in R&D to overall tax holiday period for qualifying levels of investment.

Serbia has the lowest corporate profit tax rate, set at 10%<sup>39</sup>, while the second lowest is 15% for Bulgaria. Croatia and Estonia have the highest rates with respectively 20% and 24%.

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<sup>36</sup> Table 14

<sup>37</sup> Table 14

<sup>38</sup> See Table 14 for complete analysis

<sup>39</sup> In the other state union republic corporate profit tax rate is 9% classifying Serbia and Montenegro a country with lowers corporate profit tax rates in Europe.

Serbia and Estonia have the lowest VAT standard rate, 18%, one point less than Romania and Slovakia. Croatia has the highest rate with 22%, just behind Bulgaria (20%).

### 1) Tax Holidays

Tax holidays are among the most widely used general incentives, especially in developing countries. They are generally regarded as an imprecise and unfocused form of incentive and no substitute for a transparent and efficient enabling environment.

Tax holidays are not well regarded within the European Union as they are viewed as constituting a distortion of trade rather than an incentive. However, they continue in use in various formats in various countries and the sample survey under examination revealed differing criteria for qualification for tax holidays and different tax rates.

Serbia and Croatia offer 10-year tax holidays to companies which invest respectively more than EUR 7 million and EUR 8.2 million and employ at least 100 and 75 persons. Serbia additionally provides tax exemption for concessions and non-profit organizations.

Bulgaria and Romania focus their tax holiday incentives on disadvantaged areas with high unemployment. Thus in Bulgaria corporate tax in regions with above-average unemployment is zero for manufacturing companies and in Romania the tax exemption remains for the duration of the existence of the disadvantaged zone. In Serbia, profits of companies that arise from investment in underdeveloped areas are tax-free for two years; however, Serbia does not have similar incentives for areas formally designated as devastated regions. This anomaly will be reviewed and adjusted.

New EU member countries such as Estonia and Slovakia have implemented European judicature and modernised their tax regimes to European standards. In Estonia, for example, there is no corporate income tax for reinvested profits, while in Slovakia payouts of dividends are tax free. In both cases double taxation is avoided. In Serbia, in addition to 10% profit tax rate on corporate profit, payouts of dividends are tax free.

### 2) Tax Credits and Grants

This is a more focused form of tax incentive whereby company expenditures in particular areas, indicative of agreed national or regional priorities, merits additional taxation credits. This can take the form of increased tax allowances which have the net effect of decreasing the tax liability of the employing company. Direct grants are another form of support for companies, used in a general way in a number of countries either for capital or current expenditures, but also provided in a more focused form, as for R&D expenditures.

#### 2.1 New jobs

Tax credits for employing additional workers are available in most countries in the survey. For example, in Serbia government allows tax reduction equal to 100% gross salaries plus related contribution paid by the employer. Tax credits are recognized if tax payer who terminated short term employment with a number of employees, and employs in the same tax period more full time employees than the number of employees with whom short time employment contract was terminated. Employer is also allowed to tax reduction of mandatory social insurance benefits (corporative 17.9%) equal to 100% for new employees over 50 years of age, and equal to 80% for new employees over 45 years of age. It is recognized for period of 2 years, starting from the day of starting the employment of new employee. In Bulgaria there are special programmes for employment of young people. Slovakia and Croatia provide grants which are covering costs of job creation for a period of one year (Slovakia up to 4000\$ per year add Croatia up to 2725\$ per year). Incentive measures in Romania provide for tax credits on gross salaries for one year.

#### 2.2 Re-training programmes

Serbia, unlike all other countries in the survey, does not have any specific incentive or tax credit to encourage investors to invest in staff retraining.

### 2.3 Investing in R&D

Serbia does not have any specific tax incentives for R&D. If the intention is to attract more investment in this sector, it is necessary to find the way to stimulate interested private investors, like the neighbouring countries did.

Estonia provides grants for industrial and product development research costs that can go up to 50% of total cost of projects. For establishment and operation of technological parks Croatia provides different incentives (tax reduction for fixed assets and land given for its use). In Bulgaria, financial assistance is available under an EU Phare programme which includes R&D grants for high-technology business incubator.

### 2.4 Other tax incentives

a) Accelerated depreciation or increased initial depreciation rates, which are found in Serbia, Bulgaria and Romania, is one of the more common forms of incentives.

In this direction, Bulgaria is offering increased depreciation rates for IT equipment for two years and 3 and 1/3 years for manufacturing equipment, while Serbia has offered accelerated depreciation on a wide array of fixed assets.

b) Other tax-related incentives that the countries are offering to foreign investors vary substantially from country to country. Slovakia seems to be offering the most favourable tax regime with no dividend, inheritance, or real estate transfer tax.

c) Bulgaria is offering 2 year VAT exemption for imports of equipment. Serbia, although VAT is chargeable, is offering free import of in-kind investment (import of equipment is free of customs duties).

In Romania, under the new investment law, all investments that exceed the equivalent of USD 1 million enjoy a 20% reduction in their overall corporation profits tax liability.

## **Summary and Conclusions on Incentive Review**

Taxation reform and modernization is a key element of the overall incentive package offered for new investments. In general an overall low rate of taxation, efficiently and transparently managed, is the acknowledged best approach in terms of lack of distortion on the domestic economy and a sufficient incentive for credible investor.

In this context focused supports, including accelerated depreciation provisions, prompt and efficient refund of VAT incurred, or VAT deferral on export activity, taxation provisions to encourage companies to increase the level of value added and increase skill and contribution levels of employees, represent key components of an enabling environment in Serbia to address the national goals of increased employment and exports.

It is recommended that the taxation policy of Serbia remains competitive with its neighbours in terms of its general low rate of corporate tax and limited tax holiday provisions, and that the matter be kept under review.

Studies should be undertaken to identify whether some modifications could be incorporated to include additional tax credits for accredited staff training schemes, R&D expenditures, accredited marketing expenditures and other tools utilised elsewhere to encourage companies to increase productivity and export competitiveness.

In particular clarification on inclusion of “devastated areas” within the eligibility definition covering the tax holiday situation for companies in undeveloped areas should be investigated and addressed to seek to accelerate regional development needs.

Serbia has to focus on attracting investments that bring world famous brands which create new jobs and apply new technologies. The criteria that qualify one investment as an investment of special interest have to be carefully determined:

- A company can be qualified as *world famous brand* if it is on the list of largest and most successful enterprises in the world, like *Fortune 500*,
- Investment over EUR 20 million with new jobs for 100 workers can be qualified as *significant investment* that has impact on new jobs,
- Investment in high-tech sectors can also be qualified as *significant investment*.

An investor who meets any of the above criteria, acquires right to special allowances like:

- Allocation of land free of charge (right to use, right to ownership - upon the restitution of property, privatization of urban construction land and change of Constitution),
- Release from payment of land servicing charges,
- Provision of infrastructure to the land-plot where investment of special interest is made.

## 4 FOCUS OF THE STRATEGY

The priority objective of the Strategy is to create a favourable climate, environment and framework for the attraction, retention and expansion of internationally competitive and export oriented investment to secure increased levels of sustainable employment, reduction in trade imbalance, economic and social growth.

Strategic goals for FDI in Serbia include:

- Increase the number and value of new investments in the productive industrial and internationally traded services sectors of the economy,
- Facilitate and support investors to accelerate the implementation of their planned investments in the country,
- Encourage and facilitate existing investors to deepen their involvement in the country and to maximize the level of local internationally competitive value added within the economy.

### 4.1 Internal Focus

Within the country the emphasis throughout the Strategy is to effect improvements in the investment environment through:

- a) Enhancement and measurement of progressive improvements in the legislative and regulatory environment to achieve European standards.
- b) Strengthening of the institutional capacity at national and municipal Government levels to provide an efficient, transparent and consistent level of service and support for investors.
- c) Development of an awareness campaign focussed on municipalities and utilities to highlight the national priority need to attract new investment and of the important benefits in terms of new job creation and export development that arises from new investment.
- d) Prioritization on development of a number of infrastructural and competitiveness initiatives to provide a modernized platform to support and facilitate new investment.

The main internal strategic issues in the development of an improved environment for FDI in Serbia include:

- 1) A renewed and accelerated commitment to the process of reform of legal and administrative barriers facing new investors with a focus on priority areas developed in conjunction with private sector.
- 2) A significant strengthening in institutional capacity at national and municipal level.
- 3) Facilitation of an increased level of cooperation on technical matters between the government and the private sector.
- 4) An improved customer service focus developed in relationship between the government and the private sector including the appointment of investor advocates in key municipalities and utilities.
- 5) Improved access to land, industrial and technology parks.
- 6) Deregulation of telecoms and improvements in the telecommunications infrastructure.
- 7) Focused improvements in the educational sector and establishment of linkages between universities, research institutions, private sector and municipalities.
- 8) Focused work with infrastructural and service providers to improve transparency, quality and cost of services to business.
- 9) Provision of increased access to the country's broadband and fibre network for technology initiatives and thus provision of a competitive platform for FDI entry into the country.

The priority over the initial years is the development of a system of partnership through active committee participation with a unified focus to achieve measurable levels of improvement in the investment environment and increased levels of new direct foreign investment in competitive productive sectors of the economy.

There are a number of ongoing initiatives and it is intended to broaden and strengthen these initiatives.

#### A) Committee on Facilitation of FDI in the Economy of Serbia

This committee, representative of a wide range of government ministries and agencies, was established formally in mid-2004 to provide a forum for review and acceleration of reforms on legislative and regulatory matters. To date specialist subcommittees have been formed to address the land and permits issues. This committee was mainly involved in implementation of the Action Plan for the Removal of Administrative Barriers to FDI in 2004-2005<sup>40</sup>.

The results and outcomes of this ongoing work have been advised to the international community and private sector organizations. Many of the topics are formally reviewed by the FIC in their annual White Book and the OECD Investment Monitoring Instruments and it is intended to develop this principle of open dialogue.

It is intended to broaden the scope of this initiative in terms of:

- Issues to address and composition of membership.
- Replicate the principles of this committee by the formation of similar committees in a number of the major municipalities addressing local areas of competence and responsibility.
- Provision of regular review forums to ensure complementary approach between national and municipal authorities.
- Increased private sector participation and involvement in these committees to ensure that sectoral investment issues are highlighted and addressed.
- Provision for regular formal reviews spearheaded by MIER
- Provision for annual high-level forum between government and private sector to review progress and establish priorities.

B) The competitiveness review tables (see Chapter 2.2) show the very poor rating of Serbia on a wide range of indicators and underline the need for rapid and sustained improvements in the short and medium terms.

Broad internal measures proposed include:

- Maintaining and developing macroeconomic stability through fiscal rectitude and compliance with IMF guidelines,
- Effecting improvements and refocus of reform in key national government and municipal institutions,
- Accelerating the pace of reform on Telecoms sector and other utility and service providers,
- Developing and implementing a programme on concessions and other public utilities.

C) Broad measures for strengthening the institutional capacity at national and municipal levels to facilitate and support investors include:

- Initiation of process of establishing improved linkages between public and private sector bodies at national and municipal level,
- Initiation of a process of appointing key champions and advocates of “investor promotion and facilitation“ in all key ministries and municipal bodies,

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<sup>40</sup> The Action Plan for the Removal of Administrative Barriers to FDI for the period 2005-2006 is provided in Chapter 4 Appendices – Appendix 1

- Broadening the scope of this detailed liaison and cooperation on investment matters to include coordination with educational authorities, utility providers and representative private sector industry groups,
- Establishment of a network of subcommittees and thus broadening of the remit of the Action Plan Committee on regulatory and administrative matters.

Among the measures necessary to improve the situation and to improve the positive impact of FDI for the Serbian economy are: much tighter co-ordination; design international best-practice structures for the relevant corporate entities; establish sound mechanisms for effective interaction between these institutions, and increased and refocused funding for these institutions.

The issues for consideration and evaluation by this key coordinating group of MIER include:

- Policy formulation/recommendations for government and donor community,
- Monitoring and evaluation of performance in relation to effecting improvements,
- Monitoring of national and local competitiveness issues,
- Measuring impact of various investment promotion initiatives and investor facilitation measures,
- Supporting measures to facilitate linkage between FDI, enterprise development and SME development,
- Assisting in identifying and mitigating barriers to export development,
- Monitoring progress in the identification and provision of suitable industrial sites, technology parks and industrial parks provision in key municipalities,
- Management of balanced regional development across Serbia.

The overall guiding principles of the Strategy are prioritization on actions to modernise the legislative and regulatory environments, improve institutional capacities, address infrastructural and competitiveness issues and initiate internal and external marketing initiatives and are set out in detail in Chapter 7 – Issues, Measures and Actions.

## 4.2 External Focus

On adoption of this overall Strategy the government will seek support for the development of an overall investment promotion strategy with the key message that Serbia is taking steps to improve its investment environment, highlight the reality of opportunities within this improved environment and address negative investment perceptions in key markets. This promotion programme may be presented in the context of improvements noted in the external “risk “ rating of Serbia by a number of respected international rating agencies as noted by both Standard and Poors and Fitch in 2005.

This investment promotion strategy will focus on the following main building blocks of improving the understanding and perceptions of foreign investors as they consider the optimum location for their investment plans:

- Image Building,
- Investment Generation (Promotion),
- Investment Facilitation.

### Image Building, Investment Generation and Investment Facilitation

The development of a marketing and promotional strategy to address the issues of image building, investor generation and investor facilitation highlighted above is normally vested in a separate agency, one stage removed from a direct government ministry programme to address the nationally adopted high level goals and objectives. In Serbia it is the Serbian Investment and Export Promotion Agency (SIEPA).

#### A) Image Building Campaign

Development of a marketing strategy and implementation of a promotional programme to address the negative image of the country among investors in focused sectors and key markets. The overall goal is to significantly narrow the gap between how potential investors perceive Serbia and how the government and its agencies would like it to be viewed in the future. The most important initiative in this sector is the “Serbia Branding”<sup>41</sup> project on promotion and positioning of Serbia on the world market.

Various methodologies have been adopted in different countries to address this situation including:

- Clear identification of target audience is an absolute requirement,
- Development and implementation of “Serbia Branding” strategy,
- Development of a theme to link advertisements,
- Development of key messages to highlight positive and competitive points about the economy and government’s commitment to reform,
- Series of advertisements in key economic journals such as *The Economist*,
- Promotion of inward visits by key journalists, as has been undertaken by the Tourism Board,
- Promotion and publication of good news stories.

#### B) Investment Generation and Promotion

- Focus on a number of sectors, seek to identify key companies in those sectors and key individuals in those companies,
- Develop the marketing message e.g. key skills at lower cost, university/business support mechanisms in place, modern business parks,
- Develop usage of Internet as a valuable tool in identifying growth sectors, growing companies and background on companies prior to top management presentations.
- Develop a customer service focused approach,
- Attendance at conferences and trade fairs is a very general approach to marketplace and these are usually not attended by key investment decision makers.

#### C) Investor Facilitation

It is proposed to strengthen the after-care services for investors through both the reform of legislative and administrative practices, to develop increased levels of partnerships at national and municipal levels, to nominate investor champions and advocates at ministry, municipal and utility levels and to establish a one stop shop initially focusing on construction permits.

### **4.3 Regional Development**

The achievement of balanced regional development is a key objective of Governments internationally and initiatives are often undertaken and incentives offered on a regional or district specific basis to seek to attract new investment. These initiatives often take the form of the provision of additional or subsidised infrastructure in the form of land and physical facilities, health and educational facilities or more specific industry incentives in terms of additional grant supports for fixed asset establishment and operational costs such as training and staff recruitment costs.

Regional disproportions in Serbia have deepened during the process of transition. Long-term and complex regional development issues are manifested by highly differentiated region development levels, unsatisfactory country’s development stage, structural imbalance, imperfect institutional solutions and unfavourable demographics data.

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<sup>41</sup> Ministry of International economic Relations and Ministry of Trade, Tourism and Services have initiated this action

Serbia is currently experiencing a specific regional development institutional vacuum – Regional Development Law, Regional Development Strategy and Regional Development Policy do not exist as well as regional institutions and agencies. Pilot initiatives are planned for the short term in a number of municipalities outside Belgrade in terms of developing local partnerships and initiatives to improve the investment climate. The development of specific regional policies for FDI attraction and incentives will be undertaken in line with the development of regional institutional capacities with the specific short term objective of extending the definition scope of “underdeveloped regions” to include “devastated areas”.

#### **4.4 Availability of Serviced Land and Buildings**

##### **4.4.1 Construction Land**

###### **Strategic goals:**

- **Establish a construction land market with minimal administration.**
- **Simple, clear, efficient procedures for acquisition of construction land rights.**
- **Minimizing opportunities for local level corruption.**
- **Lowering of real-estate (immovable property) building costs (both residential and industrial).**
- **Increasing lending (financial borrowing) activities based on mortgages.**

###### **Current situation**

The current situation of impossibility of gaining ownership rights on construction land under market conditions is a key barrier to improvement of the investment climate in Serbia. Legal safety has deteriorated, trade relies on *ad hoc* solutions and there are no clear criteria for price determination. Outdated and complex regulations are the main reason for this:

- The Constitution stipulates that the construction land is government ownership.
- Unlike other transition countries, Serbia still doesn't have the Law on Restitution.
- The Law on Planning and Construction, which puts local self-governments in charge of spatial planning, puts construction land at their disposal and places them in charge of issuing construction licenses (building permits), has many deficiencies and gaps.
- In order to be able to implement the Law on Planning and Construction, municipalities enacted their own sub-legal acts which further complicate the situation. Local regulation is vague with imprecise procedures and criteria for determining prices for municipal/city fees for construction (building), leasehold and site conversion licenses (permits).
- Absence of the Law on Property of Local Self-Governments that regulates responsibilities for disposition of construction land by local governments.

All of the above provides enough space for the abuse of power/rights/laws/regulations etc. on the local level and the absence of a database(s) with information about availability of land and incomplete land books and other land-related records additionally contributes to the existence of irregularities and even corruption in a process of obtaining property rights.

Certain improvement was achieved in this area. In December 2005, SIEPA developed on its Webpage a database with over 400 attractive investment locations in Serbia. The database contains details on locations and available infrastructure locations, including the information about the economy, education system and labour force in the municipality of location. Most data are illustrated by pictures and urban plans. Access to the database is free.

## Legal Actions

The required legal framework for regulating the situation in this area shall be created by adopting new and amending current regulations. In regard to the above mentioned barriers, it is necessary to quickly enact relevant legal acts and regulate the following issues:

### I The Constitution

The new Serbian Constitution should stipulate for equality of all ownership types (private, collective and government) over construction land as well as the right of owners to trade with this land category. **(Deadline: November 2006)**

### II Law on Restitution

The Law should provide for restitution of all assets taken away after WW II. Assets impossible to give back in a "natural form" shall be compensated in a different, legally defined, way. Restitution shall bring back the citizens' faith in protection of private property and rule of law and partially correct this past injustice done to former owners and their descendants. Also, it shall lead to clearing out the complicated land and other real-estate ownership situation, to better offers on the market and lowering of construction and lease prices with further positive effects on the overall activity and population standards. The risk that foreign investors are experiencing from the current "on hold" restitution situation shall be removed and in this way privatisation of construction land shall be enacted **(Deadline: End of 2006)**

### III Law on Planning and Construction

The new Law (or a special Law on Construction Land) should simplify and speed up the whole procedure in regard to availability of construction land, especially in regard to leasing construction land and issuing construction licenses (building permits). Terms of new (or amended) law need to be precise and obligatory for local self governments, which shall exclude possibilities of arbitrary dealings. Also, regulations should be precise when it comes to criteria for determining fees for leasing, land conversion and similar. Furthermore, if an investor has submitted complete required documentation for obtaining a construction (building) or lease/land conversion license (permit), the approval procedure should last no longer than 15 days. **(Deadline: July 2006)**

### IV Law on Property of Local Self-Governments

This law should enable property ownership to municipalities or their territories' immovable property handling. It is necessary that local self governments be independent in terms of finance and property and also much more responsible for their actions for true decentralization in the state. Government property management which municipalities currently *de facto* employ would get a more "in-house" manner. **(Deadline: December 2006)**

### V Law on Registering Immovable Property and Immovable Property Rights

The law should stipulate the disappearance of practice of double-booking the land (in land books and in cadastre registries). This whole procedure should be performed by a highly organized, highly trained and highly equipped cadastre services establishment. Draft Law on Registering Immovable Property and Immovable Property Rights will be submitted to the Parliament for adoption. **(Deadline: October 2006)**

### Other necessary measures

Introduction of market criteria in the area of construction land is a necessary process of modern economy development in Serbia, which calls for decisive solutions. It is necessary to **privatize the construction land** through a process open to natural and legal persons who should be given the opportunity to purchase the construction land from the state. The state would be able to use these funds to compensate to original owners of land, or their heirs, for the property that was nationalized and confiscated from their families in the past. The state

could give back to original owners the land that is not purchased from the state by its current users. This would enable the original-new owners of land to continue to collect rent from the users, instead of the state. It is estimated that the price could equal half market price for the use of construction land. It is also estimated that purchasing value of land could equal to 12-15% of the value of the premises that are allowed to be built on that land.

Other measures should be focused on creating accurate and complete land records, especially of plots designated for economic activities and are available for construction of production and service facilities.

Above all, it is necessary to complete the Cadastre Project in Serbia (currently 77% of immovable property is recorded in the central real estate cadastre). The project is funded by the WB, EAR, SIDA and GTZ and shall commence in autumn 2005 to be completed in 5 years. **(Deadline: April 30, 2010)**

The development of a statistical database with information on availability of land suitable for development in the short term is a key objective of the planned partnership approach with municipalities. This data base should be developed and available both locally and centrally. **(Deadline: November 2006)**

#### **4.4.2 Industrial and Technology Parks**

The provision of industrial and technology parks is a key tool in attraction of FDI. **Industrial parks** are ranges of businesses concentrated in one location, using the same infrastructure. The concept of planned accommodation of a range of industrial producers has developed to the stage where industrial parks are used by companies in a mixture of production and service activities and are heavily reliant on modern technologies.

**Technology parks** differ from industrial parks by accommodating companies that are oriented towards the technological development and commercialisation of scientific and technological research. Technology parks are developed with a focus on development of partnerships between business, universities and research institutions.

Industrial and technological parks can be founded by the government or private sector. Often, facilitation by state institutions is needed during the founding stage. When the construction is finished, facilities in the park can be leased or purchased.

The purpose of industrial parks is to provide accommodation for FDI and create favourable conditions for development of specific regions. Production in industrial parks contributes to increased employment of local population, change of employees' structure through trainings and education (specific skills are required), attracting business support and service activities, and use of local SMEs and logistics, which supports economic development of the entire region.

#### **Strategic Goals:**

- **Quick commencement of business operations for those who decide to invest in Serbia.**
- **Increased employment and FDI inflows.**
- **Improved infrastructure and existing technology.**
- **Can contribute in the longer term to more balanced regional development within a country.**

## Current Situation

Investment incentives studies show that tax incentives and cash grants are not the most important investment motivators. Availability of land and infrastructure, good utilities and cable systems and ownership rights are on the top of the list of location priorities. Serbia faces many infrastructure development challenges as well as issues related to land and real-estate ownership. Until these issues are resolved industrial parks might serve the purpose of an “oasis” for investors in offering fast and easy commencement of business operations, clear in terms of ownership.

Industrial parks have not yet been established in Serbia, while in the immediate neighbouring countries and rest of the world such activities are on the rise. This lowers the chances for increased FDI inflows in Serbia, especially export oriented productive sector investments. This is why it's necessary to provide for conditions that would enable establishment of industrial parks as soon as possible. For quick connection of economy with scientific, R&D and innovations sector, the Law on Innovations (as well as the Law on Scientific and Research Activities) specifies organizations for providing infrastructural support to innovation activities, as follows: *business and technology incubator* and *science and technology park*.

*Business and technology incubator* is a company that offers for fee business space, administrative, technical and other services to new companies, for maximum of five-year period after their establishment. This enables new companies to invest their funds in innovative and production activities for quicker placement of new products and services on the market, instead of being burdened by large investments in infrastructure at the beginning of operation. Limitation of period of stay in business incubator helps its "clients" become independent and sustainable and opens the possibility to other enterprises and innovative organizations to start their activities.

*Science and Technology Park* is the most frequent concept of organization in developed countries that is utilized for direct connections between science and economy in order to create innovations and increase overall competitiveness. For functioning of science and Technology Park it is necessary to establish connections with universities, science and research centres, companies and local governments which can be founders and clients of science and technology parks. According to the provisions of this law, science and technology park is a company which provides infrastructural and technical services to universities, science and research centres, high-technology and middle-technology companies within the specific scientific, R&D or production range, in order to enable their connecting for quick implementation of new technologies, creation and placement of their products and services on the market.

## Partnerships between Interested Parties

Development of industrial parks in Serbia requires synchronization of activities and partnerships between the government, local self-governments, industrial park management authority (an “operator” - a company that manages the park) and industrial park “clients” (companies that operate in the park).

The government role is important. The level of the government involvement in the development of an industrial park depends on the development level of a country or a region the park is being established in. In more developed countries governments directly provide incentives (usually cash grants) for industrial park infrastructure development, while in countries in which budgets are not of such capacity investors are offered to build industrial parks and receive special tax incentives and tax holidays in return.

It is important for Serbia to attract “operators” with international experience. That can be achieved by providing land under favourable conditions and developing primary infrastructure up to the line of an industrial park. Land should be given for free in devastated and underdeveloped regions. Best “operators” for concrete locations should be selected through an international tendering procedure. Central government and local self-government should provide the basic infrastructure, in accordance with their authority. An “operator’s” obligation is to build basic infrastructure in the park. An “operator” could also build facilities that he might lease or sell to the park “clients” later on. In addition, an “operator” could offer special services to the park “clients”. A significant contribution of an “operator” lies in the fact that by marketing his park he is also promoting Serbia as an investment location.

Industrial park “clients” are offered a possibility to swiftly commence with their business operations, are exempt from bothersome administrative procedures for obtaining a variety of licenses and have a clear picture about land ownership their facility is located or leased on.

Naturally, both “operators” and “clients” would not be exempt from other, regular incentives Serbia offers: for large investments, for SMEs, for newly hired work force in underdeveloped regions, etc.

### **Legal and Other Necessary Measures**

It is necessary to enact the **Law on Industrial Parks** that should:

- Designate industrial parks as areas of a public interest; define criteria by which individual investment can be considered as a strategic one – an investment of a public interest (up to €20mil and employing 100 people); authorize the government to expropriate the required land in both cases by reimbursing the owners in accordance with market prices of the land.
- Define the industrial park concept – what are the conditions that certain zones need to meet in order to obtain the status of an industrial (business)/technology/scientific park.
- Designate that the government is in charge of assigning the industrial park status to a certain area and that it can (through a competitive process) assign government owned land to interested investors – future industrial park “operators”.
- Describe the procedure and conditions for establishing industrial parks (criteria should support underdeveloped regions or municipalities).
- Designate that a unit in SIEPA is in charge of the process while the government makes the final decision (provides an approval) based on SIEPA’s proposal.
- Define that the “operator” can be a foreign or local legal entity or a joint-venture company (partnership between a private company and local self-government).
- Stipulate that local self-governments can receive financial aid from the government during the development of an industrial park and, on the other hand, private companies can also enjoy tax incentives benefits.
- Provide a framework for relative rights and obligations between an “operator” and park “clients”.

**(Deadline: July 2006)**

Finally, it is necessary to execute the programme of industrial park sites identification in close cooperation of central and local governments. Beside the so-called Greenfield locations (empty land) it is necessary to explore available sites with already built but not (efficiently) used infrastructure. These are the so-called Brownfield locations and they designate enterprises (and their assets – land, etc.) that would be privatized through the bankruptcy procedure. Deserted Serbia and Montenegro military bases are also interesting locations to consider as they are equipped with basic infrastructure and facilities that can be adapted to the future park “clients” needs. In particular, border region military bases that are virtually deserted due to the decrease in number of soldiers and implementation of a variety of international agreements should be taken into serious consideration. These are usually

located in economically critical regions, so turning military bases into industrial parks and economy centres signifies the importance of the issue. The final result should be a complete and up-to-date database. Also, these activities should be performed in parallel with the aforementioned regulations.

**(Deadline: May 2006)**

### **Securing the Required Financial Support**

Development of industrial parks requires significant financial resources for purchasing land, evening out the terrain, introduction of utilities, modern telecommunications and road infrastructure, etc. Development of one industrial park in Slovakia requires an investment of €3.4-4.5 million.

Provided that local and central government will offer “operators” either free land or government participation in assets (capital) of a shareholding company that operates the park, government institutions must resolve the issue of financing the development of a relevant primary infrastructure.

Considering the limiting government and local self-governments budgets, resources from the current budget reserve can serve as financing sources. The practice of using such resources for similar purpose exists. In June 2005 the government has dedicated 100 million dinars from the current Budget reserve for participation of Serbia in financing the Programme for Encouraging Employment and Production in cities of Kragujevac, Bor and Vranje. Existence of functional industrial parks in those cities would contribute to creation of new jobs and productivity boost.

Funding for development of parks’ primary infrastructure can be obtained by redirecting resources from economy subvention funds (considered to be unpopular in terms of boosting the economic activity by the WTO). Redirecting the mentioned resources is in agreement with the fact that as privatization process is forwarding the number of enterprises – users of government subventions – is decreasing.

In rare cases (in Serbia) in which a local self-government has financial capabilities, it can establish a partnership relation with a private entity and based on a joint investment develop an industrial park and run it in accordance with the proportion of ownership.

Having in mind that Serbia is on the path to the EU, development of industrial parks can be funded by using the EU funds – from the Pre-Accession Instruments and Structural Funds. The requirement for obtaining these funds is partnership participation of local self-governments in developing industrial parks (especially in ownership terms).

Strategic investments are the area of a special investors’ interest. Direct negotiations with a potential investor should result in a better offer than those of competitor countries. Upon successful conclusion of negotiations the public should be informed about all by-the-government accepted obligations as well as benefits that a new investor shall bring. In such cases the government could prepare a special legal framework that would diminish the risk for investors and reimburse the eventual required land expropriation costs from the Budget. In the event of having a strategic investor, along with incentives that are generally available, the government may decide to take over the task of developing the infrastructure in the area in which the strategic investor shall be located. Educational system readjustments are also possible in those areas where a strategic investor is located – development of a workforce with specific skills, provision of teaching in a foreign language, etc.

#### 4.4.3 Free Zones<sup>42</sup>

The concept of “free zones “ has developed since the 1950’s as a tool for the creation of an enabling environment for businesses, primarily companies seeking a cost effective exporting base. The process involves the identification, designation and fencing of a “customs free area” within a country wherein exporting businesses are permitted to operate without normal compliance with the laws of the country in terms of customs, tariffs and duty obligations.

In addition businesses are normally permitted to designate their operations in foreign currency and often are not required to comply with normal regulations and obligations in terms of labour legislation, foreign currency holdings and other administrative and regulatory compliance. They have operated most successfully in least developed economies where the normal laws and regulations have not been updated and modernised to meet investor requirements. The principles of a “free zone” have developed beyond these initial driving forces of cheap labour, limited company taxation and reduced bureaucracy and have been developed beyond a “bonded warehouse” concept into a trading and transshipment location and even marketed as centres for key retail outlets catering for tourists. Dubai is the leading example of this form of usage of the “free zone concept”. The Free Zone concept could be utilised in the context of developing a “Free Port “ on the Danube , as part of the development of an “export transportation and logistics hub” in Serbia. However it is recommended that the existing usage of the “Free Zone“ concept be examined in greater detail to ensure that real and incremental exporting benefits are achievable. Development of Serbia based only on the concept of “free zones “ could indicate that Serbia is not prepared to implement reforms on its all territory.

Normally, businesses are permitted to operate in an insulated manner from general imperfections in the national environment. Main free zones attractiveness factors are: favourable customs treatment, certain tax relief and simplified administrative procedures.

Free zones are hosts to a variety of economic activities - aimed at encouraging exporting activities in a sense of increasing foreign trade levels of a host country and positively contributing to domestic economy. However in the modern world of WTO with an emphasis on harmonisation of taxes and duties, general reduction of rules and regulations governing business and overall lack of differentiation in treatment between investors both domestic and foreign the rationale for a focus on the development of Free Zones is diminishing for many countries.

In Serbia with the overall emphasis on achieving convergence with EU rules and procedures through overall modernisation of business rules and regulations with the specific overall goal of achieving improved access to development land and provision of industrial and technology parks, it is recommended that the practise and focus on the development of the Free Zone concept be re-examined and whether the needs of some existing users could be better addressed by increasing the number of Customs Bonded Warehouses.

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<sup>42</sup> General Information on Free Zones – See Appendix 2

#### 4.5 Concessions - Public Private Partnership<sup>43</sup>

The Law on Concessions was adopted in May 2003 and governs the development of public/private partnerships.

The following areas are defined as areas and sectors where concessions may be granted in Serbia:

- Exploration and exploitation of mineral resources,
- Construction, maintenance repair and operation of road infrastructure,
- Provision and management of railway infrastructure,
- Management of airways and waterways facilities,
- Provision and management of energy, telecommunications,
- Solution of utility problems, primarily water supply and solid waste management,
- Tourism infrastructure and sports and recreational facilities,
- Spa facilities, thermal springs, river and coastline areas.

A public private partnership approach is regarded internationally as a good mechanism to secure private sector finance and management expertise into the provision and development of key services. To date in Serbia some private sector interest have been expressed in a number of potential opportunity areas but the overall area has been relatively underdeveloped and lacking an overall proactive strategic approach.

It is recommended that as an initial step support be sought for the provision of capacity building measures in this area with a focus on developing a better overall understanding of the key components including project selection criteria, project financing options (including normal criteria for access to international funding institutions), legal documentation and provision for project monitoring and review. It is important to note that the overall cost of capital including the level of equity and loan funding inherent in all concession and public private partnership proposal is greatly determined by the levels of perceived political and economic county risks and the international ratings by specialist agencies.

The following commentary by private sector international agencies shows Serbia, despite recent improvements, is still poorly rated in comparison with other developing and developed economies.

A) "Despite Serbia's recent short-lived and weak coalition governments, progress with institutional and legal reforms, and toward macroeconomic stability, has been fairly steady". "Although the current governing coalition is fragile, we expect it to adhere to its prudent policy program, and to maintain its agreement with the IMF". "By contrast, improvements in the political environment and more stable governments would facilitate the implementation of Serbia's challenging reform agenda, support the inflow of much-needed foreign direct investment, and help to rebuild the economy's competitiveness. Together, these would eventually improve Serbia's creditworthiness, short term rating B, long term rating B plus".<sup>44</sup>

B) Serbia's "BB" ratings are supported by its improving public finances, comfortable public and external liquidity position, and good prospects for continued structural reforms and GDP growth, anchored by potential EU accession".<sup>45</sup>

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<sup>43</sup> Further Details on Concessions – See Appendix 3

<sup>44</sup> Source: Standard and Poors, April 2005

<sup>45</sup> Source: Fitch Ratings, May 2005

It should be mentioned that Serbia increased again its credit rating with Standard and Poor's, one of the most influential world agencies that deals with risk assessment of countries and companies. Standard and Poor's has increased credit rating of Serbia from "B plus" to "BB minus". According to this agency, political risk in Serbia is reduced, government obtained positive opinion about the Feasibility Study, EU plans the beginning of SAA, Serbia has reduced its foreign debt and budget surplus will be achieved in 2005.

Serbia managed to improve credit rating obtained for the first time in November last year. Credit rating used as a basis for assessment of credit risk is still low in Serbia. Further improvement of credit rating will allow for gradual decline of interest rates in Serbia and create more secure conditions for investment.

In view of the potentially wide range of other government agencies and institutions involved it is recommended that MIER establish an inter ministry committee, on similar lines to the established Action Plan committee on legal and regulatory reforms to prioritise and develop activities and planning for this overall area of concessions.

It is envisaged that in the medium term that a detailed plan and manual of specific concession opportunities will be developed for inclusion in overall FDI marketing plan.

Several concession projects have started and it is expected to sign many concession contracts in the future. Therefore, it will be necessary to establish adequate concessions administration unit for developing papers, analysis and studies that will be used for improvement and implementation of concession policy; administrative and technical monitoring of concession contracts execution and permanent communication with existing and potential concessionaries.

## 5 CONDITIONS FOR FDI IN ANALYZED SECTORS

The challenge for Serbia is to increase the overall level of investment in the productive and internationally traded sectors of the economy. Serbia missed out on investment in all sectors of the economy over the entire decade of the 1990's, which was also globally a period of significant growth in international investment.

This pace of restructuring and consolidation of most industrial and agricultural sectors accelerated globally in the 1990's and continues. It is supported by advances in technology and logistics and driven by competitive pressures. These industry trends towards increased globalization and specialization of production units have accelerated further during this new millennium and have impacted directly on all economies and on traditionally competitive and sustainable companies.

The principles of market economy and trends of global development of economy indicate that there is no justification for some sectors to be considered as "strategic". In the developed countries, even the military industry is often privatized. This should be taken into account during the analysis of economy sectors in Serbia. Apart from that, bylaws should not be used for regulation of economy, in order to preserve the principle of legal security and rule of law. Companies in all sectors are facing increasing pressures to reduce costs and improve quality and service delivery, the pace of specialization has accelerated and modern market pressures are forcing consolidation with continued pressures on companies to locate in countries with greatest competitive advantage.

Serbia is facing considerable challenges in most of its traditional sectors which because of lack of investment and modernization are effectively non competitive in this modern world. Many of its traditional markets have changed and companies delivering new employment and export earning opportunities require higher levels of product quality, service delivery and accreditation to international standards at globally competitive pricing. It is recognised that the private sector investor will determine the most optimum sector or sub sector for investment and the Strategy recognises this fundamental principle whilst seeking to effect significant improvements in the operating environment for investors in the country.

The following broad sectors in need of new investment are highlighted with broad recommended approaches under each heading:

### 5.1 Public Utilities Including Telecommunications, Electricity, Oil and Gas, Waste Management

Overall there is a considerable need for new investment in all these sectors, which were traditionally a direct responsibility of Government. The Government has passed the law on "concessions" which basically facilitates and permits the entry of private sector participants into these sectors and has developed an overall programme for privatization of a number of traditional public utilities, extractive industries and infrastructural facilities.

The Strategy recognizes the need for significant level of improvement of institutional capacity coupled with prioritization of certain programmes from the PPP area, increased levels of prioritization and commitment to develop both an understanding of global best practise, documentation of precise investment opportunities and an action plan to attract new investment into these sectors.

## A) Telecommunications

Modernisation of this sector is a key competitive driver impacting on many sectors with a particular impact and influence on the development of the ICT sector. Introduction of competition in both fixed and mobile, improved access to broadband and fibre optic cables, increased investment and the appointment of a regulator have been shown internationally as key requirements for the development of the IT sector.

Surveys have shown that on a number of international benchmark standards the availability and access to telecoms in Serbia is amongst the poorest in the region, ranking worse than Croatia, Bulgaria and Romania and well behind Slovenia, which is ranked at 50% of the standard of Sweden, which is among the top European countries.

The government has moved towards privatisation in the sector; the Managing Board of the Telecommunications Agency (a Regulator) has been appointed. Achieving international competitiveness and attracting new participants on the market is a fast-paced activity. This is a vital first step development, coupled with increased investment and greater access into the broadband network and further development of the e-government initiatives.

## B) Electricity Generation

There is a need for additional capacity and the provision of additional coal fired plant of 700-750 MWatts in 2009-2012. The provision of additional coal and gas fired plant of 200-300 MWatts is planned in case of dynamic increase of economy, including the construction of several smaller power plants for district heating and hot water distribution.

Existing capacities in this sector became outdated during the last decade of last century and with low efficiency. During the last five years these capacities have been improved and their capacity increased.

There is a need for additional surface level coal mining and processing facilities for coal dust, transmission systems, interconnections, environment protection equipment and development of mini hydro power plants. The in Serbia adopted by Parliament in 2005, recognizes these needs and envisages that the above mentioned will be addressed through implementation of Strategy for Energy Development programmes.

## C) Oil and Gas

Key project areas include improvement and modernisation of existing refineries and storage facilities for provision of development of product that is competitive on international market. FDI are important sources of funds used for improvement and modernization of these capacities. The key changes in oil industry (implementation of Serbia Oil Industry restructuring program) opened the room for FDI in this sector. The next important step for attracting FDI is the adoption of Serbia Oil Industry Privatization Strategy by Serbian government. Further development in oil industry creates the opportunity for improvement and development of petrochemical and related industries.

An important project in the area of oil industry is the construction of international pipe line through Serbia (Pan-European pipe line), that will ensure supplying Serbian market with crude oil. International experiences show that the construction of one segment of pipe line will have positive effect on attracting FDI and providing work to domestic industries.

Adoption of the Law on Energy and establishment of Energy Agency has created basis for liberalization of energy sector. Liberalization of energy sector and creation of stable environment are preconditions for attracting FDI in energy activities in the territory of Republic of Serbia.

#### D) Waste Management and Recycling

Internationally the business of waste collection, segmentation and reprocessing is a growing sector and is often undertaken in a form of public/private partnerships at local and municipal levels. The storage of hazardous and other wastes is becoming a sophisticated and lucrative business as companies and countries increasingly face legislative and regulatory pressures for improved compliance.

Project areas and the modalities of public/private partnership should be investigated.

#### E) Air, Rail, Road and River Transport

Efficient logistics is increasing becoming more important as a key factor in investment location decision making and Serbia with its regional position must effect improvements to maximise its opportunity in this area. Exporters are increasingly seeking private sector expertise and initiatives in this area which offers both opportunities and challenges for Serbia.

Internationally private sector investment is becoming increasingly involved in these sectors on a private sector, concession, management contract or public/private partnership basis.

Examples of project opportunity include development of a cargo terminal on the Danube, linkage with rail and air networks, improvement of highway network and the development of key logistics nodes.

#### F) It is recommended that:

- a) Detailed privatisation and concession proposals are developed for these sectors with a particular urgency attaching to the reform of the Telecoms sector as it provides the bedrock for development of all sectors in the modern competitive market place and is crucial for development of ICT sector.
- b) An intensive short term focus on developing capacity and expertise in the entire area of concessions and PPP be undertaken.
- c) That the role of international financing institutions and their expertise in this area be investigated and incorporated in development of sectoral plans.
- d) That programmes of investment opportunities by sector be developed covering the period 2005-2010.

### 5.2 Agriculture and Food Processing Industry

The key issues impacting on the development of this sector include the fragmented and small scale of agricultural holdings and the difficult land tenure situation for foreign investors. Serbia has extensive land good quality and land resources which are not being fully utilised in a modern competitive manner, but its owners generally lack access to finance and understanding of competitive factors impacting on traditional crops and the expectations of the modern market place.

Key areas and investment projects that deserve the attention of the investors are as follows:

- Investments in intensive production of fruit and vegetables, nurturing newly planted species, using modern species and planting methods as well as using the method of integrated protection; development of hotbeds and polythene greenhouses especially in the areas where there are thermal springs;
- Development of live stock breeding systems based on using and improving grazing resources in high mountain areas in order to spur production of high quality meat and for limited production of special cheeses and other dairy products, wool and animal skin products all produced in environmentally friendly procedures, also, production of breeder stock of highly productive species;

- Construction and modernization of facilities for storage, packaging and processing of agricultural products – equipping facilities for high degree processing of different agricultural products used for mass production of safe and high quality food products;
- Establishing and organizing systems of small and medium enterprises and relevant services (production of machinery parts) for accumulative production lines where the products of agriculture are being turned into products of high demand in the market and combustible materials as well as into materials that can be used as alternative energy sources;
- Conversion and certification of land suitable for organic fruit and vegetable production; connecting production and processing sectors; production of high quality virus free planting material;
- Connecting producers and modernizing and standardization of their production realized according to: niche principle and classical technologies; their promotion in the markets and linking with investments in tourism in order to support both sectors through new image and tourist destination management, virtual export and development of local markets, etc;

Considering the fact that these two area additionally impact regional development it is of strategic importance for Serbia to provide conditions for development of these branches by supporting specific local initiatives and building local business capacities to support rural development as well as by attracting FDIs.<sup>46</sup>

Goals specified by Strategy for Agricultural Development in Serbia:

- Development of sustainable and efficient agricultural sector that is competitive on international market.
- Improvement of quality standards and security.
- Support to sustainable development of village.
- Increase of living standard of population dependant on agriculture who cannot cope with reforms.
- Preservation of environment.
- Preparation of agriculture in Serbia for application of EU agricultural policy and membership in WTO.

Recommendations:

The focus of the Strategy, having regard to current and anticipated trends on primary production in Europe should relate to:

- a) The development of value added niche agribusiness production, focussing on the attraction of “brand names” and companies/products with potential for international distribution and seek investment from companies in these marketplaces.
- b) Development of the supporting mechanisms and institutions on production, certification, quality control and accreditation to support modern market focussed production in the growing specialty food and organic sectors.

### 5.3 Tourism<sup>47</sup>

Modest results achieved in tourism show that in last several years Serbia could not compete with other countries as tourist destination. At the same time, Serbia failed to adjust its tourist offer to big changes that took place on the international tourist market. However, Serbia has potentials to become tourist country. Development of tourism in Serbia requires unified, well-funded international campaigns that would contribute to the global improvement of image of

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<sup>46</sup> The listed sectors and investment projects are in accordance with the Strategy for Agricultural Development in Serbia.

<sup>47</sup> Taking into consideration the situation in tourist sector, the Ministry of Trade, Tourism and Services has started the development of Strategy for Development of Tourism, that will define framework of tourist development until 2015.

Serbia. An additional campaign that would increase the awareness about Serbian tourist attractions is also required. Future Strategy for Tourism Development and Law on Tourism must be harmonized with the Spatial Plan of Republic of Serbia. Regulations and laws on tourism will have to be aligned with EU regulation and laws, including hunting tourism.

Serbia does not have any representative agency abroad. There are no comprehensive tourist offers and tours through Serbia. The existing and potential tourist locations should be listed and ranked and provided adequate detailed descriptions of tourist trips (itineraries and supporting synopsis). Availability of hotels is not adequate even in larger cities. It is necessary to immediately address this barrier, having in mind the expected expansion of leisure/business visits. A number of hotels are currently being privatized. The government should focus on a swift privatization of hotels that are not subject to restitution. Previously nationalized buildings (in hotel and service industry) should be returned to original owners as soon as possible which, once again indicates the Law on Restitution should be given priority. Development of family hotels (capacity of up to 50 guests) should be encouraged in towns and smaller capacities in the villages (existing houses).

Significant developments and increase of number of visitors will only occur upon modernization of hotels, and when cheaper and better access to the country, facilities and locations is facilitated by constructing adequate infrastructure.

In relation to the cheaper access to the country it is necessary to attract low cost airline service (e.g. Ryan Air, Easy Jet). A first step requirement is recent signing of Agreement on European Common Aviation Area (ECAA) that will come to effect in the first six months in 2006. Along with Serbia, this document with EU was signed by all other South Eastern Europe countries. The agreement envisages application of European standards and full harmonization of regulations on air transportation and creation of common international air market.

With reference to this, it should be understood that this agreement will have impact on non-privatized JAT<sup>48</sup> (national airline company) and condition the privatization of this public enterprise.

Bearing in mind directions on global tourist market and trends of spending leisure time, as well as the changes of tourist demand and resources in Serbia, it is determined that certain parts of tourist offer of Serbia are specially interesting and that Serbia should focus on the following types of tourism:

- City tourism, touring and cultural events,
- Business tourism (congressional tourism and excursions for businessmen),
- Health tourism that follows the growing "health movement", rehabilitation and prevention (spas, biosphere resorts); it is possible to strengthen the spa tourism by faster privatization of spa capacities and concessions,
- Active vacations, i.e. recreation tourism – especially for local tourists (rural and mountain tourism, Nordic skiing, bird-watching - Obedska Bara and Carska Bara, etc.),
- Nautical tourism (Danube, Sava, Palic Lake, Silver Lake, etc.),
- Cultural and religious tourism (restoration of cultural and historic facilities is required -donations and concessions could be used to fund it),
- Industrial heritage: revitalization and refurbishment of abandoned industrial facilities could be attractive to tourists or film-making industry (example of Sarganska Osmica),

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<sup>48</sup>There are some initiatives for signing the Open Skies Agreement with USA.

Recommendations:

- FDI should be directed towards development of “special interest tourism” and niche offers. Foreign investors have shown interest for participation in the privatization programme for hotels, but also for building new accommodation facilities. Foreign interest is expected for spas. This interest has to be use for development of adequate investment projects. Construction of necessary infrastructure and acceleration of the privatisation process, including progress on the important restitution and land ownership reform issues are key prior requirements to the attraction of major foreign investors in this sector.

#### **5.4 Chemical Industry and Pharmaceuticals**

The chemical industry has the potential for a significant level of down-stream product development and marketing - it is however dependent on the modernisation of a base line petrochemical refinery and ancillary facilities.

The pharmaceutical sector is well established in Serbia with one significant export oriented manufacturing plant developing and marketing generic drugs (drugs without patent protection). Opportunities should be investigated to build on this quality and export accredited status to develop other initiatives in this sector and also to seek investment activity by suppliers to deepen the level of value added within the economy.

The development of pharmaceutical sector is globally increasing (facing more rapid development than other sectors). This creates opportunities for new quality jobs and significant inflows from the export. Number of clinical tests carried out in Serbia in the health sector and there is a need for development of necessary infrastructure for performing clinical testing of expensive and innovative drugs. Therefore, the country should determine guidelines for education on principles for performing clinical testing, expand the society of educated researchers who know necessary regulatory procedures and provide necessary funds for that.

Recommendations:

Attract FDI by highlighting the track record and potential of the pharmaceutical industry by development of infrastructure for clinical testing and undertaking studies on the feasibility of the petrochemical industry.

#### **5.5 Engineering and Auto-Components**

The car assembly and its dependent auto components industries are growing rapidly in Central and Southern Europe. The industry is characterised by severe cost reduction pressures, demands for increasing levels of improvement on product specification, zero defect tolerance, exacting logistics and delivery scheduling.

In general, the existing industry base in Serbia in this sector requires a rapid privatization of “Zastava Automobili” and presence of an internationally accredited supplier, but also a significant level of new investment. Whilst Serbia may not be internationally competitive across its traditionally wide range of production activities it should be possible to interest new investors on a Greenfield or partnership basis in a number of areas.

Recommendation:

Develop the cluster concept, identify key sub sectors with perceived competitive advantage and market directly to key auto industry supply companies presently based in Europe.

## 5.6 Wood Industry

There are wood resources and a tradition of furniture manufacture in many regions of Serbia. The key weaknesses have been identified as the lack of development in the area of design; need for modernisation of production facilities; unfinished privatization process of big wood processing factories owned by the state resulting in low utilization of their capacities and poor organization of wood industry; poor representation of value added products in export; obsolete technology used in large systems and uncompetitive products on the demanding international market.

Level of innovative processes and products is not satisfying, while the quality standards are almost not applied. At the same time, this industry is exposed to strong pressures of competition.

It should be noted that this sector is characterized with very low efficiency and that Serbia should aim at attracting investment, improving design and quality of furniture, and ensuring raw material with sustainable forest certification to maximise competitive advantage and export value added products.

Recommendation:

Assessment of existing capacities for wood processing; privatization of wood processing enterprises; development of quality control system and alignment with European and international standards; creation of conditions for increasing competitiveness and export of value added products; use on new technologies and innovations; creation of conditions for forest certification; identification of key medium scale suppliers to the top ends of the European retail and design markets and make specific marketing approaches on either a Greenfield or privatisation.

## 5.7 Metals, Mining and Exploration<sup>49</sup>

There is some evidence of the existence of basic raw materials, mining and other exploration opportunities which are presently underdeveloped. In the last two decades, the investments in this sector were very low, while exploration was performed only from known mineral reserves. All metal mines are in the process of privatization and some have already been sold. Privatization process should be speeded up and finished by 2006, so that positive trend of prices on the international market can be used.

The government and local self government will highlight the availability of concessions and permissions for exploration and subsequent processing and value added on key raw materials.

Recommendation:

- a) Develop and publish a basic inventory of the key geological features of Serbia, indicating areas where metals and minerals have been found. Provide this basic information coupled with the broad principles of the concessions and partnership prospects for the development of the potential resource. Urgently changes of the Law on Geological Research and Mining Law that is currently in the Parliamentary procedure. Another important step will be enactment of bylaws adopted by Mining Agency (envisaged by amendments to the Mining Law).
- b) Re-establish National Geology House.
- c) Strengthen institutions in charge of this sector, especially the functions in relation to: cadastre of research and exploitation locations, collection of charges for the use of raw minerals, mining and geological inspection, environmental protection and impact of mining industry on local communities, promotion of investing in mining for the improvement of financial planning in this sector.

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<sup>49</sup> Mining of energy related materials (coal, uranium, oil, gas...) is not covered by this Chapter

## 5.8 ICT Sector

Internationally the ICT sector continues to grow with considerable opportunities for outsourcing, product and market development. Serbia with the quality of its human resource base and educational system has the basic raw materials for the development of this sector in place. Growth and development of the sector is however dependent on a number of key initiatives including the liberalisation of the Telecom monopoly, development of partnerships at municipal levels in key university towns for the creation of technological parks and physical facilities, modernisation of the educational syllabus to incorporate IT and other suggestions on technology conversion courses for science and engineering graduates, campus company development, etc.

Indicative project areas include software development, back office services, call centres, initiatives based on strengths of university/research centres.

Recommendation:

- Technology park development – initially in Nis, Novi Sad and Belgrade,
- Formation of industry / academic / municipal / infrastructure groups at local level to guide development of local facilities,
- Formation of industry / academic / government high-level group on technology opportunities, educational requirements, action plans,
- Focus on potential strong FDI interest with privatisation of research institutes.

## 5.9 Textiles

The global textiles industry is subjected to a considerable level of consolidation in China and other low cost south East Asian economies placing severe pressures on many traditional producers. It is anticipated that private sector interest and potential in this sector in Serbia will be limited to short run CMT and higher value design based production. The situation is similar in leather and footwear production.

This is where may have some competitive advantage due to proximity to market and basic industrial tradition, but only through strong facilitation and aggressive export policy.

Restructuring of textile sector is a must, since the productivity in this sector in Serbia is several times lower than in EU countries. Rapid development will be possible through quick privatization and increased of technological level of production. This primarily relates to manufacturers who still manage to sell their products and who would be able to adopt new production programs that are attractive for Europe with relatively small investment. The dysfunctional state enterprises with obsolete equipment and low quality products have to be urgently privatized and restructured, or liquidated.

Development of employees, modernization and improvement of existing capacities, increasing energy efficiency, dissolution of unnecessary capacities and connecting producers in clusters, can contribute to further development of this industry.

## 5.10 Banking and Internationally Traded Services Sector

The presence of international banks, insurance companies and other financial intermediaries is regarded as a positive indicator for other investors in addition to direct employment opportunities created. Many banks in Serbia are owned by international owners, NBS claims that the policy of quantitative and qualitative criteria of control and auditing in banks, insurance companies and other financial organizations will continue in accordance with European standards (Basel and other criteria).

Internationally traded services include the activities like provision of administrative and business services (Back-Office Services) Call Centres and similar. They are primarily driven by ICT sector and modern telecommunications.

This strategy with its initial focus on modernisation of legislation and improvements in the communications sector will address the initial and primary requirements for this industry. In the medium term the modalities on the provision of further regulatory and international accreditation standards will be examined.

NBS and financial sector play an important role in preservation of stability of financial system and local currency, and efficient application of monetary instruments used for increasing FDI.

## 5.11 Key Conclusions

Marketing and promotional programme must be based on:

- Identification of key competitive factors in industry sectors and focus on development of some potential competitive advantage in Serbia,
- Marketing must be targeted at key players in the identified sectors.

For the successful campaign on attracting FDI it will be necessary to improve business environment for the investors.

While all investment opportunities in the productive sectors will be explored, a conscious effort will be made to enhance Serbia's competitive position and profile in those sectors that have produced the most investment to date in the central European region and where continued investment potential exists.

The above sectors are highlighted for the following reasons:

- Potential for creation of significant numbers of new, sustainable jobs,
- FDI projects in a number of these sectors can provide a regional spread in the country,
- Projects in these sectors can generate significant new exports,
- Potential to provide substantial linkage opportunities for domestic companies and to attract foreign sub-suppliers and service providers,
- The sectors are growing globally,
- Greenfield FDI into these sectors is occurring in SEE,
- Sectors have potential to develop industry clusters and foster niche competitive advantage.

Preliminary studies have shown that a number of these sectors have an element of comparative competitive advantage in Serbia and allied with the planned improvements in the enabling environment can facilitate increased levels of employment creation and export opportunity.

Key strengths:

- People strengths and capabilities – educational system, English speaking nation, traditional external exposure,
- Industrial/research tradition and background in engineering/production skills,
- Supply base of agricultural raw materials, in particular fruits and vegetables,
- Access to key markets,
- Lower cost salaries, particularly for qualified personnel.

## 6 INSTITUTIONAL SUPPORT FRAMEWORK

### 6.1 Organizational and Structure Issues

#### Policy Development and Overall Coordination of Strategy

The Ministry of International Economic Relations as the designated official body with statutory responsibility for FDI is considered as the appropriate Ministry to take lead responsibility for the overall coordination and direction of the Strategy. This is a natural extension of its role and experience in the development and coordination of the “Action Plan for the Removal of Administrative Barriers to FDI” and its central liaison role with the FIC. In this role MIER is required to act as the catalyst of reform in terms of operationalising activities and measures under the 4 main pillars of the Strategy:

1. **Legal and regulatory reform.**
2. **Strengthening of institutional capacity and development of partnership processes to facilitate business development.**
3. **Actions and initiatives for improvement of competitiveness.**
4. **Development of internal awareness campaigns and focused international marketing strategy.**

Organisational and structural issues (key international experience):

- Nomination of a National Department, such as MIER, with key policy and coordinating responsibilities and provision for inter-ministry committees and action groups to drive policy and legislative issues impacting on pace of reform,
- Creation of an implementing agency with key skills and mandate to make operative the investor marketing and aftercare responsibility,
- Development of linkages and supports with municipal authorities and utilities to create awareness of investor requirements and to positively influence local planning and provision of services for investors,
- Provision for high level review of progress on 6-monthly or annual basis,
- Strong private sector participation at both operational and review levels.

The current institutional arrangements are poorly structured and resourced by international standards in terms of:

- Policy formulation and key central driving force to advancing legislative and administrative reforms, achieve full participation and coordination of efforts by wide range of other ministries and institutions, strategic and policy planning, coordinated prioritization of key national PPP and concession initiatives,
- The development and implementation of a national marketing strategy for the identification, attraction and retention of new foreign investment in Serbia,
- Delivery of services at municipal and utility level to address investor needs.

Implications:

- a) MIER, as the ministry, needs additional resources in terms of accelerating the pace of legal and administrative reform, developing the envisaged partnership committee structures and adopting a more central role as a focal point of policy and advice in relation to the facilitation and support of investors in their dealings with national and local authorities and the overall implementation of this strategy.
- b) SIEPA as the national agency, designated with responsibility for export development and investment promotion, must be adequately staffed and resourced.
- c) The role and function of a high level Investment and Export Development committee at MIER should be supported with the capability to require submission of regular progress reports against agreed measures and targets from other institutions to ensure focus.

Actions required:

- Government needs to position and resource its key Ministry – MIER – adequately in terms of budgets and staffing to address the national priority of attracting significantly increased levels of FDI,
- Government needs to resource SIEPA as its national Agency, agree annual operational plans and budgetary provisions in the context of this overall development strategy,
- The appointment of a Board for SIEPA with private sector representation has been strongly advocated in the past. This proposed initiative should be reviewed and activated in the short term to provide a forum for focussed feedback
- Government needs to consider the creation of a national high level Investment and Export Promotion Council with representatives of private and public sectors to overview and review progress,
- Government should develop a process with municipalities and utilities for the identification and appointment of “investor champions” in all municipalities and utilities to push reform agenda. These nominated investment liaison officers would act as the primary contact point to support investors and act as key drivers of improving investor service within their organisation.

These initiatives have been adopted by governments in other countries and have resulted in improved focus on investor needs, better provision of support for investors in terms of overall competitiveness, improved targeting of investors in growth sectors, higher satisfaction levels among investors in terms of the ease of implementing their projects and higher level of investor activity.

### **Service Provision at National, Municipal and Utility Level**

The quality and effectiveness of service delivery by public institutions is recognized internationally as a key factor in determining the attractiveness of an investment location. The cost, quality and transparency of delivery of public services is an issue that requires constant upgrading to achieve and maintain competitiveness.

This Strategy recognizes this key role and proposes a series of measures involving better positioning of the importance of FDI, fuller sense of partnership and cooperation among the wide range of players involved in the provision and prioritization of services to facilitate and support new investment. In Serbia, as in other countries, these services are provided by a wide range of government ministries and semi-government organizations at national and local level. It is acknowledged that the existing organizations, although improving in many areas, are not optimal and not providing the level of service or prioritization required by modern investors.

Local governments should identify successful examples, like the municipality of Indjija, and implement them as standards. Such initiative started in many municipalities will have to continue. Although the reform of central authorities is more complex, it is possible.

The system of e-government that has not yet been introduced in Serbia is a precondition for modern and efficient functioning of administration. Estonia with the most developed e-government system in Europe can be used as a role model. Estonian concept is implemented up to the level of central government and allows sessions without presence of ministers and handout materials.

The corruption can be more successfully controlled among lower members of administration by introducing One-Stop-Shop principles and application of specific anti-corruption measures against corruption. The high level corruption cannot be controlled without adequate legislation, independence of media, prosecution, police and judiciary. In terms of reducing

the corruption in Serbia, some improvement has been achieved in customs administration and in some municipalities in which anti-corruption measures and One-Stop-Shop were introduced.

The objective of the structured measures proposed is to provide a platform for continuous improvement through a process of partnership, peer review and institutional reform over the short, medium and longer term. The partners and key providers impacting on the attractiveness of an investment location and the provision of services for investors are set out below.

Issue / Provider	Impact and influence
Utility services and providers	Costs and availability
Infrastructural improvements	Timing and provision
Educational/Training strategies	Modern Curriculum / skills level very important.
	Initial FDI focus on sciences/technology
Municipal competencies / land / physical planning	Municipalities with guidance and support can influence location decisions.

The early rollout of a number of pilot municipal and local initiatives is considered vital for the success of the Strategy given the statutory and planning role of local municipalities and their influence on a wide range of services which impact directly on investors.

**Actions:**

- MIER and the private sector to develop awareness campaign for local municipalities and universities on the key benefits from FDI and the need to improve the local investment environment,
- MIER to seek the development of a number of local partnership initiatives on the investment environment in key cities focusing on the identification of key sites,
- Pilot phase focus on the development of local partnerships between industry, university and municipal authorities in 4 major cities to provide a framework for provision of infrastructure and facilities for ICT investors,
- Arrange for early appointment of “investor champions” (investment advocates) in all municipalities and utilities.

This initiative is seen as enhancing and supporting regional initiatives to improve the local environment for investment attraction and retention. Partnership is a key, regional and other sectoral strategies must be working towards the agreed objectives of improving facilitation of new investment.

The need for the development of a strong formal coordinating role to develop and facilitate active partnerships between the various key players and institutions at national and regional levels is self evident. In addition, many of the institutions are poorly resourced in terms of both funding and staffing levels.

## Summary

International experience shows that the key building blocks for the attraction and retention of investment are:

- Improving the Investment Climate,
- Image Building,
- Investment Generation (Promotion),
- Investment Facilitation.

### Improving the Investment Climate

Relevant government ministries normally have the primary role in improving the investment climate in a country as the investment environment incorporates a wide range of legislative and regulatory. It also requires the development at all levels within society of an understanding and appreciation of the important role that FDI plays in the economic and social development of a country. In Serbia, this extends to both national and local self government levels.

In this context and in view of the scale of issues to be addressed and the need to develop a coordinated and accelerated approach, MIER has been appointed as the key ministry for FDI and is thus charged with this overall responsibility to drive the modernization process and the actions proposed under this Strategy.

### Image Building, Investment Generation and Investment Facilitation

The development of a marketing and promotional strategy to address the issues of image building, investor generation and investor facilitation highlighted above is normally vested in a separate agency, one stage removed from a direct government ministry programme to address the nationally adopted high level goals and objectives.

These broad functions of an investment promotion agency (IPA) are summarized as:

1. Development of a marketing strategy and implementation of a promotional programme to address the negative image of the country among investors in focused sectors and key markets.
2. Development of a research capability to identify the industrial and service sectors where Serbia has potential competitive advantage for new investment and identify the companies with interest and capacity to invest in those sectors.
3. Increasing the awareness of investor needs in terms of legislative, administrative and infrastructural measures and providing feedback and recommendations for action.
4. Facilitating and supporting new investors as they seek to establish their investment in the country.

Institutionally many models have been tested in different countries and in economies at different levels of development ranging from a branch of government department, unit within private sector institution or semi autonomous government supported agency. The internationally recommended best solution and results have been achieved with the establishment of an agency separate from the main body of government, staffed by professionals recruited from the public and private sector, with a commercial focus and the challenge to develop and implement a marketing strategy and promotional programme. Normally this agency has the support of a formally constituted Management Board, representatives of both the private and public sectors, to guide and measure its activities and provide a formal reporting mechanism to government.

In spite of the need for strengthening capacity of SIEPA, it should have in mind that human resources and financial situation of this agency is much better than most of other

administrative bodies. SIEPA currently has 30 employees, out of which 26 are highly educated (5 with post graduate degree). All employees speak English and often another two foreign languages and are proficient in the use of all business applications (some of the employees in database and graphic software). Most of them have 3-5 years of experience in public and private sector, including working in foreign enterprises or abroad.

As currently structured, SIEPA is not well funded, does not have role clarity and lacks the level of government support required to ensure effectiveness. The traits that are common to effective IPAs across the globe are not readily apparent in the cursory review of SIEPA. These traits include:

- Clear objectives which are anchored in government economic policy,
- Effective working relationship with clients,
- Excellent marketing knowledge,
- Excellent people with the relevant skills mix,
- Effective working relationships with government,
- Adequate and secure funding.

This raises a serious issue for the government as an effective IPA is an integral element of successful investment promotion, and institutional strengthening is a key component of this Strategy.

## **6.2 One Stop Shop Principles**

The objectives underlying the principle of a one stop shop are to provide a single point of contact for the investor to access and process all necessary permissions and regulatory issues relating to the establishment and operation of his business. It can be a special office/organizational unit within some of the existing institutions in charge of foreign investment.

Apart from foreign investors who are interested to invest in Serbia, Serbian businessmen in Diaspora emphasize express the need to obtain necessary information relate to investment in Serbia. Potential foreign investors and Serbian Diaspora are satisfied with founding and efficient work of Business Registry Agency and other institutions of government. Most objections were expressed against the cooperation with local government.

Businessmen from Diaspora can facilitate these efforts and promote economic cooperation with Serbia, not only among the Serbs abroad, but among their business partners in the countries where they work and live. They do it for patriotic and business related reasons.

Whilst in practical terms, given the wide range of regulations inherent in any system of government ranging from construction permits to normal health and safety regulations for both employees and product certification, this objective of achieving a true “one stop shop” whereby qualified personnel are all situated in one office is not generally achieved. However, there are many practical steps that can be taken to minimize the time, cost and hassle factor involved for investors.

Investment related data have to be easily accessible through electronic media and WebPages for providing necessary information for foreign investors, including Serbian Diaspora.

It is accepted that the existing organizational structures in Serbia are not offering an acceptable level of service for investors in this regard and the following steps are proposed under this strategy to address this situation.

- A) Short term:
- Establish a pilot initiative whereby all forms and documentation required by an investor in terms of building and construction are available in one office,
  - Staff this office adequately with electronic contact with all relevant ministries, municipalities and utilities,
  - Establish the position of nominated investor liaison officers in all ministries, municipalities and utilities as a function attached to the office of the relevant chief executive,
  - Develop a process within the one stop shop whereby progress on individual applications can be reviewed electronically at any time,
  - Establish working parameters on performance and standard assessment and approval time schedules,
  - Develop a monitoring, review and reporting mechanism reporting to MIER.
- B) Medium term:
- Broaden the scope of this office to include an information base on land and plot availability, industrial park and technology park developments (arising from the envisaged earlier partnership initiatives at national and municipal level to advance planning to improve the infrastructure),
  - Broaden the scope of expertise of this one stop shop to embrace all other statutory forms and regulations e.g. local sanitary regulations, labour regulations, product certifications, etc.,
  - Develop the capacity to recommend reduction and refinement of regulatory requirements based on investor feedback and international standards.

The overall guiding principles governing the work of this facilitation unit are to maintain focus on achieving results for the investor – an investor champion role. This after care unit is most often based in an Investment Promotion agency where aftercare and client support is designated as a key important function.

The experiences of neighbouring countries can become a role model and be useful for realization of this idea. According to new Bulgarian Law on Promotion of Investment enacted in August 2004, Bulgarian Agency for Promotion of Investment provides information and administrative support to foreign investors. Services provided by the Agency are conditioned with prior categorization of the investment by issuing a investment category certificate. Investors who invest EUR 5 to 20 million acquire right to use the following services: information material, provision of contacts with potential local partners, information on administrative procedures necessary for implementation of given project. By now, two certificates were issued for this investment category. The investment between EUR 20 and 35 million allows the investor to use extra services and appoint one of his employees in the Agency who shall be authorized for performing administrative and other functions on behalf of the investor. The highest category (investment above EUR 75 million), for which ten certificates have been issued so far, with another six are in the procedure, bounds the Agency to be available to the investor for any information and facilitation of infrastructure connections, including provision of advisory and administrative support.

Key investor requirements as guided by their expectation and experience of best practices in other countries are:

1. First and foremost – they want to deal with a single agency which has the competence, capacity, credibility and commitment to fully anticipate and satisfy their needs.
2. Secondly – investor confidence is reinforced when they know that the agency in question is the ‘executive arm’ of government with the responsibility for investment promotion.
3. Thirdly – they do not want the agency to represent yet another layer of government bureaucracy – quite the reverse in fact – they prefer to deal with an apolitical agency that has the power and authority to cut through the layers of bureaucracy and to consistently act

in the foreign investors' best interest (providing their investment will generate net economic gain for Serbia).

4. Fourthly – they need to know that the agency has sufficiently robust networks (public/private and regional) to enable them to draw all the strands of a development package together (otherwise the agency will be seen as a “one-more-stop-shop” – not a “one-stop-shop”).

5. Fifth and finally – they seek to know that the agency provides an effective aftercare service to ensure that their start-up and growth plans remain on track.

It is a clear requirement that the importance of aftercare services and the creation of an established base of satisfied investors willing to expand and deepen their involvement in the country are key measures of success in both policy development and implementation of a marketing strategy and that clear performance measures are included.

### 6.3 Education/Business Linkages

The important role played by the educational system in the creation of a favourable environment for FDI cannot be understated or underestimated. The reforms of the education sector impact on all modern sectors of the economy and are a key element of improving the competitiveness of firms.

The education system and the availability of skilled people is particularly crucial to the development of the overall ICT sector and for that reason a number of specific initiatives are proposed.

Internationally the business community is becoming increasingly involved and consulted in relation to specific educational reforms and it is proposed to develop a structured format for this cooperation to maximize career opportunities for current and future graduate output from increased investment in new export – competitive and higher value specialist sectors.

In the first instance the following issues are proposed as meriting the highest priority:

1. Adopt and implement Higher Education, Science and Innovation Laws as foundation stones for a Higher Education and Research sector that is responsive to economic needs.
2. Put in place a high level ICT Expert Group, with strong involvement from the ICT corporate sector, to advice on plans for ICT graduate output, content of ICT curricula and priorities for funding of ICT research activity.
3. Develop Technology Transfer/Industry Liaison mechanisms within the Higher Education sector, as part of a National Innovation System, to promote effective business linkage.
4. Document existing and planned initiatives at national and regional level on the improvement of the educational secondary and vocational levels and in particular to highlight the level of business involvement in curriculum reform and provision of business and work experience.

The practical steps that are being taken to activate above issues include:

- MIER to invite and challenge all major ICT multinationals, presently in Serbia, to participate with university leaders, and to develop and document the steps necessary to increase the level of research and product development activity in Serbia,
- MIER to identify with these key multinationals on project opportunities within their parent companies and the steps necessary to create an enabling environment within Serbia for various back office, customer support and technical services,

- MIER and Ministry of Education and Sports to spearhead the establishment of a key high level skills group including business and university interests to identify and address issues pertaining to partnership at local level and modernisation of curricula.

As an overall comment the ICT Sector can contribute powerfully to economic, export and FDI growth in Serbia if targeted actions are taken around key areas:

- Telecommunications,
- Skills & Research, including steps to attract qualified Serbian emigrants to return home,
- Business Infrastructure (Science & Technology Parks),
- Information Society.

## 7 ISSUES, MEASURES AND ACTIONS

The key barriers to the development of FDI in Serbia to date have been identified as:

- Legislative and regulatory issues e.g. complicity concerning land-ownership and non-market prices for the land usage, non-specialised court systems,
- Delayed start of reforms and inconsistent quality of implementation,
- Limited institutional capacity at both policy development and operational levels to activate issues,
- Infrastructural deficiencies in comparison with neighbouring countries,
- Lack of support structures for modern industry,
- Lack of focussed national investment promotion programme.

Progress measures – prioritisation (World Bank):

“Need to increase investor confidence but continue on the path of reform” (World Bank<sup>50</sup>):

- Strengthen contract enforcement,
- Reduce the regulatory and administrative burden,
- Strengthen property rights and reduce labour market rigidities.

In addition to this, the following measures should be made:

- Adoption and enforcement of the Law on Restitution, favoring return of assets to previous owners in their physical form wherever it is possible. This is to get good settlement and to relax the pressure to public finance,
- After a fast denationalization (and handing over property to the municipalities) allow domestic and foreign private investors to buy real estate,
- Lower start-up costs. Start ups are much more efficient than existing firms (the majority of them is just a socio-economic burden). Especially important are start-ups based on FDIs. Reduce significantly the number of papers needed to establish a firm, to keep business running and to exit some business. Reduce the time needed to obtain business operation permission. Reduce possibilities for the low level corruption by establishing one stop shops. Reduce high level corruption by imposing anti-corruption legislation, by evacuating politicians from taking part in the process of getting investment permits and by allowing media, business police and judiciary to operate independently from the executive power,
- Further improve labour legislation by abolishing some allowances inherited from the past which burden the operation and do not increase the wages of employees since they are deducted from salaries. The following allowances should be abolished: free nutrition, number of years at work and inappropriate base for calculating salary while being on leave,
- Make sure that business/construction permit implies connections for utilities (water supply, electricity, gas, phone, etc.),
- Continue privatization, start with privatization of utilities and the socialist giants,
- Establish just one agency (with different departments) for monitoring operation of networks (pipelines for gas and oil, electricity networks, water supply, sewage, fixed phone lines, etc.) This is a cost saving measure,
- Enforce bankruptcy law and liquidation of bankrupted firms. This will prevent the accumulation of debt and free their assets for new, productive use,
- Continue with reduction of customs,
- Liberalize internal market by reducing the number of prices controlled by the government. Directly or indirectly this is now around 40% of prices. Experience from developed countries shows that it is always better to have broad system of setting prices on market principles,
- Reduce different types of the banking reserves, which will lower the interest rate in mid-term, and consequently money cheaper and stimulate business,

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<sup>50</sup> Investment Climate Review in Serbia, 2004

- Progressively establish administration friendly to business, start introducing an e-government,
- Create conditions for efficient implementation of the Law on Competition by establishing an independent entity which will control abuse of monopolistic position on the market, or simply, instead of controlling market share, enable entry of competition from abroad,
- Allow establishment and a normal operation of investment, insurance, pension, mutual, and other funds,
- Start a mandatory reform of the pension fund; use privatization revenues to cover transition costs instead of spending them through the budget,
- Consider abolishment of huge restrictions for capital payments, such as those that exist for buying short-term securities on domestic and foreign financial market, for acquiring real-estate ownership, as well as for transfers in the name of family support. Bear in mind the experience of Republic of Croatia, where partial liberalization of operation with securities on the financial market, followed by full liberalization that was introduced two years later,
- Allow free circulation of foreign securities. This will provide opportunities for funds to invest, but this will also force the NBS and Treasury to offer more favorable conditions for domestic securities,
- Adoption of legislation that will provide balanced support to all stakeholders: debtors and creditors, workers (employees) and owners, labour unions and unions of entrepreneurs, residents and foreigners, state owned, private firms and funds
- Make commercial courts more efficient. Adopt the Arbitration Law, that will define process of domestic and international arbitrage and contribute to the faster and more efficient business disputes solving,
- Improve the organization and functioning of bodies in charge based on enacted legislation on quality management (Standardization Bureau, Accreditation Body and Metrology Bureau) for harmonization licenses, certificates, trade marks and quality labels, necessary for exports, with European standards,
- While harmonizing domestic with EU legislation, primarily accept solutions that enhance economic freedom and the rule of law.

There are opinions that more liberal reform steps should be undertaken immediately<sup>51</sup>. Thinking into this direction, the following changes should be considered and realised as “a second move” in building Serbia as a favourable investment destination:

- Reduce state expenditures at maximum 40% of GDP. Reduce taxes, especially payroll tax. Reduce the number of currently existing taxes. Keep the existing low taxes and the flat tax rates,
- Reduce subsidies as much as possible. There is a variety of subsidies: cash payments, transfers, tax allowances and deductions, infrastructural works, lend leasing below market price level, education of workers, tolerance of tax evasion, tolerance of late payments or even non-payment, export subsidies, subsidies for apartment credits, etc. The EU allows subsidies of approximately 1% of GDP,
- Reduce state investment as much as possible, because it represents either an inefficient use of capital or a simple waste of taxpayers' money,
- Remove rents and discourage rent seeking wherever it is possible,
- Recall the state from taking part in the economic game directly, restrain its regulative activity and limit its role on providing and enforcing the rules of the game.

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<sup>51</sup> Source: Free Market Centre Belgrade

### **Provision for review:**

The FIC annual White Book publication provides a public forum for a review process of actions taken to address these barriers for FDI and increase volume of existing ones. Key principle of this strategy is to involve the private sector in both the prioritization of key reform actions and overall dialogue with the government.

The high level measures proposed for attention under this Strategy fall under 4 broad pillars:

- 1. Legal and regulatory reform.**
- 2. Strengthening of institutional capacity and development of partnership processes to facilitate business development.**
- 3. Actions and initiatives for improvement of competitiveness.**
- 4. Development of internal awareness campaigns and focused international marketing strategy.**

These pillars are selected as key areas for attention to improve Serbia's attractiveness for new investment and the overall competitiveness rating of the country and are designed to move the country ratings into the top destination in SEE and the top 10% of desired locations in Europe within a 5-year period.

There is a broad range of issues to address which have been categorized under these 4 broad headings with recognition that there is considerable cross-cutting and interdependence between initiatives.

The guiding principles underpinning this commitment to acceleration of legal and regulatory reforms is contained in the formal partnership agreements with the European Union. This proposed focus is to accelerate the adoption and implementation of all legislative issues impacting on the economic and investment environment.

## **I Legal and Regulatory Reforms**

### **Objective**

Acceleration of the ongoing reforms and fast tracking of improvements in the legislative and regulatory environment.

Broad range of issues to address:

- Land issues – clarify ownership situation, identify key sites for development in main cities, designate industrial, science and technology park sites and address infrastructural improvements,
- Address restitution issue and clarify ownership situation initially in relation to key sites and buildings,
- Advancement on privatization and deregulation of telecoms sector,
- Adoption of future operation process for Action Plan Committee for the Removal of Administrative Barriers for FDI as set out in Appendix 1.<sup>52</sup>

With a focus on:

- Participation of municipal authorities in formal process,
- Development of linkup between education/municipal/industry representatives at national and regional levels,
- Development of public private partnerships and concessions in key infrastructural areas.

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<sup>52</sup> Action Plan for the Removal of Administrative Barriers to FDI for 2005-2006

It should be viewed that the legislation that have been reformed thanks to which Serbian reforms were assessed as positive<sup>53</sup>, have to be further improved. This is indicated by repeated proposals and occasional objections by existing foreign investors and other businessmen. It is first of all labour related legislation that has to be more flexible.

Activities would include:

- Studies to identify key sites in urban areas for industrial park development and their needs to address competitive standards in comparison with other countries,
- Structured local partnership agreements between municipalities, infrastructure and utility providers to develop and provide the required services,
- Adoption of the law on industrial parks,
- Annual competition between municipalities on progress in identification and servicing of suitable sites.

Outcomes could include:

- Initially identification of clean (title) sites in a number of major towns,
- Increased emphasis on provision of good sites with infrastructure,
- Progress on development of a market in real estate and construction land
- Progress on deregulation of telecom sector,
- Advancement of legislation and regulations on restitution issue in accordance with best practice regional experience.

## **II Strengthening of Institutional Capacity and Development of Partnership at National and Municipal Level**

### **Objective**

Improvement of investment climate by recognition and facilitation of key roles played by a wide range of public and private sector groups in improving the investment environment.

SIEPA has already initiated activities for strengthening cooperation on national and local level. During the period October-December 2005, SIEPA organized a number of seminars on "FDI-Practical Aspects" attended by local government representatives and employees of local administration who work on local economic development (city managers, business development specialists, etc.). The purpose of these seminars was to introduce local authorities with FDI advantages and challenges and instruments for their successful attraction and effectuation. The seminars had educational character with the focus on preparation of presentations, models of communication and preparation of meetings with potential investors.

It is of special importance that most of local government bodies were not familiar with the role of SIEPA and possibilities for cooperation and support. Seminars were held in the regional cities for neighbouring municipalities. At 17 seminars that covered 115 municipalities in Serbia, in average 15 representatives of local representatives were trained. This established cooperation between the Agency and 200 members of municipal administration who now have clear picture about the significance of FDI for local community and the country, and obtained general guidelines on methods of communication with foreign investors and instruments for efficient implementation of projects. SIEPA intends to continue and intensify the cooperation with local officials in 2006 and help them become specialists for FDI on the local level, through training at seminars and conferences.

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<sup>53</sup> World Bank reports (Operation in 2006) and EBRD Report on Transition in 2005.

Broad range of issues to address:

- Strengthen role and functions for MIER/SIEPA and regional investment promotion and business development organizations.
- Increased resources in MIER to support a high level supervisory committee on investment and competitiveness matters,
- Increased resources in SIEPA to address marketing and investor aftercare issues moving towards principle of “one stop shop” and a structure to highlight and address key issues of investor concern, and to engage experienced staff and experts for specific business sectors defined by Strategy as sectors that can provide competitive advantage to Serbia,
- Establish high level technical IT committee – public/private/universities to address skills and infrastructure issues,
- Examine appointment of industrial liaison officer/contact person in each ministry, municipality and utility as champion of investment,
- Establish the principle of private sector involvement in all initiatives.

Key need for a range of initiatives at national and municipal level incorporating a large number of key institutions.

This will involve:

- MIER as the ministry with designated responsibility under the Law of Ministries to provide the overall guidance for FDI policy making and driving the FDI initiative and improvements in the investment climate in the country,
- A wide range of other ministries whose policies and initiatives will focus on implementing agreed national priority FDI matters,
- SIEPA as the established investment promotion and facilitation agency and any regional agencies that may be established,
- Municipal authorities who have specific statutory powers and abilities to influence the investment climate in their area,
- Wide range of utility providers, where the cost and efficiency of services are of paramount competitive importance,
- Strengthened and facilitated role for private sector participation in preparation and prioritization of initiatives proposed under various national and regional action plan committees.

Partnership issues:

- Between national government departments in terms of prioritizing initiatives,
- Between government and private sector interest groups including FIC, Chambers, sectoral organizations,
- Between national departments and municipal authorities,
- Between national Government departments and agencies i.e. SIEPA and VIP (Vojvodina Investment Promotion),
- At municipal level with local universities, colleges and private sector.

Activities will include:

- Development of an action plan to activate the above partnerships,
- Agreement on broadening of scope of existing committee to include all aspects of investment climate and its range of players,
- Agreement on establishment of specialist subcommittees,
- Appointment of key players at ministry/agency/municipal level as “champions” of the Strategy.

Performance measures would include:

- Demonstrated seriousness of commitment by significant incremental increase in resources at both MIER and SIEPA levels
- Agreement on terms of reference and respective responsibilities for implementation of the Strategy,
- Frequency transparency and quality of reporting on progress,
- Provision for annual review on progress, involving significant private sector representation,
- Composition and level of inclusiveness of various committees.

Desired outcomes could include:

- Improvement in aftercare for existing investors through focused avenues for prioritizing and addressing barriers,
- Improved transparency in terms of addressing investor concerns,
- Initiation of studies and actions to identify key companies and key decision makers,
- Actions on key issues impacting on development of IT sector, including increased access to modern broadband facilities, increased liaison between industry and educationalists and reforms of education curriculum,
- Deepening of involvement with key representatives of international companies already in Serbia leading to increased private sector support in the identification of potentially mobile investments within their own or supplier companies,
- Identification of suitable sites/buildings in municipalities and agreement of steps to prioritise infrastructure planning and develop clarity of ownership and speed up access for qualifying companies.

### **III Enhancing Overall Competitiveness**

#### **Objective**

To increase the attractiveness of Serbia for investment through the development of initiatives to address competition, productivity and access to market issues.

Broad range of issues to address:

- Development and implementation of a programme on public/private partnership and concessions in key utility and infrastructural areas,
- Accelerate liberalization of key sectors and maximize industrial development role of key research and scientific institutions,
- Development of Scientific and Technology Parks and Industrial Parks,
- Measures to facilitate full operation of regional and international trade agreements,
- Development and facilitation of supports for quality and accreditation proposals to facilitate international market access,
- Protection of Serbian "brands" (kajmak, ajvar, lozova rakija) for their promotion and placement on international market,
- Development of supports on productivity and training issues through focused initiatives in cooperation with private sector,
- Elimination of barriers to export development including focus on facilitating modern logistics through development of physical and regulatory environment.

Activities will include:

Infrastructural/Concession Initiatives:

- Develop the modalities for public/private partnership through international best practice – legal documentation, safeguards etc.,
- Identify a schedule of public/private potential infrastructural projects,
- Identify key indicators for evaluation of public/private partnership proposals and offers,

- Identification of a number of key potential international partners,
- Development of a data base of reputable international potential partners,
- Identification of key requirements and practices of international lending institutions (e.g. EIB).

Desired outcomes could include:

- Number and level of position papers prepared and submitted for formal government approval,
- Number of qualifying PPP projects identified for international marketing,
- Optimisation of Serbia's pivotal regional location.

General initiatives:

- Technical and legal supports for the identification of key sites for pilot initiatives on industrial and technology parks,
- Development and agreement of criteria on broader access to university broadband network, pending overall modernisation of services,
- Improved availability and access to various international quality assurance and certification schemes,
- Improved access to specialised short term consultancies, conferences, papers, and international meetings.

Desired outcomes could include:

- Facilitation and support measures for support of modern industry and export activity in place,
- Facilitation of trade through abolishment of customs and other measures, and removal of all barriers for free flow of goods,
- Initiatives underway on technology parks and industrial zones development in key locations,
- Increased access and improvements to "university" standard broadband network
- Maximising benefits of key strengths in industrial tradition, language skills and general high standard of education,
- Developed focused sectoral action plans in place to highlight key issues impacting on international competitiveness using the ICT sectoral development programme as a model,<sup>54</sup>
- Development of niche quality oriented exporting sectors,
- Key needs identified and programmes activated to address the specific certification and quality requirements of a modern marketplace,
- Support mechanisms in place for the activation of key private sector industry and sectoral specialist groups e.g. Exporters association, fruit processors cluster etc.

#### **IV Development of Awareness Campaigns and Focused International Marketing Strategy**

##### **Objective**

To increase internal awareness of the benefits arising from new investment and to market the country effectively.

Broad range of issues to address:

- Initial awareness campaign aimed at local political and official levels,
- Development of a process for local political figures and officials to gain understanding of their key role in creating a favourable local environment,

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<sup>54</sup> See Appendix 5 – ICT Sector Action Plan

- Development of a focused international investment promotion campaign in key markets to raise awareness of the reality of the improved investment environment in Serbia,
- Development of a focused investor targeting and attraction campaign in key sectors,
- Measurement and review on an annual basis of the effectiveness of the marketing and communications.

SIEPA was very active in this sector. In cooperation with OECD this Agency selects the "Investor of the Year in Serbia" for many years and recommends the investors from Serbia for regional awards on largest investors in SEE in several categories. The most prestigious regional recognition for Greenfield investment in 2003 and 2004 is awarded to investors who implemented their investment projects in Serbia (Ball Packaging and Coca Cola).

Activities within the Strategy would include:

- Development of an Investment Promotion Plan in alignment with the Strategy,
- Development and agreement on goals of marketing and communications strategy,
- Development of sectoral marketing messages,
- Development and implementation of awareness and image building campaigns,
- Development of database on possible investment projects, that will apart from Greenfield investments, contain other opportunities for investment, like Brownfield, enterprises that are being privatized, possible concessions and joint ventures.

Desired outcomes would include:

- Developed and evolving database of target companies,
- Increased level of investor site visits to Serbia,
- Increased level of actual investments in productive and internationally traded services sectors,
- Accelerated level of implementation of investment projects through a supportive local environment.

## V Summary Measures

### a) Legal and Regulatory Reforms

This summary of actions is detailed in the Action Plan for the Removal of Administrative Barriers to FDI for 2006 and in Section I of Chapter 7 – Issues, Measures and Actions.

Issue	Action	Objective	Responsibility	Timeframe
<b>Administrative Barriers to FDI</b>	Adopt revised Action Plan on Administrative Barriers to FDI in 2006	To achieve renewed commitment to goals	MIER	Together with Strategy
<b>Land</b>	Legislative	Adopting new and amending current legislation	MIER	2006-2008
<b>Industrial parks</b>	Technical	Develop a register	MIER / Municipalities	2006
	Legislative	Adoption of the law	MIER	April 2006
	Technical	To adopt criteria and identify sites	MIER / Municipalities/ Private sector	2006-2007
<b>Science and Technology Parks</b>	Legislative	Implementation of law	MIER/ Min of Science and Technology /Govt	2006
	Technical	To adopt criteria , identify sites	MIER/ Min of Science and Technology/Universities	2006-2007
<b>Free Zones</b>	Legislative	Review legislation /operations and eligibility	MIER, Ministry of Finance, Ministry of Trade, Tourism and Services (MTTS)	2006 - 2007
<b>Deregulation of telecommunications</b>	Activate and empower the Telecommunications Agency	Increase competition / Improve services	Ministry of Capital Investments	2006
<b>PPP/Concessions Utilities / services e.g. roads / oil / gas / electricity / waste management</b>	Develop detailed programmes	Provision of Modernized infrastructure	MIER / Government Departments	2006-2007

**b) Strengthening of Institutional Capacity and Development of Partnership at National and Municipal Level**

These topics are covered in detail in Chapter 6: Institutional Support Framework and in Section II of Chapter 7: Issues, Measures and Actions.

Issue	Action	Objective	Responsibility	Timeframe
<b>National Government and Agency Levels</b>	Clarify and agree roles and responsibilities	Improved services to investors	Government / MIER / SIEPA	2006
	Review staffing and budgeting	Progress from existing uncompetitive situation	Government / Ministry of Finance / MIER	2006
	Development of a pilot one-stop-shop – initial study planned on construction permits	Focused aftercare service on permits	MIER / SIEPA	2006
<b>Strengthen Primary FDI Institutions</b>	Appointment of investment champions on local government level / utility services / universities	Provide key focal points and direct monitoring and improvement of services to investors.	MIER	2006
	Establish high-level review committee	Emphasise government commitment and formal progress review	Government - Cabinet level	
	Establish High level university / industry / government committee	To prioritise educational infrastructural reforms	MIER / Ministry of Education/ government / universities / Education / IT industry	2006
<b>Develop IT Partnerships</b>	Establish 4 pilot IT committees at municipal level with private sector participation	To prioritise development of Technology parks/local initiatives	MIER / Universities /municipalities Nis, Novi Sad and Belgrade, Kragujevac	2006
	<b>PPP/Concessions</b>	Develop staff capability	Enhanced advice and support for government in developing PPP options	MIER to establish inter-ministry committee to establish prioritization

**c) Issues and Activities to Address Overall Competitiveness Issues**

These issues are covered in more detail in Section III of Chapter 7: Issues, Measures and Actions, in Chapter 5 on key sectors and Chapter 4.5 on Concessions.

Issue	Action	Objective	Responsibility	Timeframe
<b>Public Private Partnerships (PPP)</b>	Development and Implementation of a concessions programme	To improve services and infrastructure	MIER/Government ministries	2006-
<b>Logistics</b>	MIER to review with private sector barriers on movement of goods	To facilitate increased volumes of trade	MIER / MTTTS	2006-2007
<b>International Trade Agreements</b>	Legislative and technical review	To ensure maximum facilitation of trade.	MIER / MTTTS	2006-
<b>Research and Scientific Institutes</b>	Prioritise development of PPP models	To enhance marketing of skill and asset base to international sector	MIER to spearhead actions with government Departments and Institutes	2006-
<b>Provision of Industrial and Technological Parks</b>	Prioritise development of policies and incentives	To provide clear access to land and buildings for investors	MIER to spearhead with SIEPA	2006-
<b>Quality and Accreditation Benchmarking</b>	Identify and develop programmes to improve access to international expertise	To facilitate companies in development of export markets	MIER / SIEPA to highlight current and potential initiatives	2005-2007
<b>Productivity and Training Issues</b>	Identify and develop programmes to improved access to international expertise.	To provide supports to modern export oriented industry	MIER / SIEPA to codify existing and planned initiatives	2005-2007
<b>Cluster development</b>	Mobilise supports for development of sector driven groups and associations	To improve overall capability and levels of local value added.	MIER/SIEPA	2006-

**d) Development of Awareness Campaigns and Focused International Marketing Strategy**

These issues are covered in more detail in Section IV of Chapter 7: Issues, Measures and Actions and in Chapter 6 – Institutional Support Framework.

Issue	Action	Objective	Responsibility	Timeframe
<b>Internal FDI Awareness Campaign</b>	High level approach to municipalities and utilities	To highlight competitiveness issues within their areas of competence and of their vital role in FDI attraction	SIEPA supported by MIER and government	2006-2007
	Appointment of investor champions and advocates	To provide key senior point of contact and drive improvements	MIER / SIEPA to coordinate with Municipalities and utilities	2006-
	Establishment of local committees involving key players	To provide key coordination role and facilitate developments on land and infrastructure issues	MIER and SIEPA with government - support to spearhead	2006-
	Pilot initiative with 4 universities and municipalities on IT sector	To provide focus for implementation of national and local priority of developing IT sector	MIER / Ministries of Science / Education	2006
<b>International Marketing</b>	Develop and adopt an Investment Promotion Strategy	To prioritise usage of resources and funds	MIER / SIEPA	2006
	Development of an image building and awareness campaign	To increase awareness and highlight positive developments	MIER / SIEPA	2006-2007
	Activities could include development of advertising messages and focused FDI speeches / presentations.		Government / MIER / SIEPA	2006
	Agreement on goals of marketing and communication strategy	To ensure uniform understanding and realization of medium term impacts	Government / MIER / SIEPA	2006
	Development and marketing of sectoral strategies	To ensure focus on key sectors with perceived competitive advantage	SIEPA / MIER	2006-
		To ensure focus and orientation of marketing message to proper target market	SIEPA / MIER	2006-

## VI Possible Outcome

The suggested changes in their character, deepness and the planned speed of implementation are far beyond everything that was done within the economic reform agenda of Serbia after 2000. It is practically an offer of a wider reform. The reform benefits depend on its deepness, consistency and speed. The reform would increase the quality of business environment and the quality of life in Serbia.

Although it would bring improvement for the vast majority of population in a year or two, the reform has the corresponding cost. The change is often followed by the post-reform recession, laying-off and retraining part of employees, lost of rents and corruption income, higher competition for jobs. Some interest groups that would loose privileges are of course against the reform. Corrupted politicians are reform losers by default. Reform politicians loose support in the short term, because part of the electorate is punishing them for the reform costs that they have to undertake; but reform politicians politically recover in the long term and can win the elections again. Anti-reform politicians loose because the environment where the state is heavily interfering in the economy vanishes, i.e. they loose power and the possibility to become rich through corruption. That is why they are against the reforms and that resistance should be overcome.

By completing tasks envisaged in this Strategy, and depending on the extent of their implementation, Serbia will get a business environment not worse than in Bulgaria and Croatia, and as good as in the Baltics and Britain. The country will be ranked between 10<sup>th</sup> (in case of deep reforms) and 75<sup>th</sup> place (in case of weaker reforms) at the country rankings in economic freedom and investors lists<sup>55</sup>.

That is a huge move from current 140<sup>th</sup> place, among 200 countries and territories in the world. The investment equivalent would move around € 2-6 billion annually<sup>56</sup> in ten forthcoming years, depending on the selected option. Paid adds (in *The Economist* and similar) and public relations activity could be a waste of resources before reform steps suggested in this Strategy are undertaken.

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<sup>55</sup> Heritage Foundation/Wall Street Journal *Index of Economic Freedom*, Fraser Institute *Economic Freedom of the World Index*, etc.

<sup>56</sup> The estimated FDI inflow into Serbia was projected according to the current FDI inflows into countries with levels of economic freedom similar to scenarios of “weaker reform of the environment in Serbia” and “deeper reform of the environment in Serbia”, successively.

**8. TABLES**

**TABLE 1**

**SERBIA AND MONTENEGRO: IMPORTS AND EXPORTS 1998- 2005**  
(in millions US dollars)

	Trade Value of IMPORTS	Trade Value of EXPORTS	Foreign Trade Deficit
Period			
<b>2005</b>	10,576	4,553	6,023
<b>2004</b>	11,139	3,701	7,438
<b>2003</b>	7,473	2,755	4,718
<b>2002</b>	6,320	2,275	4,045
<b>2001</b>	4,837	1,903	2,934
<b>2000</b>	3,711	1,723	1,988
<b>1999</b>	3,296	1,676	1,620
<b>1998</b>	4,770	3,637	1,134

Source: National Bank of Serbia

**TABLE 1A**

**COMPARATIVE EXPORT DATA, 2004**  
**SELECTED SEE COUNTRIES**

	Total Exports (a) (% of GDP)	Exports to EU (a) (% of Total Exports)	Exports to EU (% of GDP)
<b>Central Europe (average)</b>	49.9	67.1	33.2
ALBANIA	7.1	89.4	6.4
BiH	20.5	52.7	10.8
BULGARIA	37.3	56.2	21.0
CROATIA	21.9	51.5	11.3
FYR MACEDONIA	29.1	47.0	13.7
ROMANIA	30.9	68.2	21.1
SERBIA AND MONTENEGRO (b)	13.8	42.7	5.9
<b>Balkans Average</b>	<b>23.0</b>	<b>58.2</b>	<b>12.9</b>

Source: The Economist Intelligence Unit

Note: Central Europe comprises the Czech Republic, Hungary, Poland, Slovakia and Slovenia.

(a) Exports refer to merchandise exports. The data, and associated ratios, are for 2003. The EU refers to the pre-enlargement EU-15

(b) Data for Serbia and Montenegro exclude Kosovo.

**TABLE 2**  
**SERBIA - INDUSTRIAL PRODUCTION STRUCTURE 1989-2004**

Republic of Serbia	1989	1990	1993	1994	1995	1997	1998	1999
Industry total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Work tools	11.37	7.40	4.91	4.49	4.10	4.70	4.67	4.33
Raw material	57.76	53.29	49.90	49.91	50.53	59.14	58.00	52.59
Expandable goods	31.72	39.12	44.96	45.38	45.17	35.99	37.21	42.96
Electricity	7.67	7.91	18.89	19.03	19.53	19.37	18.63	21.66
Coal mining	3.14	2.95	6.70	8.79	8.91	2.99	2.93	2.60
Extraction of crude petroleum and natural gas	0.42	0.32	3.60	3.39	3.34	0.99	0.94	1.13
Oil derivatives production	0.88	0.59	1.15	1.07	1.09	1.98	1.74	1.08
Steel ore production	0.00	0.00	0.01	0.00	0.00	0.03	0.02	0.01
"Black" metallurgy	1.54	1.21	0.34	0.20	0.39	2.94	2.98	0.70
"Coloured" metals ore production	1.65	1.80	1.44	1.52	1.75	0.98	0.99	0.90
"Coloured" metals production	2.13	1.65	1.70	2.12	2.29	2.71	2.34	1.65
Processing of "coloured" metals	1.16	0.89	0.26	0.34	0.31	0.73	0.78	0.72
Production of non-metal mineral products	0.35	0.21	0.17	0.23	0.21	0.30	0.28	0.24
Processing of non-metal minerals	1.97	1.72	1.27	1.29	1.29	2.06	2.28	2.25
Metal-processing activities	8.13	7.77	3.92	3.21	3.09	4.71	4.72	4.54
Engineering	7.41	5.62	2.24	1.59	1.50	1.62	1.50	1.43
Manufacture of transport vehicles	8.77	8.12	1.97	1.80	1.70	3.53	3.85	3.18
Shipbuilding	0.67	0.69	0.13	0.16	0.03	0.03	0.11	0.10
Manufacture of electrical machinery and apparatus	8.12	6.78	2.49	2.53	3.05	3.97	4.09	4.14
Manufacture of chemical products	4.42	3.74	1.11	1.35	1.28	8.51	8.36	4.26
Processing of chemical products	4.14	4.63	4.03	4.56	5.00	6.03	6.49	6.97
Manufacture of stone, gravel and sand	0.47	0.44	0.50	0.55	0.60	0.65	0.62	0.55
Manufacture of construction material	1.64	1.58	2.47	2.85	2.97	2.45	2.50	2.47
Manufacture of sawn timber	0.51	0.43	0.52	0.46	0.47	0.42	0.41	0.40
Manufacture of finished wood products	2.15	1.89	2.81	2.55	2.50	1.90	1.75	1.84
Manufacture of paper and paper products	1.87	1.49	1.61	1.53	1.62	2.12	2.18	2.33
Manufacture of textile yarns and textiles	3.73	4.08	3.35	3.30	2.90	2.32	2.36	2.56
Manufacture of finished textile products	6.44	7.54	5.45	5.78	4.57	4.26	4.38	4.02
Manufacture of leather and fur	0.68	0.60	0.33	0.33	0.32	0.33	0.27	0.34

**TABLE 2 - continued**

Republic of Serbia	2000	2001	2002	2003	2004
Industry total	100	100	100	100	100
Extraction of ore and stone	5.10	4.50	4.50	7.40	6.40
Processing industry	75.20	76.20	76.20	76.50	80.70
Production and distribution of electric power, gas and water	19.70	19.90	19.30	16.10	12.90
Extraction of ore and stone					
Extraction and packing of coal	2.51	2.35	2.34	3.80	3.50
Extraction of crude oil and gas	1.12	0.92	0.76	2.40	1.80
Extraction of uranium and thorium ore	0.00	0.00	0.00	0.00	0.00
Metal extraction	0.65	0.40	0.44	0.20	0.10
Non-metal minerals and stone extraction	0.85	0.81	0.98	1.00	1.00
Processing industry					
Food and water production	19.97	19.50	20.63	26.50	23.00
Manufacture of tobacco products	1.61	1.47	1.71	1.70	1.30
Manufacture of textile yarns and textiles	4.11	4.31	3.74	1.90	1.50
Manufacture of clothing and fur	3.00	3.09	2.00	1.30	1.20
Manufacture of leather, leather garments and footwear	1.23	1.22	0.99	1.00	0.70
Manufacture of wood and cork products, other than furniture	0.84	0.69	0.46	0.40	0.50
Production of celluloses, paper and paper processing	2.68	2.73	2.65	1.90	2.00
Publishing, printing and reproduction activities	0.97	0.89	0.84	0.70	0.90
Manufacture of coal and petroleum derivatives	1.14	1.85	2.24	4.90	5.80
Manufacture of chemical products	9.50	10.62	10.95	10.60	12.10
Manufacture of rubber and plastic products	3.63	4.04	4.12	3.60	3.50
Manufacture of non-metal mineral products	5.49	2.21	5.20	5.40	9.60
Production of base metals	5.74	1.89	2.81	2.55	2.50
Manufacture of metals products, other than machines	3.20	2.73	2.99	2.70	2.70
Manufacture of metal products, other than electrical equipment	3.11	3.16	3.05	3.30	5.10
Production of office equipment and computers	0.01	0.01	0.00	0.00	0.60
Manufacture of electrical machinery and apparatus	2.41	2.22	2.47	1.60	1.90
Manufacture of radio, TV and communication equipment	0.31	0.23	0.89	0.20	0.30
Manufacture of precise and optical instruments	0.22	0.21	0.22	0.20	0.20
Manufacture of motor vehicle and trailers	3.10	2.64	2.95	1.80	1.80
Manufacture of other means of transportation	0.76	0.66	0.69	0.40	0.30
Manufacture of furniture and other products	2.02	2.43	1.80	1.60	1.20
Recycling	0.11	0.13	0.12	0.20	0.30
Production and distribution of electric power, gas and water					
Production and distribution of electric power, gas and water	19.69	19.92	19.25	15.00	12.00
Collection, treatment and distribution of water	0.00	0.60	0.33	0.33	0.32

Source: Statistical Office of the Republic of Serbia

Remark: The structure of industrial production to 1999 was presented in accordance with old classification of business activities (Law on Uniform Classification of Business Activities), while the structure of industrial production after 2000 presented in accordance with the Law on Classification of Business Activities and Register of Classification Units, enacted on January 1, 2001.

TABLE 3

## PRIVATIZATION RESULTS – 2002 – 2005 (IN THOUSANDS €)

2002	Offered Total	Sold Total	Success (%)	Sales Proceeds	Investment Program	Social Program
Tenders	24	12	50%	201,456	305,929	140,690
Auctions	256	183	71%	55,679	13,085	
Tenders + Auctions	280	195	70%	256,896	319,061	140,690
Capital Market	87	48	55%	81,610	5,902	
<b>Total</b>	<b>367</b>	<b>243</b>	<b>66%</b>	<b>338,745</b>	<b>324,915</b>	<b>140,690</b>
2003	Offered Total	Sold Total	Success (%)	Sales Proceeds	Investment Program	Social Program
Tenders	40	18	45%	595,709	281,064	128,685
Auctions	773	615	80%	251,035	56,211	
Tenders + Auctions	813	633	78%	846,744	337,275	128,625
Capital Market	211	121	57%	67,768		
<b>Total</b>	<b>1,024</b>	<b>754</b>	<b>74%</b>	<b>914,512</b>	<b>337,275</b>	<b>128,625</b>
2004	Offered Total	Sold Total	Success (%)	Sales Proceeds	Investment Program	Social Program
Tenders	12	9	75%	15,234	75,389	2,580
Auctions	322	255	79%	120,615	48,680	
Tenders + Auctions	234	264	79%	135,850	124,069	2,580
Capital Market	122	67	55%	51,406		
<b>Total</b>	<b>456</b>	<b>331</b>	<b>73%</b>	<b>187,255</b>	<b>124,069</b>	<b>2,580</b>
2005	Offered Total	Sold Total	Success (%)	Sales Proceeds	Investment Program	Social Program
Tenders	20	15	75%	96,336	75,159	0
Auctions	257	201	78%	175,006	42,809	
Tenders + Auctions	277	216	78%	271,342	117,968	0
Capital Market	353	287	81%	125,054		
<b>Total</b>	<b>630</b>	<b>503</b>	<b>80%</b>	<b>396,396</b>	<b>117,968</b>	<b>0</b>
2002 – 2005	Offered Total	Sold	Success (%)	Sales Proceeds	Investment Program	Social Program
Tenders	96	54	56%	908,736	737,541	271,955
Auctions	1,608	1,254	78%	602,095	160,785	
Tenders + Auctions	1,704	1,308	77%	1,510,831	898,326	271,955
Capital Market	773	523	68%	325,838	5,902	
<b>Total</b>	<b>2,477</b>	<b>1,831</b>	<b>74%</b>	<b>1,836,669</b>	<b>904,227</b>	<b>271,955</b>

Source: Privatization Agency, Republic of Serbia

**TABLE 4**  
**FDI INFLOWS, BY HOST REGION AND ECONOMY, 1992-2004**  
 (Millions of dollars)

Host Region/ Economy	1992-1997 (annual average)	1998	1999	2000	2001	2002	2003	2004
World	310 879	690 905	1 086 750	1 387 953	817 574	716 128	632 599	648 146
Developed countries	180 750	472 545	828 352	1 107 987	571 483	547 778	442 157	380 022
Western Europe	100 796	263 016	500 045	697 436	368 828	427 560	359 369	223 400
European Union	95 845	249 931	479 372	671 417	357 441	420 433	338 678	216 440
Central and Eastern Europe	11 533	24 305	26 518	27 508	26 371	31 232	26 503	42 892
Serbia and Montenegro	178	113	112	50	165	475	1 360	996

Source: UNCTAD, FDI/TNC database ([www.unctad.org/fdistatistics](http://www.unctad.org/fdistatistics))

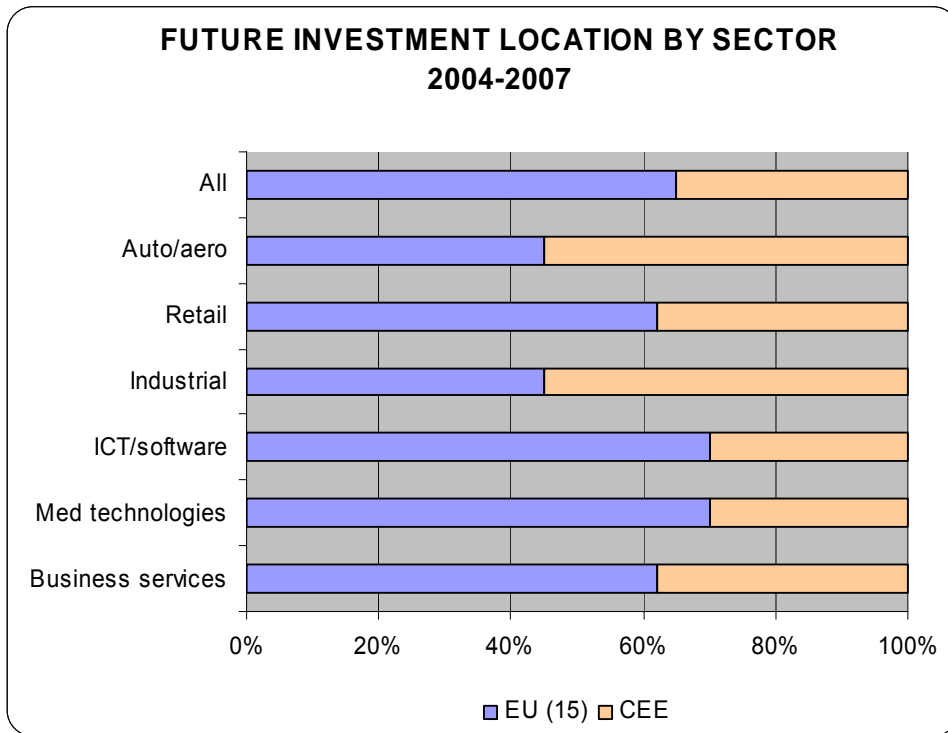
**TABLE 5**  
**FINANCIAL INFLOWS, BY COUNTRIES OF PAYMENT**  
**2000-November 2005**  
(Thousands of US dollars)

No.	Country	2000	2001	2002	2003	2004	January- November 2005	Total
1	Netherlands	0	102	2,248	598,963	102,008	91,121	<b>794,442</b>
2	Austria	183	1,421	33,876	93,747	146,104	149,706	<b>425,037</b>
3	Germany	6,152	9,788	82,801	75,708	51,985	181,874	<b>408,308</b>
4	Greece	334	1,280	12,496	62,268	52,968	236,185	<b>365,531</b>
5	Slovenia	33	11,254	9,561	29,036	15,706	173,200	<b>238,790</b>
6	Great Britain	0	1,225	6,618	20,631	79,620	61,926	<b>170,020</b>
7	Cyprus	762	2,045	41,717	31,581	16,310	69,122	<b>161,537</b>
8	France	0	81	87,489	7,858	24,022	34,730	<b>154,189</b>
9	Switzerland	343	86	2,913	12,559	29,401	55,196	<b>100,190</b>
10	Luxemburg	0	128	3,619	4,108	2,387	68,994	<b>79,236</b>
11	USA	35	1,906	18,099	15,068	18,187	23,268	<b>76,871</b>
12	Croatia	0	1,096	5,243	34,446	10,806	23,257	<b>74,848</b>
13	Italy	2,006	594	7,553	21,325	10,149	19,555	<b>61,182</b>
14	Hungary	0	275	1,167	4,224	16,567	24,526	<b>46,759</b>
15	Latonia	0	0	5	15,330	17,082	6,393	<b>38,810</b>
16	Russian Federation	736	3,581	2,556	3,359	538	14,642	<b>25,412</b>
17	Slovakia	3	10	10	18,342	0	292	<b>18,657</b>
18	Israel	0	0	260	207	3,052	14,435	<b>17,954</b>
19	Belgium	0	0	344	1,925	2,523	11,773	<b>16,565</b>
20	B&H	189	169	2,951	5,056	2,104	2,181	<b>12,650</b>
21	Bulgaria	0	0	133	129	9,910	540	<b>10,712</b>
22	Lichtenstein	0	216	57	2,162	2,974	2,148	<b>7,557</b>
23	Other Countries	476	131	4,738	13,378	182,000	42,496	<b>233,542</b>
	<b>TOTAL</b>	<b>11,252</b>	<b>35,388</b>	<b>326,454</b>	<b>1,071,410</b>	<b>796,403</b>	<b>1,297,883</b>	<b>3,538,790</b>

Source: NBS

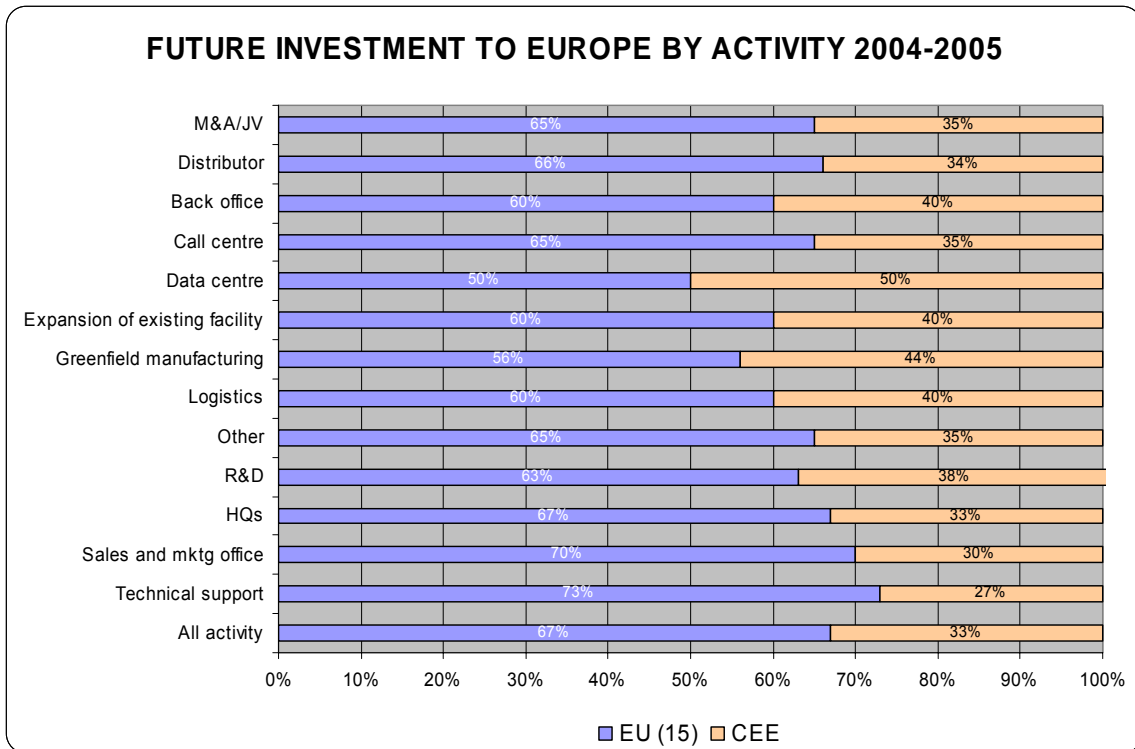
*Remark: The above data relate to financial inflows based on investment of non-residents in Serbia*

**TABLE 6**



Source: CorpTracker (Oxford Intelligence) November 2004

**TABLE 7**



Source: CorpTracker (Oxford Intelligence) November 2004

**TABLE 8**  
**FDI INWARD STOCK, US\$M**

Country	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Albania	211	311	349	394	435	578	786	929	1107	1514
B&H	-	-	-	67	244	390	509	774	1155	1660
Bulgaria	337	446	951	1597	2403	2257	2758	3662	5000	7569
Croatia	359	874	1443	1903	2578	3560	4706	6711	11351	12989
Macedonia	33	45	75	203	235	410	851	929	1024	1175
Moldova	94	117	196	258	232	459	600	727	789	940
Romania	821	1097	2352	4418	5469	6480	7638	9022	12764	18009
Serbia and Montenegro	-	-	740	853	965	1015	1180	1655	2915	3974
<b>SEEC-8</b>	<b>1856</b>	<b>2881</b>	<b>6105</b>	<b>9691</b>	<b>12561</b>	<b>15149</b>	<b>19028</b>	<b>24409</b>	<b>36105</b>	<b>47803</b>
Czech Republic	7350	8572	9234	14375	17552	21644	27092	38669	47527	56415
Hungary	11304	13282	17981	20746	23381	23015	27698	38028	47809	60328
Poland	7843	11463	14587	22479	26075	34227	41247	47900	60500	61427
Slovakia	1297	2046	2083	2890	3188	4746	5582	8530	11250	14501
Slovenia	1763	1998	2207	2777	2682	2893	2605	4081	5000	4962
<b>CEC-5</b>	<b>29557</b>	<b>37361</b>	<b>46092</b>	<b>63267</b>	<b>72879</b>	<b>86525</b>	<b>104224</b>	<b>137208</b>	<b>172086</b>	<b>197633</b>

Source: WIIW, OECD-FDI in SEE 2003-2004, June 2004, Gabor Hunya, UNCTAD

**TABLE 9**

**FDI INFLOW AS A PERCENTAGE OF GDP- SELECTED COUNTRIES (US\$M)**

<b>COUNTRY</b>	<b>1995</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
<b>Bulgaria</b>	0.7	8.0	6.0	5.8	7.1	11.7
<b>Croatia</b>	0.6	5.9	7.9	5.0	6.9	3.5
<b>Czech Republic</b>	4.9	9.7	9.3	11.5	2.9	4.1
<b>Hungary</b>	10.7	6.0	7.6	4.4	3.0	4.6
<b>Poland</b>	2.9	6.0	7.6	4.4	3.0	4.9
<b>Romania</b>	1.2	2.8	2.9	2.5	2.7	8.7
<b>Serbia and Montenegro</b>	n/a	0.6	1.4	3.0	6.4	5.3
<b>Slovakia</b>	1.3	9.5	7.6	17.0	1.8	3.1

Source: OECD, wiiw

*Remark: The data provided by the Serbian Ministry of Finance show that share of FDI in SCG GDP in 2002 was 3.3%, 7.15 in 2003 and 4.3 in 2004.*

**TABLE 10**  
**GDP AT CURRENT PRICES IN US\$M**

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Albania	2171	1010	676	1228	1949	2479	3022	2236	2824	3549	3836	4263	4832	6065	7600
Bosnia and Herzegovina	13105	14480	1387	1231	1096	2043	2750	3784	4228	4687	4443	4674	5420	6714	8100
Bulgaria	20726	7629	8604	10833	9708	13106	9900	10365	12737	12955	12600	13599	15563	20000	24100
Croatia	24778	22464	10241	10903	14583	18811	19872	20294	21628	19906	18428	19861	22422	28329	34200
Czech Republic	37721	27647	32240	37842	44430	56265	62418	57305	61602	59502	55603	61077	73566	90425	107000
Hungary	36111	33742	37604	38958	41896	44669	45163	45724	47049	48044	46681	51833	64927	82806	48000
Romania	38242	28852	19578	26361	30073	35478	35315	35286	42115	35592	37025	40166	45749	56951	73200
Serbia and Montenegro	30196	27391	38925	13486	13196	25772	16064	19309	15576	17842	11011	11697	15572	19397	24000
Slovakia	16312	11421	12382	13369	15467	19402	20828	21200	22179	20407	20291	20884	24188	32519	41100
Slovenia	17382	12673	12523	12673	14386	19762	19932	19194	20600	21125	18964	19527	21960	27443	32200
TFYR Macedonia	4471	4685	2317	2544	3384	4475	4413	3720	3580	3673	3587	3437	3712	4575	5200
Republic of Ireland	47301	47762	53646	50283	54775	66467	73183	80139	86961	95474	94753	102678	121729	153729	184800

Source: UN Statistics Division

Remark: The data provided by the Serbian Ministry of Finance show the following GDP in SCG (in millions US dollars): 15,000 in 1997; 14,726 in 1998; 9,674 in 1999; 8,050 in 2000; 10,816 in 2001; 14,280 in 2002 and 19,100 in 2003.

**TABLE 11**  
**ESTIMATES OF GDP AT CONSTANT 1990 PRICES IN US\$M**

Country or Area	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Albania	2221	1599	1484	1626	1762	1996	2178	1955	2204	2427	2605	2792	2888	3062	3245
B&H	2016	1772	1309	956	1018	1353	2087	2852	3326	3643	3840	4013	4163	4295	4466
Bulgaria	20725	18580	17232	16977	17286	17780	16109	15211	15821	16185	17058	17751	18619	19416	20486
Croatia	24778	19552	17262	15877	16809	17957	19016	20309	20821	20642	21232	22175	23331	24328	25252
Czech Republic	37041	32739	33173	32593	33316	35294	36762	36495	36076	36512	37932	38933	39513	40982	42886
Hungary	36110	31816	30841	30663	31567	32037	32460	33942	35592	37070	39000	40501	41916	43150	44974
Romania	38242	33300	30380	30845	32057	34346	35702	33541	31925	31558	32236	34088	35833	37684	40809
Serbia and Montenegro	27486	24291	17513	12434	13193	13968	15346	15002	15377	11619	12362	13042	13538	13673	14494
Slovakia	16308	13937	13018	13266	14089	14912	15829	16559	17256	17510	17866	18543	19399	20264	21379
Slovenia	17381	15834	14969	15395	16215	16881	17496	18329	18989	20037	20816	21374	22085	22642	23678
TFYR Macedonia	4472	4196	3921	3628	3564	3524	3566	3617	3739	3902	4079	3895	3929	4062	4164
Republic of Ireland	47301	48213	49825	51167	54112	59325	64237	71199	77520	86126	94666	100354	106509	110401	115779

Source: UN Statistics Division

**TABLE 12**  
**ESTIMATES OF PER CAPITA GDP IN US\$**

Country or Area	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Albania	675	503	482	547	614	791	970	701	891	1124	1206	1337	1460	1960	2553
Bosnia and Herzegovina	468	440	350	330	310	597	806	1085	1169	1250	1158	1204	1394	1759	2017
Bulgaria	2377	883	1006	1280	1159	1580	1204	1270	1571	1609	1576	1712	1974	2535	3137
Croatia	5485	4939	2231	2355	3129	4029	4270	4395	4730	4393	4090	4415	5060	6369	7557
Czech Republic	3594	2634	3077	3599	4224	5349	5926	5461	5904	5744	5425	5935	7198	8832	10462
Hungary	3484	3261	3637	3769	4053	4325	4378	4440	4579	4687	4565	5081	6379	8085	9908
Romania	1648	1245	848	1148	1318	1564	1566	1573	1887	1602	1674	1824	2088	2622	3358
S&M	2706	2456	1795	1261	1310	1412	1519	1824	1473	959	1044	1113	1480	1844	2178
Slovakia	3103	2163	2341	2510	2893	3617	3874	3936	4113	3781	3757	3866	4487	6047	7607
Slovenia	9023	6549	6443	6492	7344	10193	10247	9896	10598	10836	9710	9974	11246	14106	16359
TFYR Macedonia	2342	2437	1198	1308	1732	2279	2236	1876	1796	1835	1785	1705	1875	2302	2593
Ireland	13458	13564	15172	14138	15294	18379	20054	21791	23478	25420	24979	26739	30629	37967	44521

Source: UN Statistics Division

Remark: The data of the Serbia Ministry of Finance show the next GDP per capita in SCG (in US dollars): 1,498 in 1997; 1,474 in 1998; 1,243 in 1999; 1039 in 2000; 1340 in 2001; 1903 in 2002 and 2,536 in 2003.

TABLE 13

**FDI IN THE EU25, 2002-2004.**  
(Billions of euros)

Country	2002	2003	2004
<b>EU25</b>	<b>424,2</b>	<b>357,5</b>	<b>189,8</b>
<b>EU15</b>	<b>399,7</b>	<b>346,4</b>	<b>174,5</b>
<b>10 newcomers from 2004</b>	<b>24,5</b>	<b>11,1</b>	<b>15,3</b>
Belgium	13,3	28,5	27,7
Czech Republic	9,0	2,3	3,6
Denmark	4,0	2,3	-
Germany	38,3	24,2	-31,1
Estonia	0,3	0,8	0,8
Greece	0,05	0,6	1,1
Spain	38,2	22,7	7,9
France	52,0	41,6	21,6
Ireland	30,8	23,8	11,3
Italy	15,5	14,6	12,1
Cyprus	1,1	0,9	1,0
Latvia	0,4	0,3	0,6
Lithuania	0,8	0,2	0,7
Luxembourg	124,3	81,8	45,9
Hungary	3,0	2,1	3,3
Malta	-	-	-
Netherlands	28,2	17,1	-3,6
Austria	1,0	6,5	3,9
Poland	4,4	3,7	4,9
Portugal	2,0	5,8	0,9
Slovenia	1,0	0,2	0,4
Slovakia	4,5	0,6	-
Finland	7,4	2,9	3,7
Sweden	12,5	-0,1	-3,8
UK	29,5	18,0	63,1

Source: Eurostat, *News release* 94/2004, July 29, pp. 1-4; *News release* 88/2005, July 8, 2005, pp. 1-4. Note: inflows without outflows.

**TABLE 14**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>COUNTRY POPULATION, MLN PEOPLE</b>	7.5	7.9	4.4	22.3	5.4	1.3
<b>GDP per CAPITA (US\$) 2004</b>	2972	3137	7557	3358	7607	7930
<b>REAL GDP GROWTH RATE (2003/2004)</b>	7.5%	5.5%	3.7%	8.3%	4.9%	6.2%
<b>INFLATION RATE 2004</b>	13.7%	6.1%	2.1%	9.3%	8%	3%
<b>UNEMPLOYMENT RATE, 2004</b>	18.5%	12%	18.2%	7.8%	16%	9.7%
<b>TOTAL EXPORT (% OF GDP), 2003</b>	13.8	37.3	21.9	30.9	65.5	49.9
<b>TOTAL FDI INFLOW (US\$ billion ) 2004</b>	0.97	2.49	1.08	5.17	1.12	0.93
<b>TOTAL FDI STOCKS (US\$ billion) END-2004</b>	3.95	7.57	12.99	18.01	14.50	9.53
<b>FDI STOCK per CAPITA (US\$) END-2004</b>	526	958	2952	807	3222	7330

*Remark: The data provided by the Serbian Ministry of Finance show the following: real GDP growth rate in 2004 was 9.3; total export - 14.4% of GDP; total FDI from 2000 to 2004 - \$3 billion and FDI per capita - \$402,7.*

**TABLE 14 - continued**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>CORPORATE PROFIT TAX, 2005</b>	<b>10%</b>	<b>15%</b>	<b>20%</b>	<b>16%</b>	<b>19%</b>	<b>24%</b>
<b>PERSONAL INCOME TAX, 2005</b>	14% for salaries, while other personal income is taxed at a rate of 20%	Tax rate is rising progressively according to the level of income. 12% - 29%	- up to HRK 3000 (410€)tax rate is 15% - 3000 (410€) - 6750 HRK (924€)tax rate is 25% - 6751 (924€) - 21000 (2876€)tax rate is 35% - Over 21000 (2876€) tax rate is 45%	<b>16%</b>	<b>19%</b>	<b>24%</b>
<b>VAT (standard rate/lower rate), 2005</b>	<b>18% / 8%</b>	<b>20%</b>	<b>22%</b>	<b>19% / 9%</b>	<b>19%</b>	<b>18%</b>

**TABLE 14 - continued**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>TAX INCENTIVES</b>						
<b>1. TAX HOLIDAYS</b>	<ul style="list-style-type: none"> <li>- taxpayer who invests in fixed assets an amount exceeding 600 million Dinars (app. EUR 7.3 million) and also employs at least 100 employees shall be exempt from the profit tax during period of 10 years</li> <li>- tax exemption for concessions and non - profit organization</li> <li>- companies that employ disabled persons are exempt from the corporate profit tax</li> </ul>	<ul style="list-style-type: none"> <li>- companies engaged in production enjoy 100% exemption of the corporate tax for 5 year if their production assets are located in the regions with high unemployment and if the company does not have any due tax or obligatory social security liabilities</li> <li>- 0% corporate tax in areas with above average unemployment</li> </ul>	<ul style="list-style-type: none"> <li>- companies investing in Croatia are able to avail of up to a 10-year tax holiday when they invest more then HRK 60mil. (EUR 8.2 million) and employ more then 75 persons</li> </ul>	<ul style="list-style-type: none"> <li>- companies locating in severely disadvantages areas in Romania are exempt from payment of corporate profits tax for “the duration of the existence of the disadvantaged zone”</li> </ul>	<ul style="list-style-type: none"> <li>- payouts of dividends are tax free</li> <li>- <i>after entering EU</i> - EU approves a subsidy (max 10% of investing value) for every individual investment</li> </ul>	<ul style="list-style-type: none"> <li>- NO corporate income tax on re-invested profits</li> </ul>

**TABLE 14 - continued**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>2. TAX CREDITS FOR:</b>						
<i>New jobs</i>	- the amount of tax reduction is equal to 100% of the gross salaries, increased by the related contribution paid by the employer; the tax credit is recognized for period of 2 years from the day of employment of new workers, provided that the number of employees is not reduced during that period	-The Employment Agency's Programmes and measures for employment of young people	- incentive measures are provided directly for job creation where up to HRK 15000 (approx. \$2.725) per employee may be granted for covering the cost of job creation and retraining on a one-time basis	- one year tax holiday on gross salaries for every new employed employee	- Labour Office grants up to 50% of the wage form the Structural Funds for the one year and also, depending on region, grants may go up to 4000\$ per job	None
<i>Re-training programmes</i>	None	- Financial assistance through EU Phare programme which includes vocational training programmes	- an investor in Croatia who invests in an employee's vocational training or re-training may be reimbursed by the by the Fund for Stimulation of Creation of New Jobs and Retraining for up to 50 % of related costs		- Labour Office grants up to 50% of the training cost	- All companies established in Estonia can apply for financial support for the employee training projects. The rate of the grant depends on the size and location of a company, the nature of the training, and can be no more than 80% of the cost of the training project

**TABLE 14 - continued**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>2. TAX CREDITS FOR:</b>						
<i>R&amp;D</i>	None	<ul style="list-style-type: none"> <li>- Reduction of the corporate tax base with the expenditure made for research and development (R&amp;D) in cooperation with research institutes and/or universities</li> <li>- Financial assistance through EU Phare programme which includes research and development grants for high-technology business incubator</li> </ul>	<ul style="list-style-type: none"> <li>- For establishment and operation of technological parks, there are benefits from the different incentives (tax reduction for the fixed assets and land given for its use)</li> </ul>	<ul style="list-style-type: none"> <li>- Exemption of customs duties for the technological machinery, installations, equipment, measuring and control equipment, automation equipment and software products purchased from Romania or abroad according to the list approved by a joint Order of Minister of Development and Prognosis</li> </ul>	None	<ul style="list-style-type: none"> <li>- grants are provided up to 50% of industrial research costs directly related to a project</li> <li>- grants are provided up to 25% of product development costs directly related to a project</li> </ul>

TABLE 14 - continued

COMPARATIVE DATA – SELECTED COUNTRIES

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>3. OTHER TAX INCENTIVES</b>	<ul style="list-style-type: none"> <li>- The tax loss stated in the tax return can be carried forward and offset against future profits over a period of up to ten years</li> <li>- A company that has an established business in an area of Serbia that is not underdeveloped and who establishes a new business entity in an underdeveloped region may deduct the profits made on such investment as a proportion of the total profits of the company for a period of two years</li> <li>- A 5-year tax holiday is granted for concession-related investments, from the day the concession investment has been completed - Accelerated depreciation of certain fixed assets</li> <li>- Import of equipment as investment is free from custom duties, VAT is charged</li> </ul>	<ul style="list-style-type: none"> <li>- 2-year VAT exemption for imports of equipment, consumables and components related to investment projects valued over € 5 million</li> <li>- Depreciation rates – 2 years for computers and related equipment and 3 1/3 years for manufacturing equipment</li> </ul>	<ul style="list-style-type: none"> <li>- Includes leasing, granting of construction rights and purchase or usage of real estate or other infrastructure owned by the government or the local government under commercial or favourable conditions including or without a fee.</li> </ul>	<ul style="list-style-type: none"> <li>- Accelerated depreciation</li> <li>- New investments whose value exceeds the equivalent of USD 1 million and contributes of creating new jobs, enjoy a 20% deduction of their value</li> </ul>	<ul style="list-style-type: none"> <li>- No double taxation</li> <li>- Dividend tax, Inheritance tax, Gift tax and Real Estate Transfer tax are 0%</li> </ul>	

TABLE 14 - continued

COMPARATIVE DATA – SELECTED COUNTRIES

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
<b>PROPERTY RELATED INCENTIVES</b>	<p>- Foreign investors are allowed to buy real estate when reciprocity condition is provided, except urban construction land which is state-owned. Foreign investors can lease construction land for a maximum period of 99 years through public auctions, announcements and direct bargain. Investors are obliged to pay a land fee, as well as a fee for the land use.</p>	<p>- Foreign investors receive the same rights as any domestic investor concerning real estate property</p>	<p>- Foreign investors who establish a company in Croatia are considered to be a domestic legal entity and may acquire real estate ownership, as well as mortgage rights on real estate, provided the condition of reciprocity is met. Property ownership is regulated by Property and Other Proprietary Rights Act and has to be approved by the Ministry of Foreign Affairs.</p>	<p>- Foreign individuals or legal entities may own buildings and/or acquire the right to use the land (based on lease agreements, concession agreements, etc). Legal entities without Romanian nationality (i.e. headquartered abroad) may not own land in Romania. Companies headquartered in Romania may own land even though their share capital owned is 100% foreign. From 2007 foreign individuals will be allowed to own land</p>	<p>- Ownership titles to immovable property may be acquired by individuals or legal entities not registered in Slovakia. -With some exceptions, they may not acquire land which is included in the agricultural land fund or the forestry land fund and they are located beyond the borders of residential area. Those restrictions do not apply for EU citizens.</p>	<p>- Foreign Investors have right to purchase and own land without restrictions. -In case of purchasing bigger areas of forest and agricultural land the company must be registered in Commercial Register and must have been active in areas of forestry or manufacturing of agricultural products for at least past three years</p>

**TABLE 14 - continued**

**COMPARATIVE DATA – SELECTED COUNTRIES**

	<b>SERBIA</b>	<b>BULGARIA</b>	<b>CROATIA</b>	<b>ROMANIA</b>	<b>SLOVAKIA</b>	<b>ESTONIA</b>
<b>ABOUT RESTITUTION</b>	- Law of registration and evidence of nationalized property has been adopted in June 2005. Process of evidence will last until Jun 2006. Meanwhile a Restitution law should be adopted.	- Current restitution law (1991) stipulates that both Bulgarian citizens and foreigners are eligible to receive property confiscated during the fascist and communist periods, but foreigners, however, must sell the property.	- The Croatian parliament in July 2002 amended the law to extend to foreigners the right to claim nationalized property or receive compensation in accordance with existing bilateral agreements	- In 2001 Romania passed the Restitution Law. Restitution can not be claimed under this Law for the properties that belonged to religious communities or national minority groups.	- Restitution law was enforced in 1993. Today there is very small percent of nationalized property. Slovakia had very capacious evidence of taken property.	Restitution in Estonia began in 1992. The restitution of property has been settled & currently there are no pending property claims or disputes.

**TABLE 14 - continued**  
**COMPARATIVE DATA – SELECTED COUNTRIES**

	SERBIA	BULGARIA	CROATIA	ROMANIA	SLOVAKIA	ESTONIA
AVERAGE GROSS WAGES LEVEL (EUR) in 2004	282	149	785	196	657	465
	*307 (average 2005)	*167 (June 2005)	*849 (September 2005)	*275 (September 2005)	*435 (June 2005)	- Engineering (management) 1500 - Blue collar workers 400 *489 (September 2005)
SOCIAL INSURANCE CONTRIBUTION RATE (EMPLOYER`S)	17.9%	32%	17%	33%	35%	33%
TOTAL AVERAGE COST PER EMPLOYEE	333	196	918	336	886	614
PERCENTAGE OF POPULATION SPEAKING ENGLISH LANGUAGE	42%	14%	14%	16%	n/a	30%

Sources: Selected countries' Investment Promotion Agencies, Central Banks and Ministries of Finance, The United States Government official Internet Presentation ([www.state.gov](http://www.state.gov)), National Statistics Agencies, The Economist Intelligence Unit.

## **9. FINAL PART**

Appendices 1 to 5 are integral part of the Strategy.

This Strategy shall be published in the "Republic of Serbia Official Gazette"

No:

Belgrade,

Date:

GOVERNMENT

PRESIDENT

## **APPENDIX 1**

### **ACTION PLAN FOR THE REMOVAL OF ADMINISTRATIVE BARRIERS TO FOREIGN INVESTMENTS FOR 2006**

At the time of adoption of the first Action Plan for the Removal of Administrative Barriers to Foreign Direct Investments by the Government of Serbia on May 27, 2004 it was agreed that the Plan would be regularly updated in order to enable ongoing improvements in the business climate, which would in turn increase the inflow of FDI, the basis for further economic growth of Serbia.

In order to monitor the implementation of the Action Plan for the Removal of Administrative Barriers to Foreign Direct Investments, in June 2004, the Government of Serbia set up the Committee on Promotion of Investments in Serbian Economy. The activities of this Committee are coordinated by the Ministry of International Economic Relations. Committee members have contributed substantially to the relatively successful implementation of the Action Plan, as well in identifying new measures at improving the investment climate. It should, however, be pointed out that some of the earlier measures have not been implemented within the set period and are therefore repeated in the present Action Plan.

This Action Plan shall govern in detail the following issues:

**I Start-up Procedures for Companies with Foreign-owned Equity**

1. Movement and Residency of Foreigners in Serbia
2. Business Registration
3. Intellectual Property Protection (Industrial Property and Copyright and Related Rights)

**II Infrastructure development**

1. Acquisition of Building Land
2. Lease of Real Estate
3. Real Estate Registration
4. Construction Projects and Permits
5. Industrial Parks
6. Public Utilities
  - 6.1 Electricity
  - 6.2 Water and Sewerage
  - 6.3 Telecommunications
7. Transport
8. Training and Skills

**III Company Operational Procedures**

1. Labor Legislation
2. Taxation
3. Foreign Transactions and Foreign Credit Arrangements
4. Customs and Inspections
5. Standardization and Accreditation

**IV Other Systemic Measures, Public Administration Reform and Reform of the Judiciary**

1. Other Systemic Measures
2. Public Administration Reform
3. Judiciary Reform

## I START-UP PROCEDURES FOR COMPANIES WITH FOREIGN-OWNED EQUITY

### 1. MOVEMENT AND RESIDENCY OF FOREIGN PERSONS IN SERBIA

#### **Current situation:**

A foreign person (national of a country to which the visa regime of Serbia and Montenegro applies) intending to stay in the territory of the Republic of Serbia must, with a valid travel document, obtain a visa before entering the country. A visa can be valid for up to one year and can cover multiple entries/exits. The regulations create the possibility for tourist visas, valid up to 30 days, to be issued at border crossing points; in practice, this is done only as an exception. A business visa is issued to a foreign person for the purpose of carrying out his business activity and to a foreign person who cannot be employed without an employment permit (for the performance of expert tasks envisaged by a business and technical cooperation agreement, technology transfer agreement, or foreign investment agreement). The validity of a business visa is related to the period needed for the respective work. This visa also regulates the residence of that foreign person in the country.

In addition to the visa, a foreign person must obtain a permit for residing in the territory of the Republic of Serbia (except when a business visa is issued). The residence permit may be in the form of a temporary residence permit (up to one year) or of a permanent residence permit for a foreign person who has invested funds in Serbia for the purpose of undertaking business operations and other activities. The regulations pertaining to movement and residence of foreign persons in Serbia and in Montenegro are not harmonized. A foreign person wishing to set up a representation office in the Republic of Serbia must have a temporary residence permit, even though this requirement contradicts the provision according to which a person applying for temporary residence permit must enclose evidence that the representation office has already been set up.

In addition, the service in charge of permit issuance is insufficiently prepared in organizational and technical terms to process the applications filed by the parties. A specific problem arises in when foreign nationals cross the State border, particularly when vessels with foreign tourists arrive: travel documents are checked in each port at which the vessels dock, instead of only once at arrival in the country.

#### **Planned objective:**

To approximate visa regimes of Serbia and of Montenegro, harmonize regulations with *acquis communautaire*, to improve accessibility of information concerning the requirements and necessary documentation, to improve State border crossing procedures, and to improve procedures of granting residence permits to foreign nationals.

Alongside the efforts to harmonize the visa regime with that of the EU, it would be worthwhile to harmonize regulations that govern temporary residency issues and the free movement of foreign nationals. Standard practice in EU countries is that a foreign national fills-in one document for declaring his visitors status, provides a passport with a valid visa, several photographs, verification of employment status (or any other relevant status). It is counterproductive to have a restrictive visa regime in place for the very people that Serbia is seeking to attract, namely investors and associated professionals. Movement of "third country citizens" should be controlled by visa regime.

**Recommendations:**

- A) Harmonize the visa regime of Serbia and Montenegro with EU standards  
**Competence**<sup>57</sup> : Ministry of Interior of the Republic of Serbia – in coordination with the Ministry of Foreign Affairs of Serbia and Montenegro
- B) Enact the Law on Movement and Residence of Foreign Nationals and the Law on State Border Crossing  
**Deadline:** April 2006 (initiate adoption procedure)  
**Competence:** Ministry of Interior<sup>58</sup>
- C) Eliminate the conflict of regulations requiring prior granting of temporary residence permits by the Ministry of Interior in order to be granted the working permit by the National Employment Service and vice versa  
**Deadline:** Third quarter of 2006 (Law on Free Movement and Temporary Residency of Foreign Nationals)  
**Competence:** Ministry of Interior, Ministry of Labour, Employment and Social Affairs
- D) Control travel documents at arrival in the country, instead of at each port where the ship docks  
**Deadline:** Third quarter of 2006 (Law on Border Crossing)  
**Competence:** Ministry of Interior
- E) Make accessible accurate information in several languages concerning the required documentation for the granting of residence permits in the offices of the Foreign Nationals Department as well as via the Internet  
**Deadline:** March 2006  
**Competence:** Ministry of Interior and Ministry of International Economic Relations
- F) Continue staff training (e.g. language skills) and modernization of resources (improved layout of offices where temporary residence permits are issued, particularly in larger Serbian cities).  
**Competence:** Ministry of Interior

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<sup>57</sup> The first ministry shall coordinate the activities

<sup>58</sup> New legislation should be first enacted on the level of State Union. The same applies to recommendations c) and d).

## 2. BUSINESS REGISTRATION

### **Current situation:**

The newly established Business Registration Agency began operating on 4 January 2005. The current regulations in Serbia allow for registration of the following types of commercial entities with the Business Registers Agency: d.o.o. (limited liability companies), AD (joint-stock companies), limited and general partnerships, branch offices of foreign companies and entrepreneurs. The relevant provisions allowing the establishment of business associations were removed from the new Company Law. It was considered that they do not correspond completely with the subject matter of that law. However, now there is no possibility to form a business association. The provisions should be either reintroduced in the Company Law or included in another law, such as a law on non-profit organizations.

The four main issues of concern with the registration of commercial entities are as follows: a) Paper trail, b) Slow procedure, c) Connection to utilities and communal infrastructure, and d) Corruption. Although the time for registration of new businesses has significantly improved, this procedure should improve further on. Experience indicates that it is insufficient to merely speed-up the process of business registration as the example of Montenegro indicates (where a commercial entity is registered in one day and with initial capital set at a minimum of Euro 1). The process of obtaining various utility and communal service connections (telephone, power, water etc) needs also to be streamlined. Such connections should be automatically provided upon obtaining relevant construction licenses.

### **Planned objective:**

To establish the agency for coordination of document procedure for business registration. One-stop-shop principles should also be introduced to ensure that people are removed from the paperwork loop, leading to greater efficiency. Further administrative efficiency may be achieved by ensuring that relevant agencies maintain accurate databases eliminating the need for applicants to hoard paperwork that the particular agency has issued in the past.

### **Recommendation:**

A) Expedite the re-registration procedure for economic operators

**Deadline:** March 2006.

**Competence:** Ministry of Economy, Business Registers Agency

B) Introduction of the practice of greater reliance on a particular agency's database for documentation that it has issued in the past, and also ensuring timely re-issuance of the same requested documentation. It happens that state agencies request from client a document within its own competence. This should be prevented by introducing a special rule.

**Deadline:** June 2006.

**Competence:** Ministry of Public Administration and Local Self-Government

C) Enactment of new legislation or amendments to relevant laws enabling the formation of business associations.

**Deadline:** Third quarter of 2006.

**Competence:** Ministry of Public Administration and Local Self-Government, Ministry of Economy.

### 3. INTELLECTUAL PROPERTY PROTECTION (INDUSTRIAL PROPERTY AND COPYRIGHT AND RELATED RIGHTS)

#### **Current situation:**

In the course of the previous year, the Parliament of Serbia and Montenegro enacted a part of a set of intellectual property protection laws (Patent Law, Trademark Law, Design Law, Law on Topography of Integrated Circuits, Copyright and Related Rights Law); the remaining laws – on geographic marks of origin, plant variety protection and undisclosed data – are to be adopted this year. These laws are EU and WTO compliant.

A substantial improvement in the implementation of the laws, however, remains to be achieved through efficient and coordinated operations of competent authorities like the customs service, inspection services, police, and citizens' associations. The introduction of adequate judicial protection of intellectual property rights is essential, and professional and organizational skills upgrade of judges in this field is underway.

Moreover, it shall be necessary to enact laws and bylaws that indirectly affect the full and efficient protection of intellectual property, in addition to regulations envisaging sanctions for those who commit infringements and criminal offences in this field. The powers of the market inspectorate are not sufficiently broad, because the intellectual property rights protection laws (specific regulations) do not allow for seizure of infringing items/articles.

The draft law on foreign trade, went through public discussion and is now considered by the Republic Secretariat for Legislation, after which it will be forwarded to the Council for Regulatory Reform and Office for EU Integrations.

Serbia also lacks a set of laws governing the fields of culture, arts, and creative work in line with the EU standards, insofar as these concern intellectual property protection.

#### **Planned objective:**

To create an environment that is conducive to practicable intellectual property rights protection and enforcement. Greater protection efforts should immediately focus on areas where the commercial value is greater (to an industry sector and to investors) such as film and sound recordings. These activities generate large profits and as such they are attractive for investors.

#### **Recommendations:**

A) Enact the Plant Variety Protection Law

**Deadline:** December 2006 (initiate adoption procedure)

**Competence:** Ministry of Agriculture, Forestry and Water Management

B) Enact the Law on Marks of Geographic Origin and the Law on Confidential Information.

**Deadline:** April 2006 (initiate adoption procedure)

**Competence:** Ministry of Internal Economic Relations of Serbia and Montenegro (Intellectual Property Office of Serbia and Montenegro)

C) Enact the adequate intellectual property protection regulations in Serbia: the new Trade Law (incorporating the above-mentioned amendments). The new legislation should remedy current limitations and strong reliance on bylaws)

**Deadline:** April 2006

**Competence:** Ministry of Trade, Ministry of Justice

D), Enact the Music and Performing Activities Law and the Cinematography Law. Ministry of Science and Environmental Protection has prepared the Electronic Data Protection Law.

**Deadline:** April 2006 (initiate adoption procedure)

**Competence:** Ministry of Culture, Ministry of Science and Environmental Protection

E) Organize special training of judges acting in legal disputes involving intellectual property rights

**Deadline:** April 2006

**Competence:** Judiciary Centre Supreme Court of Serbia

F) Apply the Action Plan on Implementation of Anti-piracy Measures

**Competence:** Anti-piracy Commission in cooperation with line ministries

## II INFRASTRUCTURE DEVELOPMENT

### 1. ACQUISITION OF CONSTRUCTION LAND

#### **Current situation:**

The impossibility of acquiring title to construction land under market conditions is a major obstacle to the development of a climate conducive to foreign investment. Legal safety is diminished, *ad hoc* arrangements are invoked, and there is a problem with setting prices of land.

In addition to the constitutional restrictions, administrative barriers have been created by the enactment of the Urban Planning and Construction Law. Article 84 permits the right of use of land to be transferred to the previous owner, but not to his successor who acquires the right of use on the basis of a related contract. Furthermore, the provision of Article 79, which requires restitution of land to the former owner, remains inapplicable until all municipalities have adopted decisions on declaration of public construction land. The time limit set by the law for declaration of public construction land has expired and only several municipalities in Serbia have adopted such decisions.

The Property Restitution Law, a systemic law, has not yet been enacted; in the meantime, the lawmakers have enacted the Law on Reporting and Recording of Requisitioned Property in order to determine the total liabilities of the State for the restitution of requisitioned property. Furthermore, Article 82c(4) of the Property Relations Law requires foreign nationals to obtain an evaluation from the ministry in charge of trade to demonstrate that acquisition of real estate is necessary for the performance of that person's business activity.

The shortage of available construction land in the market has been caused not only by legal obstacles but also by the lack of an updated and complete database on unused plots of land where property rights or a lease may freely be acquired. The insufficiently developed and inexpedient administrative procedures only worsen the situation.

In accordance with EU regulations and the trend towards greater decentralization it is imperative that local self-governments utilize land within their control with far greater autonomy. A progressive example exists in Hungary where municipalities do not need to seek national government approval for financing their budgets by using land as collateral.

A practical problem arises in the context of cadastral recording of property in Serbia formerly belonging to companies from other parts of the former Yugoslavia that had been seized in 1991 by a decision of the Ministry of Economy. This property should, in accordance with the interpretation of the Succession Agreement given by the Ministry of Trade, Tourism, and Services, be restituted and recorded as property of the earlier owners. The Decree that prevented this, however, has not yet been repealed, which results in two opposing interpretations of the issue. In other countries of former Yugoslavia, property is not being returned to Serbian companies; the lack of reciprocity in this area serves as another obstacle for the restitution procedure.

The return of real property to commercial entities from other republics of the Former Yugoslavia needs to be commenced by Serbia as soon as possible without regard to the obstinacy of other republics on the same issue. Any divestiture or assignment of real

property that are the subject of valid legal claims should cease immediately. Real property that has already been disposed of will need to be recompensed from Serbian taxpayer funds. Given that an agreement is in place for resolving issues relating to property succession, perhaps Serbia could demonstrate leadership initiative by resolving the property claims of rightful owners in other republics. This good faith initiative will no doubt produce reciprocal benefits for the entire process.

**Note:** Assumptions for a consistent, safe and well-grounded implementation of market principles in the sales of construction land title include elimination of restrictions laid down by Article 60 of the Constitution of the Republic of Serbia concerning the ownership of civic construction land and clear substantive and procedural rules for restitution of property. Issues relating to a new constitution for Serbia are a complex matter. Some legal commentators suggest that since bringing-about a new constitution would be a time-consuming process, for reasons of expediency, new legislation be enacted within the current constitutional framework, as a matter of the highest priority. This view is supported by the fact that privatization process is taking place the same way, although it does not comply with constitution, and that are several lawsuits with the Constitutional Court regarding this matter.

**Planned objective:** To grant to local self-government ownership title to construction land, to enable private owners to acquire title to construction land, to create a free market of construction land and a clear idea into market supply, and to finalize the procedure of succession of property belonging to the former Yugoslavia and to restitute property.

**Recommendations:**

A) Adopt new Constitution, or in some other way liberalize the procedure of acquiring construction land.<sup>59</sup>

**Deadline:** November 2006

**Competence:** Government of the Republic of Serbia as one of the protagonist

B) After the enactment of the Law on Reporting and Recording of Requisitioned Property, enact the Restitution Law

**Deadline:** End of 2006

**Competence:** Ministry of Finance

C) Adopt amendments to the Law on Urban Planning and Construction that would enable the sale of rights to use (Article 84) and determine new time limits for declaration of public construction land (if the municipalities fail to observe the limit, the procedure will be taken over by the Ministry of Capital Investments)

**Deadline:** April 2006

**Competence:** Ministry of Capital Investments

D) Enact the new Property Relations Law

**Deadline:** May 2006 (initiate adoption procedure)

**Competence:** Ministry of Finance

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<sup>59</sup> The Minister for International Economic Relations initiated before the Court of Serbia and Montenegro the procedure for proclaiming Article 60 of the Constitution of Serbia contrary to Constitutional Charter of Serbia and Montenegro.

E) Enact the Local Self-Government Property Law

**Deadline:** December 2006.

**Competence:** Ministry of Finance, Ministry of Public Administration and Local Self-Government

F) Create a database on available plots of construction land

**Deadline:** November 2006.

**Competence:** Ministry of Capital Investments – in cooperation with the Republic Geodesic Institute and the Ministry of Public Administration and Local Self-government

G) Amend the Foreign Investment Law to improve the competitive position of Serbia for encouraging FDI and set preconditions that have to be met for becoming the investment of special interest (world known brand, new jobs and/or high-tech investment). Free allocation of construction land, release from payment of land servicing charges and provision of infrastructure to the land-plot should be examined as incentives for encouraging investment of special interest.

**Deadline:** November 2006

**Competence:** Ministry of International Economic Relations

H) Remove the obstacles for restitution of property, subjected to the succession proceedings, to companies from former Yugoslavia through inter-state dialogue and enhanced operations of the Succession Commission.

**Deadline:** December 2006

**Competence:** Ministry of Finance, in coordination with the Ministry of Foreign Affairs of Serbia and Montenegro.

## **2. LEASE OF REAL ESTATE**

### **Current situation:**

Any lease, use, cancellation of lease, or mortgaging of real estate owned by the Republic of Serbia and used by any branch of territorial autonomy, local self-government bodies, and public enterprises, institutions, and services requires prior approval from the Property Directorate of the Republic of Serbia, in accordance with Art. 8 and 8a of the Law on Assets owned by the Republic of Serbia. Accordingly it complicates and decelerates trade in real estate.

The provisions of the Law on Urban Planning and Construction delegates the regulatory action relating to the procedure, subject, and duration of lease to bylaws adopted by local self-government, which has created differing practices among the municipalities. Local governments should be autonomous in devising local tax regimes independently. This would encourage competition and development of better climate for attracting FDI.

**Planned objective:** To remove the ineffective administrative barriers and excessive centralization and to govern by a law the procedure of leasing out State-owned land.

**Recommendations:**

A) Amend the Law on Assets owned by the Republic of Serbia which will eliminate mandatory Approval issued by the Property Directorate of the Republic of Serbia and introduce a mandatory contract registration with the Directorate, providing the possibility to the Directorate to act *ex officio* if the rule is not obeyed.

**Deadline:** May 2006 (initiate adoption procedure)

**Competence:** Ministry of Finance

B) Enact new Law on Urban Planning and Construction (or the introduction of a separate law on civic construction land) which will include provisions on leasing construction land and on lease terms which will be legally binding for local self-government bodies.

**Deadline:** July 2006.

**Competence:** Ministry of Capital Investments

### 3. REAL ESTATE REGISTRATION

**Current situation:**

Serbia applies a system which requires mandatory registration of rights to real estate in official registers (real estate cadastre and land registers) for property or other rights to be established or transferred. One of the major obstacles is insufficient coverage of Serbian territory by the Land Register (77% is registered in single registry, 15% is registered separately in real estate cadastre and land registers, and 8% is registered in estate cadastre). Besides, the Land Register Law dates back to 1930.

Legal safety is not guaranteed: real estate and rights to real estate are recorded in land cadastre in those areas where real estate cadastrals have not been established as yet. Furthermore, inscription of real estate in the cadastre cannot be made upon personal request, but only *ex officio*, which substantially hampers the improvement of cadastral records. Those are weaknesses of the existing Law on State Land Survey and Real Estate Cadastre.

Entire activity related to the improvement of the existing cadastral evidence is taking place at the Republic Geodesic Institute. At present, 77% of real estate (excluding Kosovo and Metohia) is recorded digitally.

Also, it is necessary to adopt the Mortgage Law that will regulate this subject, promote mortgage as a powerful means for the protection of creditors' financial interests and increase the total volume of loan operations. Mortgages represent an efficient financing tool, whereas precise documentation and registration of interests in property will enable greater use of untapped equity in the real estate market.

According to middle-term working program of the Republic Geodesic Institute, as well as signed Agreement on Credit for Development – Project for Real Estate Cadastre and Registration of Rights in Serbia, concluded between Serbia and Montenegro and International Association for Development, continuation of pursuits on creating the Real Estate Cadastre, digital cadastral records and on development of informational technologies is intensified, whereby the Real Estate Cadastre for entire Serbian territory will be finished by April 2010.

The drafting of the new Law on State Land Survey and Real Estate Cadastre is in progress. This law will, inter alia, enable the registration of rights upon personal request also, in the procedure of creation of the Real Estate Cadastre. Thereby, that will contribute a faster establishing of the Real Estate Cadastre, and by that improving of rights inscription ambient in the keeping procedure, development of the real estate market, law certainty of registered rights as well as creating of friendlier climate for foreign investments. Furthermore, that creates better conditions for the registration of mortgage as on the built and registered facilities so on the facilities under construction, all in compliance with the rules prescribed by the new Law on State Land Survey and Real Estate Cadastre and the new Mortgage Law, which are being drafted.

**Planned objective:**

To ensure legal certainty and reliability of official real estate registers. Also, stimulating greater private initiative in cadastre and land registry entries.

**Recommendations:**

A) Enact the new Law on State Land Survey and Real Estate Cadastre

**Deadline:** October 2006

**Competence:** Ministry of Capital Investments, Republic Geodesic Institute

B) Quickly start working on improving the records, determining current factual and legal conditions of real estate on the territory of the Republic of Serbia, and developing a registry of real estate and its ownership in accordance with prepared projects (continue with the implementation of the World Bank project). The creation of the cadastre commenced in autumn 2005 and will end by 30 April 2010, in accordance with the project financed by the World Bank.

**Deadline:** September 2010 (creation of the cadastre)

**Competence:** Ministry of Capital Investments, Republic Geodesic Institute

#### **4. CONSTRUCTION OF PROJECTS AND PERMITS**

**Current situation:**

Municipalities have not complied with the deadlines for preparation of general urban and regulatory plans envisioned by the Law on Urban Planning and Construction. Without these plans, the development of infrastructure and the removal of numerous problems in the field of property law are hampered. The municipalities lack financial resources, while the Government has no resources available for this purpose despite being required by the law to finance the preparation of those plans. A possible solution would be to extend the deadlines set by the law, which would enable the municipalities to adopt the said plans during the upcoming period, while at the same time allowing the Government to draw up higher-level plans for wider territorial units (districts).

Given that the urban planning process is a detailed and time-consuming process, it is advisable that land zoning categorizations are completed as a priority. This will ensure that greater certainty is introduced into the property development and investment sector. Clear zoning regulations will also circumvent the problems associated with unregulated construction activity that unjustifiably mixes residential neighborhoods with industrial and commercial, reducing the quality of life in many instances.

An investor is required to apply to a number of institutions when obtaining the permits necessary for construction: the Urban Planning Institute, the waterworks company, the sewerage company, the Serbian electricity company, the telecommunications company, and the gas supply company. The lengthy process slows the procedure of obtaining building permits and the implementation of the project itself. One key element that will stimulate further foreign investment is the streamlining of the process and procedures associated with obtaining construction and property development licenses. This sector is a key driver of economic growth in most transition economies in first twelve years of transition.

**Planned objective:**

To extend coverage of urban planning and regulation plans to encompass all territory in Serbia and to create simplified procedures for obtaining building permits.

**Recommendations:**

A) Draw up higher-level spatial plans for wider territorial units (districts)

**Deadline:** June 2006

**Competence:** Ministry of Capital Investments

B) Carry out ortho-photo shooting at local and global levels

**Deadline:** End of 2007 (in accordance with the project financed from CARDS funds)

**Competence:** Republic Geodesic Institute

C) Adopt amendments to the Law on Urban Planning and Construction which would extend the deadlines for the preparation of general planning documents and urban plans as well as prescribe the penalties for failure to observe deadlines

**Deadline:** April 2006

**Competence:** Ministry of Capital Investments

D) The new Law on Planning and Construction should simplify and shorten the procedure for obtaining a construction license to no longer than 15 days, and should set up a special municipal service to receive the applications for construction permits, connection to public utility and community services collect all necessary documents, and issue the permits

**Deadline:** July 2006

**Competence:** Ministry of Public Administration and Local Self-government, Ministry of Capital Investments

## **5. INDUSTRIAL PARKS**

**Current situation:**

The shortage of appropriate land for the construction of factories, business premises, and other facilities is the key obstacle to increased investment in Serbia. In addition to the problems relating to the availability and acquisition of land, infrastructural shortcomings and complex administrative procedures create difficulties. The development of a number of industrial parks and service centers would give a significant impetus to promotion of Serbia as a suitable destination for foreign investment.

Publically funded or otherwise subsidised industrial parks, albeit permissible under EU regulations, are not as preferred as privately funded equivalents. This Action Plan proposes a variety of other subsidies that the Government will utilize (tax incentives, staff training, preparation of land etc.) until eventual EU accession when the practice will be done away with due to overriding EU policy. It needs to be borne in mind that subsidies are economically unsound and present an inefficient use of taxpayer receipts.

It is recommended that the practise and focus on the development of the free zone concept be re-examined and whether the needs of some existing users could be better addressed with opening more Customs Bonded Warehouses. The legislative status of free zones should be aligned with EU procedures.

**Planned objective:**

To set up industrial parks in Serbia.

**Recommendation**

A) Adopt amendments to the Law on Urban Planning and Construction which would provide for the setting up of industrial parks

**Deadline:** April 2006

**Competence:** Ministry of Capital Investments, Ministry of International Economic Relations

B) Enact the Industrial Parks Law

**Deadline:** July 2006

**Competence:** Ministry of International Economic Relations

C) Re-examine the concept of free-zone and open more Customs Bonded Warehouses

**Deadline:** July 2006

**Competence:** Ministry of Finance, Ministry of International Economic Relations

## **6. PUBLIC UTILITIES AND OTHER INFRASTRUCTURAL SERVICES**

**Current situation:**

The field of public utilities is governed by the Public Enterprises Law and the Public Utilities Law. On the basis of the five criteria laid down by the Public Utilities Law, the costs of utility services are set by the public utility companies and approved by the municipal or city authorities. According to Article 21 of the Public Utilities Law, state-owned capital in public utility companies can be privatized only up to 49% of the total value of State-owned capital. The enacted Law on Amendment of Public Enterprises Law stipulates that the costs of utility services have to be aligned with the government price increase policy and sets the percentage of state capital that can be transferred to employees as shares, without compensation.

The privatization of public utilities raises various issues related to timing and large-scale systems in question. It is easier to privatize some utilities than others, for example it is easier to sell the parks service, graveyard, and transportation etc., than it is to privatize Water Board, Telecom and sewage due to the size of the systems in place. The latter are organized as a system of network and standard model can be applied: company is divided to production, transfer and distribution. The distribution is sold first, then production, while there are three solutions for networks: first, to remain owned by state;

second, to give in concession, and third, to sell. In all three cases, a public agency will be needed for entering foreign capital in the domain of the network. One agency with several departments can service all three networks.

**Planned objective:**

To offer efficient public utility services at appropriate costs, to provide a permanent and independent source of finance for the sector, to allow entry of private capital through elimination of monopolies held by public utility companies and to create a market environment.

**Recommendations:**

Prepare draft amendments to the Public Enterprises Law and the Public Utilities Law to lay down more precise criteria for the determination of costs of public utility services and the elimination of monopolies held by public utility services and their (partial) privatization.

**Deadline:** June 2006 (initiate adoption procedure)

**Competence:** Ministry of Economy and Ministry of Public Administration and Local Self-government

## **6.1. ELECTRICITY**

**Current situation:**

The new Energy Law, enacted in July 2004, provides for the establishment of the Energy Agency within for months of the enactment, but the Agency was set up in June 2005. The delay in establishing the Agency has caused the failure to observe other deadlines on enactment of bylaws set by that Law. Enactment of the methodology for calculation of tariffs is planned for June 2006.

Rule for setting criteria on performing the energy related activities has been enacted. The energy Agency is competent for issuance of license for performing energy related activities.

As of July 2005, the JP EPS, public company for electric power production and distribution was split in two parts. New JP EPS which continued the production, distribution and sale of electric power, and JP EMS, electric power network for transfer of electric power and management of power system.

**Planned objective:**

In accordance with the EU accession process and Agreement on setting up a regional energy federation of SEE, the goals of the energy sector reform that are set in the Energy Law and Energy Strategy of Serbia can be grouped, as follows: increasing efficiency, stability of supply, environmental protection and introduction of renewable energy sources, and development and opening of energy market.

**Recommendation:**

More effective enforcement of the Energy Law

**Deadline:** set out in the Law

**Competence:** Ministry of Energy and Mining

## 6.2. WATER SUPPLY AND SEWERAGE

### **Current situation:**

There is no sufficiently reliable record of the existing water supply and sewerage network, due to the large number of illegal facilities and/or connections. Records in Belgrade cover 70% of the network, but other cities have far lower performance in terms of accuracy of records due to an insufficient level of technical and technological skills in the public utility company in charge of water supply and sewerage. Republic Geodesic Institute keeps the record of water supply and sewerage network and maintains it. Also, it is qualified for the development of digital plans of water supply and sewerage network. Initiation for the improvement of this register should come from individuals and very utility companies.

With the privatization of the sewerage board it can be linked with water supply, where the percentage of water supply would mean accepting of the same percentage of waste waters.

### **Planned objective:**

To update the records of water supply and sewerage infrastructure

### **Recommendations:**

Updating of records of the existing water supply and sewerage network, with gradual introduction of digitalized delivery line plans

**Deadline:** underway

**Competence:** Republic Geodesic Institute and Local Self-Government and local water supply and sewerage utility companies.

## 6.3. TELECOMMUNICATIONS

### **Current situation:**

An essential obstacle to more efficient business operations is lack of phone lines and the poor quality of connections. Due to the monopoly in the field of land line networks, international calls are very costly. At the same time, the existing duopoly effectively prevents any decrease in mobile phone lines and two operators do not observe the agreement on interconnection and charging of calls. The fact that land line and mobile networks within Telekom Srbija are not separated is another form of dishonest competition – the mobile network does not pay for using the land line network of its company. Internet connections are underdeveloped and expensive. Also, the cable network is not legally regulated: only two operators pay for the programs, none of them pay for their licenses, and the manner in which the network is to be introduced is not laid down by the law.

Currently, competencies in the area of ICT are divided between several ministries and state bodies. This impedes adoption of essential regulations and efficient communication between the private and public sector.<sup>60</sup>

The highest priority on the ICT front is the expedient legal reform of the sector so that firms may adapt appropriately.

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<sup>60</sup> The establishment of the organization on the Government level that will be competent for all activities concerning ICT sector especially development and management of IT as well as coordination of all these activities with other relevant state institutions, should be considered.

**Planned objective:**

To liberalize the telecommunications sector, improving its efficiency. Greater competition will be achieved in fixed-line and mobile telephony with the entry of other carriers into the marketplace.

**Recommendations:**

(A) Adopt the Telecommunications Development Strategy

**Deadline:** April 2006 (initiate adoption procedure)

**Competence:** Ministry of Capital Investments

(B) Enable effective functioning of the Telecommunications Agency

**Deadline:** April 2006

**Competence:** Ministry of Capital Investments

(C) Regulate YU domain registration – adopt the Rulebook

**Deadline:** June 2006

**Competence:** Ministry of Science and Environmental Protection, Agency for Internet and Informatics

(E) Adopt the Law on Electronic Commerce and Electronic Contracts

**Deadline:** April 2006 (initiate adoption)

**Competence:** Ministry of Trade and Tourism and Ministry of Science and Environmental Protection

## 7. TRANSPORT

### 7.1. AIR TRANSPORT

**Current situation:**

JAT is a major problem when it comes to privatization of transportation sector assets. It is an inefficient operator which is over-staffed and overburdened with resulting overheads. As an illustration, Croatia Airlines has 1000 staff and the same revenues as JAT, whereas JAT has approximately 3.6 times more staff than is required. The solution would be to immediately commence the privatization process.

The reconstruction of the Belgrade Airport that is underway should complete.

Restructuring and privatization of JAT is underway in order to adjust this national air-carrier to the provisions of the recently signed Open Skies Agreement. Its implementation will make Serbia a part of single international market and allow for the arrival of low-cost air carriers. Low-cost carriers will be an incentive for tourism and support services, hotels, restaurants, construction industry, etc.

It is necessary to adopt legal regulations for aeronautics that will be accorded with EU Rulebook - 2409/92.

**Recommendations:**

A) Enact the Aeronautical Law

**Deadline:** June 2006

**Competence:** Ministry of Capital Investments

B) Enable the air-carriers organizing low-cost passenger transport to operate via the Internet

**Deadline:** June 2006

**Competence:** Ministry of Capital Investments

D) Improve the layout of the Belgrade Airport and bring about modernization, better service, high sanitary levels, reduced smoking areas, and clear marking of taxi areas

**Deadline:** underway

**Competence:** Ministry of Capital Investments

## **7.2. Road Transport**

### **Current situation:**

Existing regulations on road traffic separately treat domestic and international transport, on the other hand transport of goods and passengers are regulated by the same act. Those provisions are not in compliance with EU rules.

The Government of Serbia's proposed concessions for motorways Subotica-Pozega and Nis-Dimitrovgrad should soon be discussed by the National Assembly of the Republic of Serbia.

The Ministry of Capital Investments of Serbia is in the process of concluding an agreement with other countries' ministries of transport concerning the number of permits for goods transport, while the Serbian Chamber of Commerce grants these permits to specific companies. Nevertheless, the permits designated for Serbian carriers, who are more competitive than others, tend to run out in a short time. Through international negotiations, Serbia can increase the total number of permits.

### **Recommendations:**

A) Enact the Law on Passengers' Transport and the Law on Goods' Transport, both in accordance with EU rules

**Deadline:** third quarter of 2006

**Competence:** Ministry of Capital Investments

B) Grant concessions for the construction of motorways (Subotica-Pozega, Nis-Dimitrovgrad)

**Deadline:** underway

**Competence:** Ministry of Capital Investments

C) Negotiate a higher number of permits for forwarders and carriers

**Deadline:** to be set annually

**Competence:** Ministry of Capital Investments

### 7.3. Inland Waterways Transport

**Current situation:**

This means of transport is about to be legally regulated and aligned with EU Rulebook. The inland ports in Serbia are in poor condition after years of neglect, and need refurbishing. Despite individual efforts to refurbish the ports and the river banks, a large economic potential remains unused.

**Recommendations:**

A) Enact the Law on Inland Waterways Transport

**Deadline:** third quarter of 2006

**Competence:** Ministry of Capital Investments

B) Propose a plan of measures for improvement of river ports

**Deadline:** May 2006 (for the proposal of measures)

**Competence:** Ministry of Capital Investments

## 8. TRAINING AND SKILLS UPGRADE

**Current situation:**

Drafting of the Education Strategy is underway and will be followed by the adoption of the Law on Education of Adults; these regulations must be aligned with *acquis communautaire* (European Educational Space). The currently applicable regulations do not provide for certificates that would be issued to adults, nor do they lay down a mechanism for recognition of such certificates. A National action plan for the implementation of the Copenhagen criteria of 2002 and of the Communiqué of European Ministers in Maastricht in December 2004 has been drafted and it is being implemented in line with efforts made by the European Training Foundation of Torino.

Furthermore, the National Employment Strategy, aligned with the principles of the European Employment Strategy and Lisbon Convention has been adopted. Its main objectives include full employment, work quality and productivity, social cohesion, and reintegration in the labour market. The Strategy has identified 10 general priorities to which two further priorities (support to business operations of foreign investors and leveling of differences between regional labour markets) were added to take into account the specific situation of the Serbian labour market.

It is lofty to expect that Serbia can reasonably aim at achieving full employment at this stage of its transition. With the unemployment rate hovering at around 35%, it would be more realistic to focus on stimulating the levels of private sector development, re-educating the public service, and generally focusing on the cause of unemployment and not its symptoms.

Given the technological obsolescence of Serbian companies, new market-driven solutions based on greater R&D and innovation need to become a part of the Serbian commercial culture. The Law on Scientific Research and Development and Innovation Activities Law have been adopted. Their implementation will lead to freedom in of research activities and liberalization of financing science and research projects. SMS should have access to research results when they need, because the planning based on science proved to be ineffective. A vital starting point for this endeavor is ramping up the pace of reform in the tertiary education sector.

The current liberal policy stance towards tertiary education reform is positive. The Polish experience demonstrates that 15-20 years is required for the development of a private university sector that will be on par with the public universities. The competition will influence the quality of tertiary institutions.

**Note:**

The European Agency for Reconstruction (EAR) is implementing the Vocational Education and Training Reform Program – VET Serbia. This Program aims to identify the measures necessary to upgrade knowledge and skills in the Serbian workforce in accordance with the needs of foreign investors.

**Planned objective:**

To integrate of Serbian education with the modern European education area, to provide knowledge and skills tailored to the changing demands of modern business, to create a qualified workforce that is responsive to the needs of foreign investors (to serve as a competitive advantage of Serbia), to facilitate the creation, development, and operation of innovative SMEs, and to support a technological upgrade of the existing enterprises.

**Recommendations:**

A) Adopt the Vocational Education Strategy and Policy

**Deadline:** May 2006

**Competence:** Ministry of Education and Sports

B) Enact the Law on Education of Adults

**Deadline:** August 2006 (initiate adoption procedure)

**Competence:** Ministry of Education and Sports

C) Coordinate and take part in implementation of the VET Serbia Program in the area of vocational education and training reform, with the particular aim of upgrading skilled workforce for manufacturing, by setting up schools (regional training centers) for training of redundant workers at manufacturing enterprises and university graduates in the following areas:

1. Operators (process operational skills, organizational skills and personal attitudes toward quality production);
2. Engineering (CN/CNC operational skills, measurement skills, documentation and statistical skills and personal attitudes toward quality production);
3. Group leaders (project work, team work, skills in production and production flow management) and
4. Quality assurance, planning and control.

**Competence:** Ministry of Education and Sports, in cooperation with line ministries (Ministry of Labour, Employment and Social Affairs) and the representatives of competent institutions and experts from the Serbian public and private sectors.

D) Implement the National Employment Strategy

**Competence:** Ministry of Labour, Employment and Social Affairs, in cooperation with line ministries, social partners and other interested institutions.

E) Appoint the members of the advisory body of the Ministry of Education or the Government of the Republic of Serbia from among the representatives of the Ministry of Education, Ministry of Economy, Ministry of Labour, Employment and Social Affairs, Ministry of Science and Environmental Protection, Ministry of International Economic Relations, businessmen and experts, with a view to providing advice in the field of improvement of vocational education

**Deadline:** April 2006

**Competence:** Ministry of Education and Sports, in cooperation with line ministries.

### **III COMPANY OPERATIONAL PROCEDURES**

#### **1. LABOUR LEGISLATION**

**Current situation:**

The influence of labour legislation on businesses in Serbia significantly improved after the enactment of new legislation in 2002 and 2005. Yet, there is a room for further improvement of labour legislation that was taken from the "self-management period" listed as amendments of MPs during the enactment of Labour Law in 2005.

Salaries received for work and time spent at work are comprised of the base salary, job performance part and increased salary. The use of average salary for calculating salary while being on leave is inappropriate as it affects the increase of part of salary that is given for job performance when there was no job performance.

**Planned objective:**

Delete from the Labour Law the provisions that were taken from old legislation (self-management period).

**Recommendations:**

Remove from the Labour Law the following provisions:

- Provisions of Article 108 relating to the right to increased salary, based on number of years at work.

- Provisions of Article 108 relating to the right to right to free nutrition and vacation allowance.

Item 2 of article 108 according to which the salary shall be increased for working at night and in shifts, should also change. Provision of Item 2 that allows for increased salary for working in shifts should delete, since the right to increased salary was provided for working in shifts.

Provisions on salary while being on justified leave (Articles 114, 115 and 116) should change and, calculate the salary based on base salary instead of average salary in last three months.

**Deadline:** April 2006

**Competence:** Ministry of Labour, Employment and Social Policy.

## 2. TAXATION

### Current situation:

The number of taxes and other levies still exceeds the optimum level. Potential weaknesses of the current situation are particularly reflected in the contrast between low corporate income tax rate (10%) and high payroll tax and collection of numerous charges and fees which the course of regular operations (mainly in the field of utilities and infrastructure). Furthermore, many municipalities in Serbia tend to set unreasonably high environmental charges without applying any defined criteria, ignoring the applicable instructions given by the Ministry of Science and Environmental Protection.

There exists a somewhat paradoxical taxation climate within Serbia. On the one hand, personal, corporate, and VAT tax rates are some of the lowest in the region (profit tax, corporate income and VAT of 18% is not high). The first two taxes are charged based on linear tax rate. Tax incentives are provided to all enterprises, regardless the size, for investment in fixed assets and registered business activities (small enterprises have higher allowances for special operations) and hiring new employees. However, the payroll tax rate is an enormous 73% and government expenditure hovers at around 55% of GDP (the highest rate in Europe). Therefore, it is imperative that fiscal policy be overhauled in order to:

- a) Ensure that government expenditure plateaus at around 40% of GDP (some EU members have capped government expenditure at around 30% successfully, such as Lithuania, Ireland, Albania).
- b) Eliminate all taxes where the costs of collection exceed receipts is recommended;
- c) Entrench fiscal federalism.

Insofar as it is implausible to achieve all of the above goals simultaneously, it is highly advisable that taxation policy heads in the above direction.

Specific models of tax incentives are not adjusted to the structure of investments in Serbia. The 10-year tax exemption for any investor that invests CSD 600 million and employs at least 100 persons is intended as a key incentive in the Corporate Income Tax Law. Criteria thus tend to stimulate only large-scale investments from the aspect of SMEs (with notable exception of the tax credit for new employment and for fixed investments).

The implementation of tax incentives is also hampered by the undefined and vague approach to the devastated areas and areas of special interest. The areas of special interest have to be determined according to instructions on tax incentives defined by tax legislation. Devastated areas are not treated in tax laws, and there exists no recommendation concerning the application of tax laws to these cases. A certain number of incentives relate to the underdeveloped areas, defined by the 1995 Law on Underdeveloped Areas for a 10-year period, and a new law should be enacted to extend the incentives.

Fiscal decentralization<sup>61</sup> should be introduced in the territory of Serbia. Several reasons exist for this. Firstly, this may prove to be a powerful local development tool as may be evidenced from the experience of the Indjija and Pazova municipalities. Secondly, other

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<sup>61</sup>: Known as *fiscal federalism* in economic theory

municipalities will feel greater competitive pressure to follow suit and utilize budgetary resources in a more efficient manner. Thirdly, this will provide a lower cost stimulus for firms and entrepreneurs. Regulatory options will be considered that may eventually lead to the introduction of treasury mechanisms that will apportion a percentage of the Republic revenues derived from personal income taxes, corporate profit tax and excise duties to competitive municipalities. These potential mechanisms will be simulatively structured on a sliding-scale basis that will be proportional to the local municipal tax structures. Such measures will be instrumental in boosting budgetary flows to municipalities that offer simulative taxation structures for businesses relocating/investing in their respective local government jurisdiction.

The Corporate Income Tax Law lays down that up to 3% of annual capital turnover can be allocated to advertising.

There have also been certain problems in the practical implementation of value added tax (VAT). At the Belgrade Airport, for example, there is not a window in charge of administering VAT refunds and the office that is rather difficult to find. Moreover, the information concerning VAT refund stated at the Airport is written in poor English. Foreign nationals need to have the "REF 4" form in order to have their VAT refunded; this form can only be taken in the store where goods are purchased, but most retailers in Serbia do not have it. If the country of origin has concluded a Social Insurance Convention with Serbia and Montenegro, double collection of social insurance contributions is avoided.

The financial year of an investor often differs from the calendar year, but the Tax Administration deems the financial year of a company to be over on the 31<sup>st</sup> of December.

Also, in order to improve legal certainty Ministry of Finance should publish all legal opinions connected to taxes on the Internet. This is particularly important in the sphere of legal interpretations of tax laws and would generate greater certainty amongst taxpayers as to their legal obligations. Law on Corporate Income Tax defines (Article 40) that tax on income generated by non-resident tax payer from resident tax payer based on dividends and shares in legal entities, author fees, interest, capital gain and rental fee, shall be calculated at the rate of 20% upon the deduction, unless it is differently regulated by international treaty on avoiding double taxation. It is stated that taxation upon deduction shall not be calculated and charged if the income referred to in Paragraph 1, Article 40 of the Law on Corporate Income Tax is paid to the permanent business office of non-resident tax payer, referred to in Article, of the Law.

The position of Tax Administration is that the tax payer of the tax on capital gain shall be the payer of income, if the vendor is non-resident foreign legal entity.

Trading with securities is carried out primarily by brokers through regular electronic procedure on Belgrade Market, meaning that seller and buyer cannot know each other's identity. Therefore, a question can be raised about legal obligation of tax payment upon deduction by non-resident legal entity, if the buyer is a resident legal entity referred to as payer in Article 40 of the Law on Corporate Income Tax.

Such regulation can further be interpreted as if the buyer of shares is resident or non-resident legal entity, such obligation does not exist and that is directly connected with domicile legal entity. This ultimately leads to unequal position and treatment of participants in the financial market.

At the moment of calculating capital gain tax upon deduction for sold shares, the payer (resident legal entity) cannot know how much the seller (non-resident) paid for the share that was sold in the market, and therefore it is not possible to calculate and fill in the corporate income tax form (PDPO) at the moment of payment of the purchase price for shares (electronic clearing in the Central Registry, T+3) in accordance with Article 40 of the Law on Corporate Income Tax.

It happens in practice that Tax Administration does not issue a certificate confirming that non-resident legal entity covered its tax obligation with the Republic of Serbia, because there are no clear instructions for that. In this case the bank cannot transfer legal entity funds in accordance with Article 25 of the Law on Foreign Currency Transactions, and in practice there are foreign investors whose funds have been kept since June 2005.

**Planned objective:**

To introduce a clear and simple fiscal system of both central and local authorities with the minimum number of different levies and different rates, to define clear and centralized criteria for determination of local charges and fees in order to eliminate the frivolity of local self-government bodies. The determination of local tax rates should remain the prerogative of municipalities. This will instill a competitive spirit amongst municipalities that are serious in attracting greater business and investment. The Republic government will only determine the lower and upper limits for local taxes, whereas the municipalities will be unfettered in choosing their desired local tax rates.

Creating the conditions for incentives targeted at increasing the frequency of foreign investments and the development of entrepreneurship; to encourage investments in SMEs and other types of investments suited to the Serbian market; to establish a clear framework for application of tax incentives; to improve the procedures applied by Tax Administration to the implementation of VAT and to apply the concluded Double Taxation Treaties and Double Social Contributions Treaties.

**Recommendations:**

A) Develop a detailed study on possibilities for lowering of the burden on economic activities in order to acquire a complete insight into expenditures arising for economic operators on the basis of taxes, duties, fees and other costs charged by the Republic, local self-governments and public enterprises

**Deadline:** May 2006

**Competence:** Ministry of Finance, in cooperation with the line ministries (Economy, International Economic Relations, Mining and Energy, Capital Investments, Trade, Tourism and Services, Science and Environmental Protection, Agriculture, Forestry and Water Management, Public Administration and Local Self-government).

B) Amend relevant laws and prescribe tax incentives for environmentally responsible behavior, investment in research and development, ongoing employee education and training and opening of industrial parks. Solve the problem of tax on capital gain.

**Deadline:** May 2006 (initiate adoption procedure)

**Competence:** Ministry of Finance

C) Rectify the practice of Tax Administration, which, for the purposes of tax charging, does not distinguish between the calendar and the financial year

**Deadline:** April 2006 (initiate adoption procedure)

**Competence:** Ministry of Finance

D) Improve the practice of competent services in connection with VAT refund, and the control over the operations of economic operators and retail outlets, with particular emphasis on refunds made to foreigners

**Deadline:** April 2006

**Competence:** Ministry of Finance

E) Resolve the issue of payment of social contributions for nationals of foreign countries with which Serbia and Montenegro has concluded an agreement to that effect

**Deadline:** Third quarter of 2006

**Competence:** Ministry of Finance, Ministry of Labour, Employment and Social Affairs

F) Identify and declare the underdeveloped areas, devastated areas, and areas of special interest, as referred to in tax incentive rules laid down by tax laws

**Deadline:** May 2006

**Competence:** Ministry of Economy, in cooperation with the Ministry of Finance

G) Define more precise criteria and create penalties in connection with determination and collection of local charges and fees, including local fee for environmental protection, in order to avoid legal uncertainty.

**Deadline:** Third quarter of 2006

**Competence:** Ministry of Public Administration and Local Self-government in connection with local government units, Ministry of Science and Environmental Protection and Ministry of Trade, Tourism and Services.

H) Adopt Law on Local Government Financing and implement fiscal decentralization that will stimulate greater taxation competition between municipalities.

**Deadline:** Third quarter of 2006

**Competence:** Ministry of Finance in connection with local government units.

I) Expedite the implementation and application of a single tax information system.

**Deadline:** May 2006

**Competence:** Ministry of Finance.

I) Publish on Internet all tax legal opinions

**Deadline:** April 2006

**Competence:** Ministry of Finance

## **2. FOREIGN CURRENCY TRANSACTIONS AND FOREIGN CREDIT ARRANGEMENTS**

### **Current situation:**

The Law on Foreign Currency Transactions enacted in April 2002 introduced full liberalization of payment abroad by removing some old restrictions, based on which the IMF determined external convertibility of dinar in current transactions on May 15, 2003. For capital transactions, the principle of partial and gradual liberalization of long-term capital operations first, followed by short-term ones. The new Draft Law on Foreign Currency Transactions that is in the Parliamentary procedure envisages further liberalization of capital accounts. It defines the possibility of payment for investment in long-term securities, based on direct investment and portfolio investment. The limitation is kept only for short-term portfolio investment, except for authorized banks.

The new Draft Law on Foreign Currency Transactions regulates payments by residents and non-residents based on investment in foreign and domestic long-term securities, investment and voluntary pension funds. The Draft Law allows for transactions based on investment in securities nominated in foreign currency (issued by residents and non-residents). This will improve the development of financial market in Serbia. Provisions of the Law that is currently applied are constraints to development of financial market.

In accordance with the Law on Foreign Currency Transactions, a resident of Serbia is permitted to carry out of the country a total of Euro2000 (or equivalent) in hard currency. Foreign nationals on the other hand, upon entering the country are obliged to declare the amount of currency they are bringing into Serbia, for which an official customs declaration is issued. This restriction is in the function of preventing money laundering. It is somewhat paradoxical given that a resident of Serbia may spend unlimited amounts of currency overseas by utilizing their credit card facilities.

Additional payments provided by the previous Company Law were simple and efficient mechanism for the financing of companies by their parent companies or owners without increasing registered capital or using inter-company loan mechanism but this model is excluded from the new Company Law

### **Recommendations:**

A) Adopt the Law on Foreign Currency Transactions.

**Deadline:** June 2006.

**Competence:** Ministry of Finance and the National Bank of Serbia

B) After the enactment of the new Law on Foreign Currency Transactions reconsider the amount of hard currency that can be carried out and brought in at border crossings, and enact new bylaw on this matter.

**Deadline:** Four months after the enactment of the new Law on Foreign Currency Transactions

**Competence:** Ministry of Finance and the National Bank of Serbia.

C) Return in the new Company Law the mechanism provided in the previous law regarding the possibility of additional payments as a possibility of financing companies by mother companies or owners without increasing registered capital.

**Deadline:** Third quarter of 2006

**Competence:** Ministry of Justice

### 3. CUSTOMS AND INSPECTION

#### **Current situation:**

The past few decades have displayed a global trend towards the elimination of non-tariff trade barriers alongside a constant reduction of customs duties. Currently the median customs duty in Serbia stands at 6.3% notwithstanding the planned reductions in accordance with numerous free trade agreements. Other south east European countries that are members of the WTO have significantly lower average customs duties.

In 2005, Ministry of Interior, customs, veterinary and phyto-sanitary authorities significantly improved their work at border crossings. Pharmaceutical and sanitary inspections do not perform quality control of products on the border crossing any more, but inside the country. Although this measure significantly improved the turnover of goods, which is confirmed by official measurement of waiting period of goods at the border crossing, the Commission in charge of preparation of the National Strategy on Republic of Serbia Border Crossing Management is still working on alignment of this sector.

Some inspection services lack clear legal frameworks and resources for their operations, such as the veterinary, phyto-sanitary, and sanitary laboratories and health inspection, and many of them lack modern equipment.

When sampling food and pharmaceuticals at border crossings, the competent control services tend to take larger than necessary quantities of goods. The long waiting period at the border is due to the short working hours of the control services, which in turn affects the freshness and quality of foodstuffs. Due to the long waiting periods at border crossings, companies like *DHL*, *FedEx* and *UPS* often refuse to carry packages of foodstuff samples, while the companies in charge of clinical testing are often unable to comply with the deadlines of large global manufacturers of pharmaceuticals. These problems will have to be solved according to international practice.

In the past year, the inspectors introduced the practice of sampling minimum quantities of goods for analysis and properly forwarded samples to the importer/shipping firm (inspections do not keep any samples in their offices), where the samples are kept until the end of procedure. This should become a model for all inspections.

Furthermore, the current Organic Agriculture Law is not properly harmonized with EU regulations. The Law does not stipulate necessary incentives for organic food producers and does not stimulate development of organic agriculture in any way. Therefore, it is viewed as a barrier, since it does not define the conditions for organic food production. In addition, this Law is nonrealistic and nonfunctional in terms of control and certification.

Through implementation of the food safety system, the Government of Serbia will provide its population with sufficient quantities of sanitary safe food of good quality and will ensure efficiency and cost-effectiveness in production and supervision. Harmonization of Serbian legal framework with the international regulations and application of binding standards will create the preconditions for export growth. Drafting of the Food Safety Strategy is underway.

Another current activity funded by the US Department of Labour and in accordance with the EU standards, is the project to integration the industrial relations inspectorate and the occupational safety inspectorate.

Taking into account the large number of objections relating to corruption stated by foreign investors, it shall be necessary to adopt the Anti-corruption Strategy within the shortest possible period, alongside with proposals of concrete measures.

**Planned objective:**

To organize and render more efficient the customs service and inspectorates in accordance with the EU standards, with clear separation of activities of each service and without overlapping, with the goal to protect life and health of people, interest of consumers and overall interest of the Republic of Serbia on international market. Serbia needs to continue with the reduction of customs duties, and focus on the elimination of non-tariff trade barriers.

**Recommendations:**

A) Simplify the customs procedure and the content of customs documents

**Deadline:** December 2006

**Competence:** Ministry of Finance

B) Define in close detail and simplify the inspection procedure through clear separation of powers of market inspectorate and other inspectorates

**Deadline:** June 2006

**Competence:** Ministry of Finance, Ministry of Trade, Tourism and Services, Ministry of Public Administration and Local Self-government, Ministry of Science and Environmental Protection and Ministry of Health

C) Enact the Law on Agency for Veterinary, Phyto-sanitary and Sanitary Laboratories

**Deadline:** Third quarter of 2006

**Competence:** Ministry of Agriculture, Forestry and Water Management and Ministry of Health

D) Adopt the Food Safety Strategy

**Deadline:** June 2006

**Competence:** Ministry of Agriculture, Forestry and Water Management, Ministry of Health and Ministry of Science and Environmental Protection

E) Enact the Food Safety Law

**Deadline:** June 2006 (initiate adoption procedure)

**Competence:** Ministry of Agriculture, Forestry and Water Management, Ministry of Health and Ministry of Science and Environmental Protection

F) Improve the operations of the phyto-sanitary service at border crossing points and make it compliant with the EU rules

**Deadline:** as soon as possible

**Competence:** Ministry of Agriculture, Forestry and Water Management and Ministry of Health

G) Finalize the reorganization of the Labour Inspectorate

**Deadline:** end of 2006

**Competence:** Ministry of Labour, Employment and Social Affairs

H) Propose a plan to improve inspection activities, establish the criteria for identification of redundant staff in all inspection services, and strengthen the operations of the inspection control commissions in line ministries.

**Deadline:** June 2006  
**Competence:** line ministries

I) Law on Anti-Corruption Agency  
**Deadline:** third quarter of 2006  
**Competence:** Ministry of Justice

#### 4. STANDARDIZATION AND ACCREDITATION

##### **Current situation:**

State Union Parliament adopted the Standardization Law, Accreditation Law, Metrology Law, and Technical Regulations Law in accordance with EU legislation. Accreditation and quality harmonization are instrumental to create a free and developed market. Ongoing bylaws will ensure more important role of Member States in the economic policy sector, since their competencies are regulated by the Constitutional Charter. The new laws envisage the reorganization of institutions and introduction of market principle of self-financing for most of them.

At present, a majority of the accredited organizations are laboratories – as many as 90%. Five organizations in Serbia have been accredited for issuing certificates of compliance with ISO standards, and more than 99% of organizations accredited by JUAT (Yugoslav Accreditation Body) are from Serbia. A majority of laboratories do not have certificates of good laboratory practice, which effectively prevents the development of applied sciences and investments in this sector. Without these certificates the laboratories cannot issue the certificates required for the import of medicinal products, foodstuffs, cosmetics, veterinary products, and industrial chemicals. At present, exporters are applying to laboratories of other countries for certificates, so that the overall procedure is longer and more expensive.

Furthermore, the current Organic Agriculture Law is not properly applied, which leads to dishonest competition. The definition of organic food in the Law is insufficiently clear and the Law itself is not compliant with all relevant international standards.

Certificates of origin of domestic goods are issued by the Customs Administration when goods are dispatched to the EU (EUR1) and Switzerland (A Form), while the Serbian Chamber of Commerce issues these certificates for goods dispatched to the Middle East (the White Certificate).

Within the EAR Project “Strengthening Quality Management, Capabilities and Infrastructure in Serbia and Montenegro”, six activities are underway. One of them concerns the improvement of functioning of the Accreditation Body, JUAT. The Project is envisaged to last until mid 2006.

##### **Planned objective:**

To create an effective standardization and accreditation system, based on new EU- and WTO-compliant quality infrastructure laws; to build organizational and technical capacity in JUAT (the Standardization Bureau and the Measurement Bureau)  
To improve of the legal framework in the field of organic agriculture.  
To establish the needed legal framework for environment protection and for management of all kinds of waste, in compliance with compatible EU regulations.

**Recommendations:**

A) Enact the Organic Agriculture Law and harmonize related bylaws.

**Deadline:** April 2006

**Competence:** Ministry of Agriculture, Forestry and Water Management

B) Adopt bylaws on good clinical practice, good production practice, good distribution practice, and good laboratory practice in accordance with the EU guidelines.

**Deadline:** May 2006

**Competence:** Ministry of Health, Ministry of Agriculture Forestry and Water Management

C) Undertake measures in order to obtain membership in the Pharmaceutical Inspection Convention (PIC) and to initiate the training of pharmaceutical inspectors.

**Deadline:** April 2006

**Competence:** Ministry of Health

D) Set up a single inspectorate in charge of good laboratory practice, to be governed by one of three potentially competent Ministries in accordance with bylaws that are to be enacted, primarily the Food Safety Strategy and Food Safety Law.

**Deadline:** August 2006

**Competence:** Ministry of Science and Environmental Protection, Ministry of Health and Ministry of Agriculture, Forestry and Water Management

E) Enact the set of laws in the field of environment protection: on management of chemicals, on management of waste, on packing material and packing material waste, on air protection and on water resources.

**Deadline:** third quarter of 2006

**Competence:** Ministry of Science and Environmental Protection, Ministry of Health and Ministry of Agriculture, Forestry and Water Management

F) Ensure efficient coordination of the European Agency for Reconstruction Project "Strengthening Quality Management, Capabilities and Infrastructure in Serbia and Montenegro" through the Quality Council of the Government of Serbia

**Competence:** Quality Council of the Government of Serbia – coordinated by the Ministry of Science and Environmental Protection of Serbia

G) Facilitate access to the entire documentation necessary for obtaining licenses for initiating clinical trials by updating the website of the Ministry of Health

**Deadline:** April 2006

**Competence:** Ministry of Health

## IV OTHER SYSTEMIC MEASURES, PUBLIC ADMINISTRATION REFORM AND REFORM OF THE JUDICIARY

### 1. OTHER SYSTEMIC MEASURES

In addition to the laws outlined in the text above, it is of particular importance to enact the following laws or amendments:

- 1) Investment Funds Law  
**Deadline:** April 2006  
**Competence:** Ministry of Finance

- 2) The following issues need to be redressed through suitable amendments to the Competition Law which contains several weaknesses:

First, the **exemptions** foreseen under Article 4, Paragraph 2 relating to “**broader social interest**” basically render the entire law redundant as it is possible to basically declare any matter as coming within this exemption. This Article should be aligned with the EU legislation according to which the exemptions shall apply only if the application of the rule **legally and factually** prevents the performance of activity of "broader social interest". Therefore, in this provision, after the words: "if the implementation of this law..." the following words should be added: "legally and factually (and especially if there is no market solution). The issue of activities of "broader social interest" should be clearly defined by separate law on defining these activities.

Secondly, EU antimonopoly legislation that implies fines for violation of competition by the First Instance Commission should be reconsidered. Serbian law gives this authority to regular misdemeanor body. The Law should be amended to allow the **Competition Commission to make decisions on misdemeanor offences** by entrusting it with this competence, in accordance with the Competition Law. This mean amendment of Articles 35 and 70, paragraph 2 of the Competition Law.

The third weakness relates to the fact that currently Competition Commission submits to the Government the financial plan by October 1 of current year for the next year, so that the procedure for financial plan adoption with adoption of Budget Law. This needs to be redressed and Article 51, Paragraph 1 of the Competition Law amended.

Fourth, the annual income for determining a limit above which it is necessary to acquire approval for the concentration. Comparison between total annual income of all participants in the concentration generated in previous year at the market of Serbia exceeding EUR 10 million and EUR 50 million<sup>62</sup> of income generated at the international market, indicates that big number of concentrations are subject to having a approval Therefore, this **limit has to be reconsidered**

Also, for the concentration of local and foreign enterprise, the level of income generated by domestic enterprise should be set below which the approval by the Competition Commission is not required. In relation to this, **another requirement** should be added to

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<sup>62</sup> Low limit was set because the referent legislation was Slovenian law that applies to much smaller market than Serbian.

Article 23, Paragraph 2, Item 2, of the Law on Competition Protection: EUR 10 million of annual income (generated at the market in Serbia) by **domestic enterprise** that is in the concentration with international enterprise.

Domestic enterprises should be given a chance to "grow" in order to be able to spread on international markets<sup>63</sup>. The fact is that barriers to the market are more important than the monopoly position that company might have. This might lead the government to the decision not to penalize domestic enterprises that have dominant position at the market, but to expose them to international competition.

Fifth, the government should define its position towards the technology monopoly (e.g. Polaroid in the past and Windows nowadays). Agreements on transfer of technology should be regulated by relevant bylaws that allow to the owner of technology to enjoy his right in a manner that affects competition at the market (use of technologies by all interested parties under the equal conditions).

Sixth, Article 66 of the Law does not envisage the "administrative silence" rule. Currently, in case when the Competition Commission fails to respond to the request for giving approval, it is interpreted as negative answer. This slows down the integration of enterprises and creates legal uncertainty. Therefore, it is necessary to introduce the rule of "administrative silence", which in compliance with EU legislation, will be interpreted as positive answer upon the expiration of specified deadline starting from the day of filing the request.

Finally, among the four pillars of EU Competition Law, the issue of **government subsidies** is not covered by Serbian Law. This may be the subject matter of a separate law, which will most probably be the case in Serbia. Draft Trade Law, in which one chapter covers government assistance and subsidies, rightfully appoints the Competition Commission as body in charge of approval and monitoring of the use of government assistance and subsidies.

**Deadline:** April 2006

**Competence:** Ministry of Trade, Tourism and Services.

### 3) Strategy for Encouraging and developing foreign investment

**Deadline:** March 2006

**Competence:** Ministry of International Economic Relations

### 4) Economic Development Strategy of Serbia<sup>64</sup>

**Deadline:** end of 2006

**Competence:** Ministry of Economy.

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<sup>63</sup> Low limits were set in Norway as well, making it difficult for Norwegian enterprises to grow above certain size. Therefore, Norway does not have any domestic transnational company. The example of Sweden, a country with many legal and historical similarities to Norway is opposite: having no such low limits, some Swedish enterprises managed to expand from domestic market and grow into transnational companies (e.g. Volvo, IKEA, etc.)

<sup>64</sup> The discussions about strategies on various social areas, including the strategies on specific economy sectors, that are very present in Serbia since 2000, it should be stressed out that there are justified opinions according to which the government should be in charge only of setting the market rules, while the enterprises should develop their own strategies.

## **2. PUBLIC ADMINISTRATION REFORM**

### **Current situation:**

At the beginning of November 2004, the Government adopted the Public Administration Reform Strategy as well as the Action Plan for implementation of the Strategy for the period 2004-2008. This document contains a list of concrete measures and activities with the dynamic implementation plan.

Strategy implementation is ongoing. In addition, the enactment of Government Law, Public Administration Law, Law on Public Agencies, Law on State Administration Employees, Law on Prevention of Conflict of Interest with Employees Performing Public Functions, Law on Access to Public Information, Ombudsman Law and Electronic Signature Law, almost completes the new legal framework for building the professional public administration in Serbia. The implementation of these laws, together with the process of continuous training of public administration employees, shall make public administration in Serbia capable to take the responsibility for implementation of reforms in other areas of social life. This includes efficient implementation of recommendations given in this document.

Considering that the Serbia Public Administration Reform Strategy applies to central administration and local government bodies, the continuation of ongoing decentralization of authorities through adoption of legislation and intensive training of local servants that will enable efficient, lawful and accountable functioning of local government bodies and quality performance of their responsibilities vested on them through decentralization, will create the conditions for cities and municipalities to take active role in providing incentives for FDI.

The creation of conditions for the implementation of the Electronic Signature Law will result in modernization and increase of administration efficiency, both on central and local level. Furthermore, the implementation of the Law on State Administration Employees and enactment and implementation of the Civil Servants Law, based on depoliticizing and professionalism, will make public administration in Serbia stable and independent on political changes, as a critical precondition for FDI.

### **Planned objective:**

To make professional, accountable and efficient public administration and local government, able to provide high quality services to citizens and other interested parties.

### **Recommendations:**

Continue with implementation of the Action Plan for public administration reform in Serbia, with regular evaluation of implemented measures and activities.

### **Deadline:** In line with the Public Administration Strategy

**Competence:** Ministry of Public Administration and Local Self-government together with the line ministries, organizations and authorities in charge of public administration reform and adequate associations.

### 3. REFORM OF THE JUDICIARY

#### **Current situation:**

Reform of the judiciary is an area essential for overcoming obstacles to FDI. The rule of law is non-existent without good and efficient regulations and an efficient and independent judiciary.

Some positive steps are made in education of judges that is continuously implemented in all segments of law. The efficiency of courts functioning is regularly monitored through monthly, quarter, six month and annual reports on functioning of courts and judges. The reports are submitted to the Ministry of Justice and the Supreme Court of Serbia.

The Ministry of Justice monitors execution of court orders within the prescribed deadlines and execution of appeals and complaints. The Supreme Court of Serbia determined Measurement Criteria for assessment of minimum performance of judge's function that will be temporarily applied until January 1, 2007, when Articles 21 to 28 of the Law on Courts will become effective. These Measurement Criteria will enable the assessment of professional abilities, diligence and performance of judges.

Focus on specific fields of law, like the protection of intellectual property and competition raised the need for education and development of judges to meet the needs of modern business both in civil proceedings and in execution of enforceable court orders.

The arbitration procedure, as a mode of resolving disputes, is underdeveloped<sup>65</sup>. Furthermore, the Serbian legal system does not include notaries (public scriveners), who could take a certain amount of burden of the courts (e.g. certification of signatures). The resources available to courts are insufficient for high-quality performance of their roles.

#### **Planned objective:**

To create of a judiciary system with sufficient expertise and efficiency to respond to the needs of modern business, where expedience and safety come first.

#### **Recommendations:**

A) Enact the Arbitration Law

**Deadline:** April 2006

B) Intensify the work on modernization of courts and on training of judges in the areas with lower level of competence, enhance the use of the information technology, inter-linkage of courts in the Republic and to other government organizations, and establish electronic databases.

**Deadline:** underway

**Competence:** Ministry of Justice

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<sup>65</sup> According to Labour Law individual and collective disputes can be resolved through arbitration. Special Law on Peaceful Resolution of Labour Disputes was enacted at the end of 2004. This Law sets the procedure for resolution of individual and collective labour disputes through conciliation or arbitration. Its implementation gave some good results in peaceful resolution of disputes.

## APPENDIX 2

### GENERAL INFORMATION ON FREE ZONES

The free zones concept represents a modern type of economy extraterritoriality and is characterized by a physically fenced in and marked territory within a country; it provides for additional guarantees and a stimulating environment for operating a business. There are more than 5.000 free zones in 120 countries around the world. Although their development levels vary, more than 20% of total international trade is performed through free zones.<sup>66</sup>

Main free zones attractiveness factors are: favourable customs treatment, certain tax relief and simplified administrative procedures.

Free zones are hosts to a variety of economic activities - aimed at encouraging exporting activities in a sense of increasing foreign trade levels of a host country and positively contributing to domestic economy.

Free zones are typical for developing countries, especially countries in transition. Depending on a broadness of the accepted definition, free customs zones could also include zones in developed countries – USA, UAE, Great Britain, The Netherlands, France, Ireland, etc. – that are slowly moving away from the classical concept with new tendencies characterized by:

- Evolution of classic, productivity-oriented zones dominated by specialty services (global trend of service sector expansion due to rapid developments in telecommunications and technology),
- Expansion of former enclaves onto wider territories (special economy zones in China or a whole province in Thailand);
- Transformation of free zones into scientific parks (areas close to university campuses or large institutes mainly engaged with agri-business or bio-engineering research);
- Establishment of special zones dealing only with “offset” procurements (large procurements of developed countries’ governments – weapons, medical equipment, telecommunication systems, energy systems and energy produced in the host-country).

Nevertheless, a huge effect from implementing the concept has been achieved in countries that used it to lessen problems arising from transition:

- **Increase of exports and foreign currency inflows** (Hungary has exported goods and services valued at \$9 billion through free zones in 2001),
- **Creation of new jobs** (40.000 employees work in Mexican free zones; first 28 zones in Hungary employed around 26.000 people),
- **Establishing cooperation between companies located in a zone and “outside” companies** (world-known names located themselves in Hungarian free zones and developed cooperation with a number of domestic companies engaging them as partners, sub-suppliers, for freight services, etc.),
- **Increase of FDI and transfer of new technologies** (500 companies operate in Turkish free zones through which \$400 million had been directly invested in

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Turkish economy. In 2004 turnover of Turkish free zones was \$22 billion with 40.000 new jobs created),

- **Efficient method of the economy in the function of going regional** (Free zones concept might be the best providing tool for efficient implementation of a regional development plan and advancement of certain, economically underdeveloped regions).

Situation in the environment speaks in favour of free zones. All neighbouring countries have involved themselves in developing the concept and, in relation to that, adopted certain legal solutions which have given good or less good results. Generally, free zones in the neighbourhood (except in Hungary<sup>67</sup>) are just being developed now which is a chance for Serbian free zones.

For better success and operating of the zones in is necessary that the host country provides certain conditions, which means: the existence of a unified and encouraging Law on Free Zones, general legal and political certainty, available and less-costly work force, liberal import-export flows, minimal administrative procedures, quality financial services, developed infrastructure and telecommunications.

The first step in supporting the free zone concept should be the development of a quality, liberalized, fully autonomous and affirmative legal solution that would precisely define all terms and institutions important for business operations in a zone and would, in detail, systematize all other areas.

In such way, all negative outcomes of non-harmonization and legal gaps would be avoided in legislature. In that sense, it is of a special concern to define the following areas:

1. **Taxes and contributions**

(The main significance in existence of free zones is in tax incentives and relief system)

2. **Labour relations and zone employees' status**

(Present labour legislation is applied on some issues, important for any enterprise that is operating in the Free Zone).

3. **Customs regulations**

(Necessary to define a procedure for customs processing within zones, especially when it comes to production).

4. **Foreign currency and international trade**

(Define a way and appropriateness of handling foreign currency, ways of getting and suitability of international loans, way of establishing domestic and foreign banks' branch offices in zones, foreign currency remuneration methods between a managing company of the zone and zone users).

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<sup>67</sup> Free Zones in Hungary went through long and hard way towards the success. Since their establishment (1982), until the beginning of the Nineties the Free Zones stagnated, but after the enactment of the law that facilitates Free Zones they significantly developed. Until recently, 43% of all export activities were carried out through Free Zones. Since Hungary recently became a member of EU, it is clear that Free Zones had big impact on increase of FDI and foreign inflows, reduction of unemployment and promotion of national economy. In accordance with EU requirements, Hungary had to align its legal regulation within a three year period and abolish some allowances to Free Zone clients (EU does not require abolishment of Free Zones). It is assumed that a number of investors will operate in the Free Zones, but many other will move their investments to neighboring countries located along the EU borders. This represents an opportunity for Free Zones in Serbia.

**5. Construction land and building of amenities**

(It is necessary to define a cohesive and encouraging procedure for obtaining construction licenses (building permits), system of exemptions or incentives in a process of paying fees and taxes regarding the issue, as well as fees for renting facilities).

**6. Zone managing company authorities**

(Authorities of a zone managing company. Authority has to be precisely defined – it would have to be of an autonomous character and to follow the liberal nature of zones, but only with clearly defined rights of a managing company towards the state and clearly defined modalities for control and zone performance monitoring).

There are different interpretations of Free Zones. One interpretation is supported by argument that special regime of operation in Free Zones ruins the competition and that equal development of all areas and increase of competitiveness should be achieved by creating simulative business environment on the entire territory with legal and political stability, skilled workforce, liberal export-import, minimum administrative procedures, quality financial services, developed infrastructure and modern telecommunications, modern technology and innovative activities and encouraging tax policy, especially for the investment in underdeveloped parts of the country.

Local regulation on Free Zones should be aligned with EU regulation. In addition, needs of current users of Free Zones in Serbia can be addressed by opening more Customs Bonded Warehouses.

## **APPENDIX 3**

### **FURTHER DETAILS ON CONCESSIONS**

The Strategy, which also intends to support private sector development, should rely on concessions promotion – a confirmed modality of cooperation between private and public sectors in a wide variety of areas.

Investment opportunities in Serbia have been significantly increased thanks to the adoption of the Concessions Law (Official Gazette of the Republic of Serbia, 55/2003). Concessions are investments into the domestic economy in accordance with the legislative practice of providing equal conditions for all potential private investors (domestic and foreign) through partnerships with public sector, guided by the “build, operate, transfer” (BOT) principle. This is all about a unique regional law<sup>68</sup> that represents principles of transparency, non-discrimination, proportion, efficiency and certainty in publishing procedural information internationally. The key for encouraging investments through concessions lies in secure property and contractual rights.

The fact that the Law offers a variety of opportunities for investment for up to 30 years, along with the Foreign Investment Law, provides a solid basis for inflow of new investment into the Serbian economy (excluding the armaments sector). In parallel with market reforms, the Serbian economy is undergoing through privatization and restructuring of enterprises where the concept of investing through concessions (along with well known benefits of solving infrastructure problems, unemployment and budget revenues) greatly contributes to de-monopolization (usually, governments have monopolies over transportation infrastructure), growth of competitiveness and increasing the quality of goods and services.

Investors have so far expressed an interest for concessions in areas of transportation infrastructure, mining and energy and regulation of solid waste in cities. In that regard, realization of interest of Serbia has been initiated through cooperation. This talks about concessions for highways from Nis to the Bulgarian border and from Horgos to Pozega, concessions for research and exploitation of various ores on several locations, establishment of facilities for managing solid waste, etc. At all times this involves cooperation with the Ministry of Capital Investments, Ministry of Mining and Energy and representatives of local self-governments.

The experience shows that it is necessary to prepare and develop a Concessions Manual. It should point out relations among different laws that need to be applied/respected in preparing the concession proposal as well as throughout the realization of a proposal/project. The Manual would provide enormous help to both domestic and foreign investors as it would have all required information compiled.

This would be the way to promote concessions, familiarize the public with benefits of such investment type and strengthen local self-governments.

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<sup>68</sup> EBRD-Concessions Assessment Project-Analytical Report, August 2004

With respect to natural, legal and “de facto” monopolies, the goal is to increase competition in areas where Serbia has competitive advantages through its strategic geographical location. In such way PPP areas emerge: development and usage of energy capacities, development of tourism infrastructure, exploitation of thermal springs, utilities, development and usage of roads, research and exploitation of ores/minerals.

The neighbouring and Central European countries’ experience shows that concession projects were primarily used to solve infrastructure development issues, where the toll proved to be too high and socially barely viable solution (Hungarian Highway M15).

## APPENDIX 4

### GENERAL SECTORAL ANALYSIS<sup>69</sup>

#### 1. World Trends and the Situation in Serbia

It is estimated that 50% of GDP today comes from the industry. It is also estimated that +by 2025 the globally positioned industry shall participate in the world GDP over 75%. These tendencies show the following:

1. The industrial production has the highest participation in creating GDP. It is especially important for small countries that lack in raw materials and energy and do not have high tourism and transportation potentials. Serbia is one of such countries.
2. National economies cannot be closed any longer and protect their markets and economies in a traditional way.
3. Each country, especially small and medium-developed countries, must find its share of the global industry as the global industry is the technical and technological development driver, has the lowest cost per product unit and it is hard to stand up to it with a competitive offer.

Global economy creates and imposes new standards and in such way eliminates those who are not able to follow swift changes.

It is a general estimate that Serbia is late in reforming its economy in comparison to countries in the region. This particularly pertains to privatization and providing foreign investors with free access to all economy sectors. The region has already established particular economy structure which is reflected in the example of the automobile industry. Major world manufacturers have invested in Slovenia, Czech Republic, Slovakia and Romania.

Neighbouring countries - Hungary, Romania and Bulgaria – are already part of the EU or will be so in the next 2 years. This is why the interest to invest in Serbia is low, especially into those sectors that do not have a significant domestic market share. With an exception of telecoms and energy sectors, the most attractive investments into Serbia have already been completed (cement, tobacco, breweries). This fact is a difficult factor that influences the future development of the Serbian economy. Defining priorities is not possible as the “Strategy for the long-term development of the economy of Serbia” does not exist (this strategy should define the most important sectoral policies – industrial, agricultural, etc.). At this moment, the only two strategies that have been developed on an acceptable level are the strategy for energy development and the strategy for the development of transportation.

#### 2. General Assessment of the Economy of Serbia

The fall of the former Yugoslavia, wars, international isolation and economic sanctions have caused a decrease of all economic indicators in the interval of 1990-2000. National economy has not been significantly recovered from 2000 to 2004.

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<sup>69</sup> Sources: Different Sources: World Bank, Chamber of Commerce in Serbia, Draft Strategy on Local Economic Development in Serbia to 2010 developed by Expert Bureau of Statistics, etc. The assessments in this document are based on the analysis of data obtained from these sources.

General assessment of the Serbian economy is as follows:

1. Low level of technological and market capabilities of industrial enterprises.
2. Inefficient business (low productivity, high cost/product).
3. Unsatisfactory levels of quality of goods and services.
4. High trade deficit that is not sustainable in a long term.
5. Number of new jobs is lower than the number of jobs lost in the privatization programme, which increases unemployment and decreases employment.
6. High level of public consumption in GDP.
7. Low level of investments from 1990 to 2004. In 2002 Serbia had the lowest percentage of investments in GDP – 12%, whereas Croatia had 27%, Czech Republic 28% and Hungary 25%. Having in mind that GDP in Serbia is low, than 2002 investment absolute values were: Czech Republic – 12 times higher, Hungary – 9 times higher, etc.

#### 4. Industry Structure and Participation of the Industry Sector in GDP

Serbian industry structure was not satisfactory even before 1989. However, it has been dramatically changed – it deteriorated from 1989 to 2000. This is best shown in Table 1. Electricity, coal, oil, natural gas and oil derivatives production share in the total industrial output in 1989 was 11.92% and in 2000 – 24.39%. However, the physical productivity level has remained almost the same.

In 1989 share of the most important industry branches – metal processing, machinery building, transportation means manufacturing, ship building, production of electrical machinery and appliances, textile (apparel) and leather footwear and accessories – in the total industrial output was 42.56%, and in 2000 – 19.74%. Having in mind that levels of industrial output in 2000 was approximately at 50% of the level in 1989, then the most important industry branches output declined more than 4 times. This has affected exports as these were the main exporting industries in Serbia.

Comparative GDP share of certain sectors: - in % -

	200	2001	2002
▪ Agriculture, hunting and forestry	23.8	25.0	19.2
▪ Processing industry	33.9	32.0	30.3
▪ Ore and stone	1.8	2.5	2.2
▪ Electricity, gas and water production	1.8	2.3	5.0
▪ Construction	6.1	5.4	5.0
▪ Wholesale/retail and repair	17.6	16.4	18.6
▪ Hotels and restaurants	1.9	2.0	2.1
▪ Transportation, warehousing and linkages	9.2	10.9	12.4
▪ Real estate, renting	3.5	3.0	3.4
▪ Other	0.4	0.5	0.4

Public sector GDP share in 1989 was 90.8% and private sector share – 9.2%. This significantly changes in 2000: public sector share is 59.5% and private sector share is 40.5%. The ratio will continue to change in favour to the private sector – the private sector GDP share in 2002 was 42.6%. In the light of economic reforms, this is a positive trend. We have to bear in mind that 2002 GDP was only 45.3% of 1989 GDP. Excluding Kosovo, GDP is twice as lower in the mentioned time-frame.

## **4. Sectoral FDI Potentials and FDI Needs**

### **4.1. Telecommunications**

Telecommunication sector is one of the most important infrastructural systems of modern world. It's necessary for good functioning of economy systems, primarily ICT, transportation, electricity, banking, but also for other systems like health care, education, police, military, tax administration, etc.

Main goal that needs to be achieved by FDI is rapid sector development and decreasing development level differences in comparison with neighbouring and the EU countries.

Telecommunication development level is measured by number of land lines and mobile phones, cable TV, PCs and Internet connections. If development level in Serbia is marked as 1.0, then it's 1.5 in Romania, 1.7 in Bulgaria, 2.0 in Croatia, 2.8 in Hungary, 2.8 in The Czech Republic, 4.1 in Slovenia, 5.5 in Austria and 8.0 in Sweden which is one of the most developed countries.

This shows high long-term investment needs for investing in telecoms in Serbia.

Resources:

- Significant domestic market,
- Highly educated and skilled work force,
- Good existing network.

Problems:

- Disparity of prices for local and international calls,

Needed investments:

- Modernizing existing telephone stations and building new ones,
- Development of a communication and accessibility network,
- Introduction of new services.

Domestic investment inputs – 20%, with a growth tendency.

Recommendations:

- As the government presently has a monopoly in telecoms, the pre-condition for FDI inflows into the sector is defined (sector) privatization programme.

### **4.2. Electricity**

A decade of no investments in the sector of electrical energy resources resulted in technologically obsolete system; technological parameters show that the revitalization and modernization of capacities conducted in the last 5 years yielded good results and brought an increase of efficiency. The Law on energy resources allowed foreign investors to invest in electrical energy resources under equal conditions as that for domestic investors. Reserve capacities do not exist and increased consumption during winter months is bringing the system to the verge of sustainability. Prices for provided electricity are considerably lower than cost of production and distribution and prices in the neighbouring countries.

Electricity consumption in Serbia is not huge in comparison to the EU countries – 3.500kwh annually per inhabitant, but it is large if brought down to the energy intensity (approx. 1.4100 kwh/000 \$ of GDP, Greece 400, Portugal 300, Denmark 200)

With the current electricity consumption growth rates and extreme disparity among prices of different energy resources, Serbia is soon to face the problem of supply, due to lack of production resources and unfavourable consumption structure. Indirect sectoral goal is building new production capacities.

Resources:

- Coal (lignite),
- Highly educated and skilled work force,
- Renewable energy sources.

Problems:

- Disparity of prices – kw/h; This is not possible to solve in a short-term,
- Ecological problems (ash residues, etc.).

Needed investments:

- A power plant – 700 -750 MW,
- Natural gas combined power plants for production of electricity and heating– 200-300MW,
- A number of smaller power plants that can be used for heating larger cities and distribution of hot water,
- Equipment for surface mining (coal),
- Transmission systems,
- Interconnectivity,
- Environment protection,
- Processing of coal dust and other renewable energy sources,
- Building new mini hydro-power plants,

Domestic investment inputs could amount to 35-40%.

Recommendations:

- It is necessary to allow foreign investors to build new power plants independently from the flow and dynamics of a privatization process relative to the sector and to create conditions for market economy based prices of electricity and services. Inadequate tariffs cannot attract investors. Reach a decision regarding a half-built power plant “TE-TO Kolubara B”.

#### 4.3. Oil Industry and Gasification

The oil sector includes exploitation of domestic oil reserves, import, transport and processing of crude oil and petroleum products as well as distribution and sale/export of petroleum products. Oil and natural gas production is constantly falling due to low investments in maintenance and lack of funds for researching. The total installed processing capacity of domestic refineries amounts to 7.8 million tons per year, however, because of serious damages occurred during the 1999 bombing capacities are lowered to 6.6 million tons.

Adoption of the Law on Abolishment of the Law on Establishing Public Enterprise for research, production, processing and turnover of oil and natural gas and relevant decisions of the Government enabled establishing: Public enterprise for transport of oil to oil pipelines and petrol products to product pipelines, Public enterprise for transport, storage, distribution and trade of natural gas and Shareholding Company for research, production, processing, distribution and trade of oil and petrol products and research of natural gas. Coming into effect, these decisions marked successful end of first phase of restructuring of the company “NIS- Oil Industry of Serbia “.

Energy sources development strategy foreseen 360 million dollars of investments for oil sector and 840 million dollars for natural gas sector; the total investments required in the entire energy sources sector amounts to 6,375 million dollars.

Shareholding company "NIS" is comprised of four sister companies: NIS-Naftagas, NIS-Petrol (incorporates former parts of NIS- Pancevo Refinery, NIS- Novi Sad Refinery, NIC-Jugopetrol and NIC-Naftagas Promet), NIS-TNG (organization parts of NIS-Gas, NIS-Energogas and NIS-Jugopetrol which used to deal with turnover of liquefied natural gas in metal containers ), NIS-Catering and Tourism (restaurants, hotels, catering from all former companies). A privatization advisor was selected as it was suggested by the adopted Privatization Strategy. The first phase of privatization is expected to take place mid 2006.

Further gasification in Serbia, in line with the National Action Plan on gasification, construction of underground gas storage and alternative supply gas pipeline shall secure supply of natural gas and increase the consumption of natural gas as a fuel, which will have multi fold positive effects on electric energy system in Serbia in terms of environment protection as well as the pressure put on the system.

Adoption of the Law on energy resources and forming of the Agency for energy sources that, amongst other things, should adopt the gas tariffs for the Republic of Serbia created conditions for forming adequate price of natural gas for particular categories of consumers in line with the requirements the Republic of Serbia accepted by signing the Contract on establishing community for energy resources. Big industrial consumers were enabled to gain status of qualified buyer which can buy energy for its own needs and which can freely choose the supplier.

Serbia highly depends on oil and gas imports – 75% of consumption is from imports. Domestic refineries do not produce enough quantities of oil derivatives. Oil and gas imports represent the biggest foreign currency outflows in Serbia.

Development of chemical and petrochemical industries can contribute to the increased foreign currency inflows and cover energy importing costs. Natural gas is not used in Serbia only as an energy source, but also as a raw material for producing fertilizers and methanol.

FDI in oil industry, increase in productivity of oil derivatives and development of new production facilities is a pre-condition for development of a petrochemical and base industries. Development of this sector indirectly influences development of chemical, plastics and rubber industries. FDI in this sector would be regarded as highly important for their multitude of effects.

Needed investments:

- Improvement and modernisation of existing refineries,
- Development of a part of an international oil pipeline through Serbia,
- Development of petrol products storage facilities (Belgrade, Novi Sad, Smederevo, Nis, Prahovo, Bor),
- Development of a large underground natural gas storage facility (required to balance summer and winter consumption),
- Gasification of cities,
- Production of engine oil,
- Expansion of natural gas distribution network.

Possible domestic investment inputs: 30%.

Recommendations:

- Enacting the sectoral privatization programme. Privatization of oil industry is less problematic than the privatization of other large systems and this is why priority should be given to it. It opens up possibilities for investment into chemical industry,
- Gasification and development of an underground natural gas storage facility would lower costs of gas distribution and allow for supplying large consumers on lower prices,
- Build underground gas storage facility and alternative supply pipeline

#### 4.4. Agriculture and Agribusiness

The environment for agricultural production in Serbia is good. Agricultural land is 5.12 million hectares in size, or 66% of the country's total area. This approximates to 0.68 hectares per capita which is significantly more than the European average (0.28 per capita).

Approximately 83% of agricultural land is cultivable. Major part is in Vojvodina and remaining 17% of non cultivable land is pastures (16%), and fish ponds, reeds and swamps (1%). Cultivable land per capita is 0.57 hectares which is more than European average (0.18 hectares per capita). Size of available cultivable land and its location create favorable environment for agricultural production.

Agriculture today has 21% share in the GDP, employees more than 10% of population, and has a 26% of share in the total export. There are two types of farms: big corporative farms with 15% of total arable land (0.8ha) and family farms with 85% of total arable land (3.6ha). The farm structure is also inadequate: 94.5% farms own less than 10ha. Average farm has 3ha, whereas only 5.5% of producers out of total 778,891 cultivates over 10ha. Republic of Serbia allocates resources for agriculture in the amount of 2% of GDP (EU allocates for the same purpose 0.5%).

The main characteristics of Serbian agriculture are:

- Agriculture is in transition from highly state regulated to market oriented agriculture,
- Agriculture is under pressure of playing important social role in transition period,
- Since it is still highly protected agriculture it is not in position to profile its competitive products,
- Agriculture suffers from lack of investments in the last decade and still non-existent functional credit market,
- Agriculture is with clearly visible monopolies in many sectors and undeveloped market chains.

This is the reason why it is necessary to realistically recognize what can and what can not be expected from Serbian agriculture in coming years and decades.

- Agriculture *can* produce more resources than today and contribute significantly to overall economic recovery and growth,
  - Agriculture *can* produce safe and high quality food, attractive to consumers in Serbia and abroad,
  - Agriculture *can* have effect on environmental protection and carries potential to develop lucrative tourist packages,
  - Agriculture *can* bring forth much needed changes in order for Serbia to join EU and WTO; Serbia will certainly benefit from this,
  - Agriculture *can* be short term buffer that will help mitigate consequences of a painful transition,
  - However agriculture *can not* continue employing the number of currently employed people nor it can provide an acceptable standard of life at a small farm covering wide variety of production the type that is prevailing today.
- 
- Resources:
    - Available agricultural land of good quality,
    - Favourable climate for fruit and vegetable crops,
    - Favourable geographic location for fruit and vegetable crops,
    - Forest and water resources.
- 
- Problems:
    - Farmers lack knowledge especially in the area of sale,
    - Farmers are not adequately connected,
    - Poor rural infrastructure,
    - Land market does not function adequately,
    - Rural credit market hardly exists,
    - Slow privatization with a few foreign investments,
    - Underdeveloped market infrastructure, institutions and organizations,
    - Inadequate legislation and lack of institutional framework,
    - Lack of staffing, organization and equipment in the organizations that provide support to agricultural sector.
- 
- Required investments:
    - With the aim of increasing competitiveness in the area of investments in,
      - Equipment, machinery, farms, plants, processing and storage capacities
      - Knowledge
    - Investments in building of institutions and market infrastructure in agriculture.
- 
- Recommendations:
    - Build market economy in agriculture,
    - Formulate different land policy regulations in order to achieve goals defined by the Strategy of development of agriculture in Serbia.

#### 4.5. Tourism

Tourism potentials of Serbia are not great, but the existing potentials should be streamlined towards attracting tourists from foreign countries.

Tourism is an important industry as other economy sectors are valorised through it (food and drinks production, transportation and services). It engages significant number of employees. For this reason, key objectives of the Serbian tourism development policy and its development strategy shall be:

- Increase of share in GDP,
- Raise the foreign currency inflow to a level equal of that in neighbouring countries,
- New jobs and poverty reduction through development of tourism,
- Return of Serbia to European and world markets as an important tourist destination,
- Defining leading products of Serbia, such as congressional tourism, spa, mountain and rural tourism.

Resources:

- Spas (Vrnjacka, Niska, Soko Banja, Mataruska, Melenci, etc.),
- Mountains (Kopaonik, Tara, Zlatibor, Zlatar, Divcibare, Goc),
- Rivers (Danube, Tisa, Drina),
- Cities,
- Hunting,
- Transits,
- Human resources.

Hunting in Serbia was one of the most important forms of tourism by the beginning of the 1990's. The existing potential in hunting areas is not adequately exploited first of all due to lack of legal framework that would regulate this field in a modern way and due to the fact that Serbia is not on the EU's list of "third countries" for game export. It is necessary to take into consideration both the direct and indirect impact of hunting on the image and economy of the country the latter being fact that guests who come from abroad to hunt are usually high class society members.

Problems:

- Underdeveloped infrastructure including road infrastructure,
- Low level of quality of services (sanitary problems are huge), inadequate accommodation capacities in cities, mountain centres, and spas,
- Low FDI in tourism,
- Lack of funds to support tourist promotional activities,
- Unresolved question of environmental protection of tourist centres (solid waste disposal),
- Inadequate training facilities,
- Lack of symbols of Serbia as tourist destination, souvenirs, slogans, logos (a design contest could be announced to meet this requirement).

Needed investments:

- High-category hotels (Belgrade, Nis, Novi Sad),
- Establishment of health and recreation centres (Vrnjacka Banja, Soko Banja, etc.),
- Building of high-category hotels in tourist centres on mountains,
- Establishment of nautical centres on Danube (Donji Milanovac, Golubac, etc.).

The fact that our river fleet has not yet reached the number and the quality it had before the World War II.

Recommendations:

- Ministry of Trade, Tourism and Services, Tourist Organization of Serbia and representatives of sector should define target markets and target segments<sup>70</sup> in line with possibilities of Serbian tourist packages and to go forward with their marketing campaign,
- Make Serbia get on the list of “third countries” of EU for game export, adopt the Law on Hunting,
- Investments in transportation development and environmental protection
- Make possible purchase of land or a long-term lease of land for establishment of tourist facilities.

#### 4.6. Automobile Industry – Industry of Transportation Devices/Mean/Tools

Automobile and transportation industry is the largest single market in Serbia. There are over 1.400.000 registered passenger cars and about 400.000 lorries, buses, specialty trucks, etc. in Serbia. Average age of cars is 12 years, and transportation vehicles are even older. Supposing that in the upcoming 10 years 2/3 of all vehicles are changed for new ones, the fact creates a market of 1.200.000 vehicles, that is 120.000 vehicles annually. In terms of money, we are talking about €2bil per year, including services and auto components production.

Such a big market justifies a need for a strategic partner, which could establish in “Zastava Automobili” a production line of small and mid-size capacity vehicles and special vehicles (delivery vehicles, service vehicles, ambulance) that would be developed on the basis of principle model.

Prospective annual production is 80.000-100.000 vehicles. Such line would be accompanied by production of auto-components (valves, tires, wheels, batteries, brake systems, filters, etc.). Auto components industry would be equipped to produce first-time built-in parts and spare parts for majority of cars produced in Europe.

Resources:

- Domestic market,
- Existence of production facilities with required infrastructure,
- Highly skilled and educated work force.

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<sup>70</sup> Prevailing opinion is that target groups should be middle class citizens and business people, not elite tourists.

Recommendations:

- Direct negotiations with world known companies,
- Foster privatization of the “Zastava Automobili”,
- Development of clusters of auto components producers,
- Provide incentives that would attract a serious world-known car manufacturing company.

#### 4.7. Chemical Industry

Foreign investors have already made their presence in this industry through the privatization process and their participation in future tenders is expected in the future. Building of new capacities is connected with further development of refineries and petrochemical industry as a baseline industry.

Needed investments:

- Building of one grime plant – important for rubber industry (grime is presently imported). Such a project in Elmir exists, but local inhabitants are opposing the idea because of ecological problems which could be solved with today's modern technologies,
- Building of one synthetic cord factory (used for production of automobile tires).

#### 4.8. Logistics and Inter-modal Transportation

Serbia has a good geographical position. Demand for such services is constantly increasing in the world and the country.

Needed investments:

- Cargo terminal – Belgrade airport,
- Goods transport centre on Danube close to Belgrade (Serbia does not have a modern container terminal),
- Development of the “RTI” network.

#### 4.9. Recycling (of raw materials)

Recycling is not developed in Serbia. Domestic experience does not exist within the area. Feasibility studies are needed as well as development of potential projects in cooperation with the EU.

The Government has a key role in organizing and controlling recycling of raw materials, especially of hazardous waste. Significant direct and indirect foreign investments are possible in this sector, as is the access to European funds. Recycling of raw materials will enable establishment of significant number of small private companies.

Problems:

- Huge waste quantities (10mil tons per year. 7 mil tons of ash, 2 mil tons of municipal waste),
- Huge quantities of waste disposal waters,
- Huge quantities of waste disposal of gas.

Recommendations:

- Enactment of legislation in accordance with the EU legislation,
- Determining locations suitable for landfills,
- Tax relief for new investments,
- Privatization of utilities and provision of concessions in the area of recycling and municipal waste treatment.

#### 4.10. Wood Industry

Development of wood industry should be based on exporting furniture that has been manufactured out of timber originating from renewable woodlands. The demand is increased for this type of furniture.

Domestic raw materials and labour are available.

Competitive design and quality are missing. Establishment of a number of SMEs is possible.

Recommendations:

- Attract foreign partners because of the market potential, design and modern technologies,
- By developing wood processing provide for a certain de-stimulation in exporting raw timber.

#### 4.11. Leather Industry

There is space for building capacities for processing of raw animal skin as raw materials are locally available and demand for leather goods/products is increasing in the world.

Investments are needed for technology and equipment.

By provision of necessary conditions for processing of raw animal skin exports would be de-stimulated.

#### 4.12 Mining and Geological Explorations

Serbia has significant capacities in further development of mineral-raw materials sector. Geological features indicate probability of finding new deposits of non-ferrous and precious metals (copper, lead-zinc, nickel, molibden, antimin, gold, silver, ...) in the existing metal-energy zones (Karpates-Balkans, Serbia- Macedonia, Dinara, ...) totalling in one third of Serbia.

During the last two decades, investments in geological explorations of mineral raw materials were poor, and the exploitation was carried out only in well known deposits. This period coincides with the elimination of funds or drastic reduction of funds the Government was investing in this industry. On the other hand, existing socially-owned companies (RTB Bor, PMHK Trepca, ...) failed to, firstly, meet the challenges of market oriented operations, and then, during the period of sanctions and isolation production based on non-economic and sustainability principles was forced. Imperative of the moment is to create as favourable as possible conditions for private investments (foreign or domestic) in this sector. Additionally, system institutions and legal framework represent logical starting point in terms of preconditions for achieving the set goals.

Legal framework regulating methods and conditions for geological explorations and exploitation of mineral raw materials are the Law on Geological Explorations and Exploitation of Mineral Raw Materials, Law on Mining as well as many other by-laws. Approval for geological explorations is produced according to the existing Law on Geological Explorations pursuant to the principle of priority of first submitted application (*First Come – First Served*). Exploitation of mineral raw materials can be performed only by the company that carried out explorations pursuant with the principle of investment security (*Security of Tenure*).

Geological explorations of mineral raw materials are in full funded by the private sector (domestic and foreign companies). It is estimated that in the next 3-5 years, 100-150 million dollars will be invested in Serbia in explorations of all mineral raw materials.

All metal mines (copper and lead-zinc), including RTB Bor, undergo the process of privatization while some of them have been already successfully privatized. This process needs to be fostered, or, better say, completed by the end of 2006 in order to use the favourable price trends in the world markets. Privatizations process of non-metal mines is approaching its final phase, cement factories have been privatized as well as many quarries and brick factories. There is no doubt that the process will be completed by the next year.

According to the findings of the World Bank's expert team, the task standing before the Government and the Ministry of Mining and Energy Sources should be reflected in the Strategy of Management and Development of Mineral-Raw Materials Sector (*Mineral Policy*). Briefly, this strategy defines tasks and responsibilities for achieving sustainable development and appropriate functional link with fiscal environment in accordance with the issues resulting from the principles of management in this industry sector.

Second important task is urgent adoption of amendments to the Law on Geological Explorations and the Law on Mining. In the next two years, these two laws should be merged into a single Law on Mineral Raw Materials. This would ensure more legal safety, streamline procedure of approving explorations and exploitation of mineral raw materials, and strengthen competencies and accountability in application of the law.

The third important task is related to adoption of modern by-laws that were the responsibly of the federal administration until the formation of the State Union of Serbia and Montenegro. This will be done by the Agency for Mining (to be established according to the proposed amendments to the Law on Mining) in the next several years. New Rule Book on Mining Projects Subject Matter and the new Law on Determining and Classification of Mineral Raw Materials Reserves and Geological Explorations Data (including by-laws) are the priority. This laws need to be made according to the model of best world solutions – widely acknowledged in international financial institutions, commercial banks and markets.

In order to achieve mentioned goals and ensure permanent implementation it is necessary to remove more than obvious institutional shortages. The World Bank's expert team and Germany and Japan experts teams, which in different projects have had opportunity to find out about practice and experiences of the Ministry of Mining and Energy Sources of the Republic of Serbia, it has been concluded:

Sector of Mining and Geology in the Ministry of Mining and Energy Sources of the Republic of Serbia (alternatively, Agency for Mining) should be provided with necessary technical equipment, additional staff and add missing departments:

- Within the Sector of Mining and Geology (alternatively, Agency for Mining) add staff and strengthen level of technical equipment in the Department of Cadastral of Research and Exploitation Areas and the Department for Collection of the Charge for Mineral Raw Materials Use,
- In regard to above mentioned, add staff and strengthen level of technical equipment in the Department of Mining Inspection and the Department of Geological Inspection,
- Also, establish the Department for Environmental Protection Issues and Impact of Mining Exploitation on Local Communities to strengthen two way communication between the Ministry of Mining and Energy Sources and the Ministry of Science and Environmental Protection, Ministry of Local Government and the Ministry of Labour, Employment and Social Policy and to efficiently regulate collection of required layouts for assessment of each individual case,
- Establish the Department for Mining Economy Management, to create two way communication between potential investors and mining industry sector, promote mining investments, improve financial planning and ensure better administrative efficiency and transparency,
- Establish – reactivate National Geology House (*Geological Survey*), set the funding and define the work program in harmony with the goals. Serbia is the only country in Europe and one of the rare in the world having no such institution. Serbia had this institution in the beginning of twentieth century. Ministry of Science and Environmental Protection, in cooperation with the Ministry of Mining and Energy Sources, has already prepared required documents to be soon adopted. This task will be realized through transformation of existing institutes. In 2006, necessary funds need to be provided (from the budget funds, which are understandably limited, or from the external sources) for restructuring and strengthening poor level of technical equipment.

#### 4.13. Extracting Metallurgy

Metallurgy capacities in the Republic of Serbia outside Kosovo and Metohija are Zorka-Sabac (zinc smelting plant) and Smelting plant and Refinery (copper) operation as the part of RTB Bor, as well as the Steel Factory in Smederveo. Due to obsolete technology, all facilities are big polluters.

Steel Factory Smederevo was privatized and operates successfully since then. New leadership invests significant funds in reducing pollution. This process should be continued with the same intensity to create high quality facilities in realistic timeframe. According to available information, Serbia has no potentials in new economically interesting steel deposits as well as coke coals deposits. This means that these raw materials required for operation of Smederevo steel factory will be imported in future.

Future of the two other smelting plants is under direct influence of the situation in the mining sector and depends upon the success in restructuring and privatization of domestic mines. Since in the region and Europe, these capacities do not find enough business, economical justification for existence of domestic smelting plants can be found only if sufficient production of concentrate in domestic mines is achieved.

Serbia mainly exports non-ferrous metals as semi-finished products and imports finished products. There are potentials for building capacities for finished products. Having in mind that building of these capacities would alleviate economic problems of some regions (Bor, Zajecar, Nis, Uzice), providing special conditions for investors in this activity should be taken into consideration.

#### 4.14. Production of Minerals (Non-metals)

Production in the world is recording an increase. They are increasingly used in protection of environment as well as in agriculture. Some non-metals are not used in Serbia at all (phosphates, boron, zeolite, etc.), and some are at very low levels (basalt).

Give a concession for exploiting heavy-armature relay spar, fluorspar, phosphates, basalt, bentonite, dumite and diabase. Processing facilities possible to develop based on the production of non-metals which is very important for expansion of underdeveloped regions.

#### 4.15. Mineral Waters Exploitation

World consumption and demand is increasing. Serbia has significant resources.

Make concessions available for foreign investors.

Along with exploitation of mineral waters, the industry of producing non-alcoholic beverages is being developed. It should be expected that the increased investments in exploitation of mineral waters in Serbia will result in increased development of non-alcoholic beverages industry.

## APPENDIX 5

### ICT Sector Action Plan<sup>71</sup>

#### Telecommunications services

##### Policy & Legislative Framework

1. Establish Telecommunications Agency and Regulator activity speedily to drive liberalization in telecommunications services.
2. Act to attract additional telecommunications carriers into the Serbia market and to “unbundle the local loop”, thus ending the monopoly in fixed line services.
3. Complete the legal framework for e-business adoption and align with EU regulatory framework.

##### Infrastructure

1. Review international models on how to build national telecommunications infrastructure and select suitable development model for Serbia.
2. Complete the digitalization of the telephony network.
3. Implement a plan to provide an open access fibre optic backbone network connecting the main urban centres and flagship S&T Park sites.

#### Skills and Knowledge

5. Adopt and implement Higher Education, Science and Innovation Laws as foundation stones for a Higher Education and Research sector that is responsive to economic needs.
6. Put in place a high level ICT Expert Group, with strong involvement from the ICT corporate sector, to advice on plans for ICT graduate output, content of ICT curricula and priorities for funding of ICT research activity.
7. Develop Technology Transfer / Industry Liaison mechanisms within the Higher Education sector, as part of a National Innovation System, to promote effective business linkage.

#### ICT Business Infrastructure

1. Develop investment plans for 4-6 flagship Technology Park sites in the major urban areas which have well developed access infrastructure and Higher Education linkage.
2. Use the Feasibility Study exercise into Technology Parks in Serbia to identify the development model for these sites, which should include Incubator facilities for start ups and FDI, advance business accommodation units, high speed broadband access, technology transfer linkage and business development processes.

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<sup>71</sup> Report: The Role of the Information & Communications Technology (ICT) Sector in the Development of a Foreign Direct Investment (FDI) Strategy, Patricia Byrnes – a report produced within the Terms of Reference of the SIDA funded FDI Project within the Ministry of International Economic Relations

3. Develop promotion databases for ICT graduate output, ICT R&D activity and existing base of ICT companies in each of these locations as a basis for promoting and marketing the centres for targeted ICT sub-sectors.

#### ICT and Business

1. Implement a best practice e-business programme for business and develop measurement indicators for tracking e-business adoption.
2. Develop responses to the lack of venture capital and business development finance mechanisms, particularly for start ups in knowledge-intensive sectors.
3. Facilitate and promote cluster programmes – including professional development – and networking events for ICT based companies in individual regions.

#### Information Society

1. Prepare, launch and disseminate an Information Society Programme for Serbia with strong political leadership, clear targets, devolved implementation plans and regular measurement of progress targets.
2. Implement Internet access and certified IT skills development programmes in schools and retraining programmes as part of IS Programme.
3. Implement specific e-Government actions which can deliver visible service improvement quickly at the citizen level as part of IS Programme.

Overall comment: The ICT Sector can contribute powerfully to economic, export and FDI growth in Serbia if targeted actions are taken around above key areas.