FOREIGN INVESTORS COUNCIL

Proposals for Improvement
of the Investment Climate in Serbia

2006

Foreword

The start of 2006 sees Serbia at an important crossroads in its transition process. The country's leaders can reflect on 2005 as a year with some important successes. However, in terms of the transition process, it marks only the end of the beginning: 2006 sees Serbia moving into the second stage of the process. This involves more complex and sensitive privatisations. Politically, a number of equally complex and sensitive issues are on the agenda too. Handling these economic and political issues effectively will involve a combination of courage, leadership, political capital and good fortune. Writing early in the New Year, 2006 is likely to be one of the most challenging years the country faces.

Review of 2005

Reflecting on 2005, a number of issues stand out. In the long term, probably the most significant was the positive outcome of the EU's feasibility report. This resulted in the commencement of talks towards a stabilization and association agreement (SAA) in October. It was also crucial that a preliminary agreement was reached with the IMF in December, reflecting the achievement of objectives under the three-year loan agreement. This agreement secured the write-off of significant debt as well, demonstrating that the economic policies (and resultant stability) continued to be in line with the recommendations of the IMF. The budget surplus and reduction in the trade deficit were positive economic features of 2005, although inflation is a concern.

Certain events held and reports published in 2005 were important in initiating a more positive international profile for Serbia. The EBRD Governors' Meeting in May brought many leading businessmen and journalists to Belgrade. Supplemented by the high quality of the event and outstanding organisation, this event was a great success. Serbia also received accolades in the World Bank's report on Doing Business in 2006 and the EBRD's 2005 Transition Report. Possibly more important than the content of these reports is the coverage they receive in the international business press. Nonetheless, attention must be paid to the areas where improvement is required.

Two reforms are worth particular mention. Firstly, the establishment of the Business Registration Agency (BRA) on 1 January 2005 – a centralised point for company registrations and other statutory matters – was well implemented. Secondly, the introduction of VAT proceeded very smoothly.

In terms of investment, the bank privatisation process, which began successfully in late 2004, continued in the same vein in 2005. Most positively of all, Microsoft established an important software research centre in Belgrade.

Greenfield Investment

The clearest measure of whether perceptions of Serbia, held by the international business community, have changed favourably is the number of greenfield investments. Unfortunately, by this yardstick, Serbia clearly has not turned the corner. When discussing greenfield investment, the company most frequently mentioned is Ball Packaging: an investment commitment made in 2003/4. Reference to Ball shows that Serbia is still not attracting such investors. A major objective for 2006 is to bring new investment to the country.

2006 Challenges

2006 is likely to be a very challenging year, as crucial political and economic issues come to a head. The response of the country's leadership will have a very significant bearing on our long-term future.

Politically, South East Europe will be a focus of attention. Negotiations on the future status of Kosovo, the Montenegrin independence elections and the continuation of SAA talks – closely linked to sending certain individuals to the International Criminal Tribunal for the former Yugoslavia – are all potential flashpoints.

Within Serbia, the privatisation process will be more complex and sensitive. Privatisation of the state oil company, Naftna Industrija Srbije (NIS), and insurance and reinsurance company, DDOR Novi Sad, are scheduled for 2006. Restructuring of the national air company, JAT, is anticipated, as well as commencement of the process for the electricity sector.

In terms of reforms, three issues stand out. Unfortunately, both the labour law and urban construction land remain on the agenda from previous years.

The labour law remains problematic being far too prescriptive and inflexible and, ultimately, being a significant deterrent to the creation of jobs. This is nonsensical in a country seeking investors to take advantage of its people and their skills.

The second issue is the competition law. This law prescribes extremely low merger notification thresholds (combined annual turnover of EUR 50 million or EUR 10 million depending on the circumstances), exacerbated by the competition authority having four months to respond to a notification request. Again, when Serbia is actively seeking new investment, this is an unnecessary deterrent.

The third issue, and a major impediment to the development of Serbia, is the absence of ownership of urban construction land. Currently, there is system which involves the right of use of land. Ownership of the land only arises through the registration of ownership of a building subsequently constructed on the land. Due to the fact that there is no ownership of the land per se, raising finance for the construction of a building is extremely difficult. Furthermore, the system for obtaining this right of use is open to abuse. To compound the difficulties, there is no defined procedure regarding the permissions etc necessary to construct a building: again, an opportunity for abuse. At a time when investors are looking to invest in high yielding real estate, Serbia is 'shooting itself in the foot'.

Conclusion

In closing, I would like to acknowledge two people who have made a great contribution to the FIC over the past few years. Firstly, Jerome Bayle, the former MD of Tetra Pak, who retired on 31 December 2005, and secondly, Maja Gedosev, the executive director of the FIC, who continues to be the backbone of the organisation.

Belgrade, March 2006

Mike Ahern
President and Spokesman
Foreign Investors Council

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Concrete Steps to EU Integration

Building the Stabilisation and Association Agreement

The positive Feasibility Study in April 2005 opened the way for the negotiations on a Stabilisation and Association Agreement (SAA) between the European Union and Serbia-Montenegro in November 2005. This is an important step towards fulfilling the European Union prospective embedded in the Feira European Council of 2000 and subsequent meetings in Zagreb (November 2000) and Thessaloniki (June 2003).

Within the general framework of the Stabilisation and Association Process launched in 2000 , the negotiation of a SAA constitutes a major step. It will establish the first contractual relationship between the EU and Serbia and Montenegro, setting out mutual rights and obligations to be respected.

Strengthened relations at the economic and political level will further stabilize the country, by offering a clear perspective towards EU integration, thereby providing a more attractive environment for business operators. For the state union and republican authorities, it will provide a great incentive and a road map towards accelerated reform.

The SAA Negotiations: a further step toward the EU

The content of the Stabilisation and Association Agreement (SAA)

The Stabilisation and Association Agreement (SAA) with Serbia and Montenegro will be the first comprehensive Agreement between the EU and Serbia and Montenegro. Modelled on the Europe Agreements with the Central and Eastern European countries, it contains updated elements such as the obligation for regional cooperation and provisions on justice and home affairs. Notable areas covered by the SAA are:

- The establishment of a political dialogue within an institutionalised framework, in order to promote the integration of the country into the community of democratic nations and to increase convergence of views on security and stability in Europe, as well as on international issues.

- The establishment of a free trade area between SCG and the EU after a transitional period to be agreed. The trade provisions of the future SAA will be asymmetrical in favour of Serbia and Montenegro. With a few exceptions, this means that the EU will grant unlimited duty free access to its enlarged market for all products. For Serbia and Montenegro, tariffs for industrial products will also have to be phased out after a transitional period. Tariffs for agricultural products will, on the whole, be reduced, but may remain for a number of sensitive products;

- Mutual concessions concerning the 'four freedoms': the movement of goods, movement of capital (right of establishment), supply of services, and movement of workers,

- Approximation of the legislation to the Community Acquis, including precise rules in the key fields of competition, intellectual property rights, public procurement and others.

- Wide-ranging cooperation in all areas of EU policies, including in justice and home affairs.

The full implementation of the SAA will help Serbia and Montenegro in its preparations for future EU-membership. The responsibility of the authorities to implement all necessary reforms and integrate the European dimension into the legislation will become a formal obligation, once the country signs the Stabilisation and Association Agreement with the EU.

In the period between the signing and the final ratification of the SAA by all EU member states, an Interim Agreement on trade and trade-related provisions will enter into force, enabling Serbia and Montenegro to benefit from the trade measures of the future agreement.

The Commission will provide technical and financial assistance in order to help Serbia and Montenegro in the implementation of the Agreement.

The negotiation process

Previous SAA negotiations have been conducted in different manners, from the short negotiations with Croatia and Macedonia, which took only six and nine months respectively, to the negotiations with Albania which have been going on for almost two and a half years, and are now coming to an end.

With Serbia and Montenegro, progress in the negotiations will largely depend on an enhanced co-operation with the International Crime Tribunal for Yugoslavia (ICTY). If at any moment the Commission consider that progress with ICTY is stalling, it will be in a position to make a proposal to EU member states to suspend the negotiations.

The negotiations should not be concluded until the EU is satisfied that Serbia and Montenegro will be able to actually implement the legal obligations it takes on during the negotiations. As mentioned in the 2005 Progress Report , the administrative capacity in both Republics will have to be improved during the negotiating period to be in a position to properly implement the future agreement.

The duration of the negotiations will depend on the progress made, and on the capacity of the two republics to negotiate and implement their commitments. It is therefore very difficult to predict how long the SAA negotiations will take, although the Commission would like to see them concluded before the end of 2006.

The negotiation process follows the so-called twin track approach, endorsed by the highest SCG officials and by the General Affairs and External Relations Council (GAERC) in October 2004 . Accordingly, the SAA would reflect the complex constitutional set up of the State Union and its two constituent republics, all possessing treaty-making powers in their respective fields of competence. The Constitutional Charter contains rules on the division of competences between the State Union and the two constituent Republics, although these provisions are subject to different interpretations and sometimes challenged by the republics. Nonetheless, the SAA covers matters of State Union competence and matters within the competence of the Republics and the negotiations are held with the State Union or the Republics according to the repartition of competences.

The outcome of the Montenegro referendum on independence may impact on the SAA. In the case of independence, further to its recognition by all member states, the European Commission would need a new negotiating mandate from the EU member states.

The importance of a SAA for economic operators

The SAA is of utmost importance for economic operators as it will set the ground for the development of a business environment aligned with EU standards. At the margins of the SAA negotiations, business operators will have opportunities to provide feedback on the EC services, and hence to jointly identify problems faced and possible improvements.

The SAA goes beyond the existing preferential trade measures, the Autonomous Trade Measures, established in September 2000 and renewed until 2010 , granting unlimited duty free access to the EU market for almost all exports from Serbia-Montenegro. Actually, the SAA will engage the creation of a free trade area as a contractual relationship, implying the reciprocal opening of the markets. Thus, this process will act as a catalyst to pursue reforms, and increase competitiveness, as well as improving the business environment and opportunities for investment.

Stumbling-blocks to the development of a transparent and effective market economy will be addressed under the SAA, notably concerning the development of regulatory frameworks and institutions in areas of importance to the improvement of the business environment (i.e.: standardisation, public procurement, customs and taxation, environment, energy, telecommunication). Moreover, the binding character of the SAA will strengthen the implementation of legal reforms in the above areas.

The positive progress noted in 2005, and the launch of SAA negotiations, demonstrate that the country has made an important step toward its EU integration. However, Serbia and Montenegro must gain momentum in implementing the rule of the law, strengthening the administrative capacity, and pursue the economy reform towards a better functioning, transparent and efficient market economy.

The EU will make good its commitments while taking into account the EU's absorptive capacity. Moreover, the EC will emphasise the conditionality of the process at a political as well as an economic level. The EC will remain rigorous in demanding the fulfilment of its criteria, but fair in duly rewarding progress.

From this perspective, the pace of reforms engaged in since 2005 must keep its momentum so that Serbia-Montenegro ensures credibility and consistency in its progress towards the EU.

Development Of A Single Free Trade Agreement In South East Europe

Summary Progress Report

The Stability Pact continues to facilitate the development of the Single Free Trade Agreement to ensure its conclusion in the course of 2006, in line with the SEE Ministerial Statement of 10 June 2005. This is a key objective for the Pact in 2006, and one that is supported by the European Commission and the Austrian Presidency of the EU, as stated in the recent EC Communication on the Western Balkans.

Preparation of the actual agreement is going well, the outline contents of the agreement are largely agreed and the technical experts are working on details. There is broad agreement that the text of the new agreement should ensure a modern agreement (i.e. including areas such as trade in services), which is ambitious but tailored to the circumstances in the region.

The main stumbling block to date has concerned the process rather than the substance: specifically, whether this single agreement should be achieved through a new agreement, or through an enlargement and amendment of the Central Europe Free Trade Agreement (CEFTA). The current CEFTA members, in particular Croatia, have pushed this latter option particularly hard.

Achieving a single Free Trade Agreement (FTA) for the region via CEFTA has always been an option, but we have been debating whether this is technically possible and whether it is the most efficient way forward, particularly given the range of other negotiations on-going in the region (accession, SAA, WTO etc.).

The Stability Pact had two main concerns. Firstly, the membership criteria: the CEFTA membership criteria stipulated that a member of CEFTA has to be a member of the World Trade Organisation and that it must have institutionalised relations with the EU. However, following the CEFTA meeting of 29 November 2005, the eligibility criteria proposed by the SP Trade Working Group have been accepted by all as the eligibility criteria for CEFTA and the new agreement (regardless of the process). The criteria are inclusive (all SEE countries/territories are eligible) but require adherence to strict trade policy criteria.

Secondly, under the current CEFTA procedures, transforming CEFTA into the single FTA would require onerous, time-consuming, bureaucratic procedures for all. In particular, the non-CEFTA members would have to seek a mandate to accede to CEFTA and then seek a separate mandate to negotiate a new text, followed by two separate ratification procedures.

The Stability Pact and other international members of the SP Trade Working Group asked the CEFTA countries to consider greatly simplified procedures.

At the meeting of the SP Trade Working Group held in Berlin on 14 and 15 February, Romania, as President of CEFTA, presented a non-paper setting out an approach that would allow for a simultaneous enlargement and amendment of CEFTA. This was supported by the other members of CEFTA.

This non-paper was broadly welcomed by the non-CEFTA SEE countries and the other members of the Trade Working Group. Therefore, subject to some clarifications on the exact procedures, it is now likely that the single agreement will be achieved via a simultaneous enlargement and amendment of CEFTA. Thus, it will build on a successful regional initiative, adapting it to current political and economic circumstances.

All negotiations will take place under the auspices of the SP Trade Working Group, thereby allowing the international community to continue to provide advice and guidance. The draft text currently being prepared by the SP Trade Working Group will replace the current CEFTA agreement. It is vital that this agreement is ambitious, that it addresses new areas, allows increased liberalisation if agreed, and provides a better framework for dispute resolution.

The next steps include:

• Clarification of the exact procedures required to achieve this simultaneous enlargement and amendment.

• Formal report to the SEE ministers responsible for trade, on the feasibility of a single agreement and a request for the formal launch of negotiations with a view to concluding an agreement later this year.

Reasons to maintain ambitious schedule:

• Schedule to launch negotiations and conclude agreement in the course of 2006 agreed by SEE Ministers on 10 June in Sofia: it is important that the region is seen to be meeting its commitments.

• The schedule is also timely given that Romania and Bulgaria are likely to enter the EU in 2007, and hence CEFTA will cease to exist, or at best will be a bilateral agreement.

• Under MoU, 31 FTAs have been concluded (29 of which are in force), while an improvement in the trade environment in the region means that they now represent a substantial administrative burden for government agencies, in particular customs administrations which are, in general, weak and underdeveloped.

• 31 FTAs also present a considerable challenge (possible disincentive) to businesses, both foreign and domestic, who wish to trade throughout the region. The single FTA is supported by business organisations throughout the region.

• Simplifying and harmonising the trade regime will boost trade and much needed investment in the region and integrate the region further into the multilateral trading system, which would be good for all trading partners.

• To date, the improvement in the trade regime in the region has been largely driven by the international members of the SP Trade WG (particularly the Stability Pact office, EC and USA). The single FTA, and the institutional framework that will administer it, is seen as a way to ensure that the countries take ownership of this process, albeit with continued support from the international community at the outset. This is particularly important as the SP will implement its transition strategy over the coming two years.

An Overview of the Foreign Investors Council

The Foreign Investors Council (FIC) was founded by 14 major foreign investors in Serbia with the support of the Investment Compact for South East Europe (OECD) at the official foundation meeting (Constituent Assembly) on 15 July 2002 in Belgrade, with the clear mission:

"To contribute, together with the Authorities, to a better investment environment for foreign and domestic companies on the market, through open, informal dialogue between willing stakeholders."

The main purpose of the FIC is to improve the investment and the business development climate in Serbia and Montenegro by:

- Making concrete reform proposals;
- Stimulating foreign direct investment;
- Promoting communication between the Foreign Investors and the authorities in Serbia and Montenegro;
- Assisting and supporting the international business community;
- Helping to overcome difficulties which might be encountered in a course of investment

The aims of the FIC are to:

- Improve the investment and business climate in Serbia and Montenegro, by making concrete reform proposals;
- Stimulate foreign direct investments;
- Promote communication between the FIC and the Serbian Authorities;
- Assist in overcoming difficulties which may exist in relationships with foreign investors;
- Forge links with other foreign investor organizations across the SEE region to benefit from best practices sharing;
- Study concrete means to facilitate regional operations;
- Facilitate the flow of information between the FIC Members and the Government

Aside from those already mentioned, one of the main purposes of the FIC is to work in partnership with all relevant authorities, international organizations and institutions.

Almost 120 companies – current members of the FIC – have a long-lasting presence in SEE and would like to share their rich experience of the region with Serbian and Montenegrin authorities and to support the reform work of the government. They also believe that they can draw substantial benefits from their various experiences, common interests and economic strengths to build a better enabling framework for future business in Serbia, as well as in SEE.

In its current stage of development, the FIC is a powerful and constructive tool of reference. It represents most of the FDI stock in SCG, over 15 different nationalities, a vast range of economic sectors, a large part of employment and high economic interaction with domestic SME's.

The FIC has specialized working committees, which meet on a regular basis and have counterparts within the government and administration. Committees are grouped into the following sectors: banking, real estate and construction, telecommunication and media; and cross functional committees: environmental, human resources, taxation, leasing, legal, trade and insurance.

The FIC has cooperated closely with major international organizations present in Serbia and Montenegro, such as IMF, The World Bank, The Delegation of the European Commission, EBRD, EAR, IFC, and the EU.

The Foreign Investors Council is established as a non-profit business association of foreign investors. The bodies of the Council are the General Assembly of the Council, the Board of Directors, the President/Spokesman and Director.

The FIC White Book 2006 summarizes the main obstacles to investment and business development in the country and formulates concrete proposals to overcome these impediments. It is designed and presented by the FIC as an instrument for constructive dialogue and partnership between investors and government authorities that can help to improve the business and investment environment and lead to increased private investment.

By publishing the White Book 2006, the FIC aims to respond to the Serbian authorities on some chosen subjects which are linked to several sectors of the economy. This publication can not cover all aspects of the Serbian economy and therefore does not reflect the complete picture and status quo of the reform work of the government. It has to instead be seen as a process, which is repeated on a regular basis.

The White Book 2006, in both English and Serbian languages, can be downloaded from *www.fic.org.yu*

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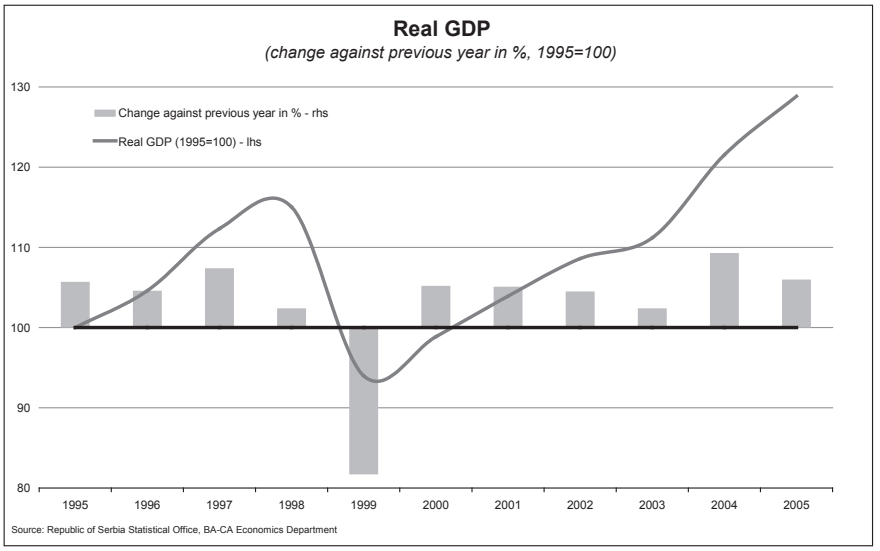
Economic overview

After the impressive growth seen in 2004, with GDP expanding at a rate of 9.3%, Serbia's economy lost momentum in the past year. Based on the data for the first nine months, GDP grew by about 6% in 2005. Serbia's nominal GDP has increased to about EUR 19.2 bn (excluding Kosovo and Methodia), which corresponds to per capita GDP of around EUR 2,550. In terms of purchasing power parities, Serbia now has a standard of living which is about ¼ of that of the EU.



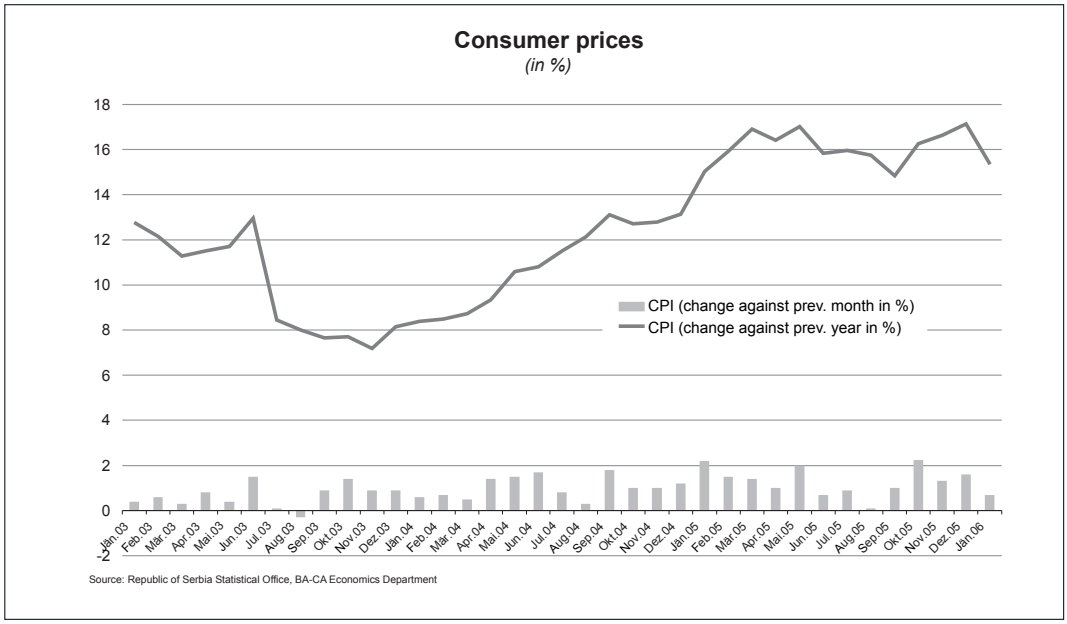
One reason for the slowdown in economic growth in 2005 is the weaker performance of the country's agricultural sector. Due to adverse weather conditions and floodings, agricultural output was some 5% down on the (record) level of the previous year. A further reason for the loss in momentum was the lacklustre performance of the industrial sector, notwithstanding very modest growth of an average 0.8% for 2005 following a slight upturn in the second half of the year. The level of industrial output reflects the radical and structural changes within the Serbian economy. The privatisation process, which was subsequently accelerated, was followed by the restructuring of industrial enterprises which involves a realignment and, in many cases, a streamlining of these enterprises. Other companies which have not yet been modernised are for the most part unable to keep up with the global competition, e.g. in the textile sector. Both factors have led to declines in output in specific industries.
The services sector was the engine of economic growth in 2005; the financial services sector (banks and insurance companies), the transport industry and trade all achieved double-digit growth.

Inflation as a weak spot

Inflation accelerated significantly in 2005 despite slower economic growth, and it has since become one of the most serious problems for Serbia's economic policy. Consumer prices rose to an average 16.5% in 2005 from 11.4% in 2004.

A number of factors contributed to this jump in inflation. For one, external factors played a key role in this process. Higher commodity prices and especially oil are reflected in rising energy prices and higher transport costs. The introduction of an 18% value added tax generally caused prices to rise at the beginning of 2005; according to estimates by the Serbian central bank this measure pushed up inflation by

about two percentage points. Food prices rose relatively rapidly, partly on account of the poor harvest. Besides these supply-side factors, the strong rise in prices is a result of robust domestic demand.



Source: Republic of Serbia Statistical Office, BA-CA Economics Department

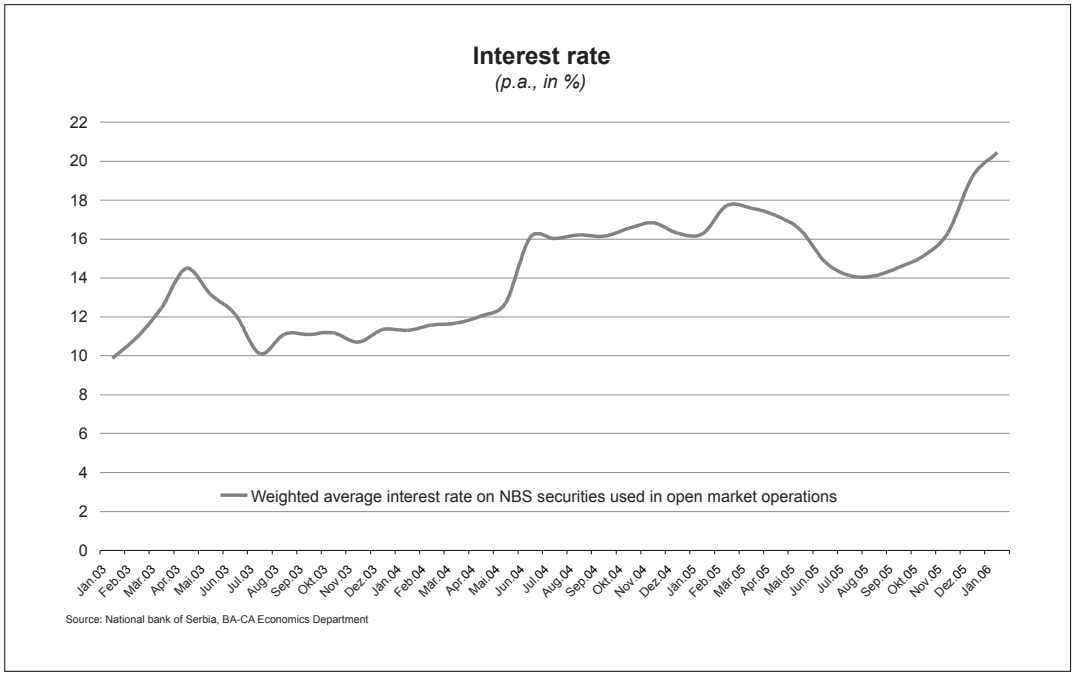
Tight fiscal policy...

As from the middle of 2005, Serbia's economic policy has given top priority to cutting the rate of inflation. The government has started implementing a more restrictive fiscal policy with a view to counteracting demand-induced inflation by curbing consumption. Upon the recommendation of the International Monetary Fund, Finance Minister Mladjan Dinkic in July revised the budget for 2005. Instead of a deficit originally budgeted at over 1% of GDP, the budget recorded a moderate surplus of 0.5% of GDP last year. This was achieved by a more restrictive spending policy, and above all, by substantial tax revenues due to the introduction of the value added tax and improved tax collection procedures.
As the more restrictive fiscal policy of the previous year has not proved to be very effective in bringing down inflation, the government has stepped up its efforts for the fiscal year 2006. Just before the turn of the year, the parliament approved a draft budget for 2006 which calls for a surplus of over 2% of GDP. The draft budget limits the rise in the salaries of public-sector employees to 10%, reflecting a restrictive wages policy. Together with a moderate rise in pensions, this has prepared the way for curbing domestic demand.

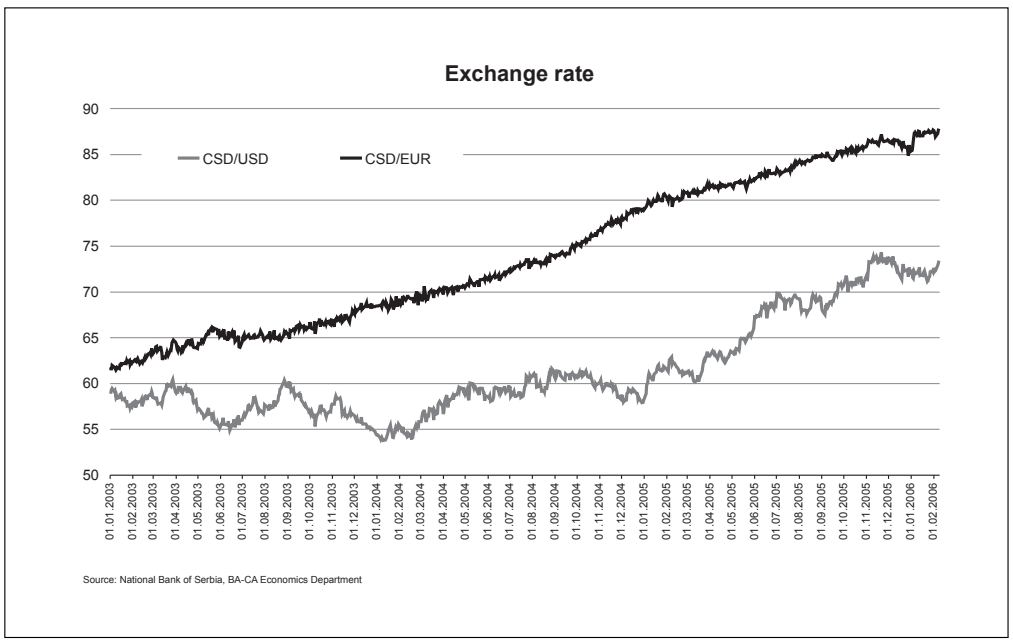
...and a rigorous monetary policy

The government's cautious fiscal policy geared to reduce the rate of inflation is supported by an appropriate monetary policy of Serbia's central bank (NBS). The central bank is helping to curtail the strong growth of the money supply with a more rigorous monetary policy implemented in June 2005. While open market operations are designed to neutralise the excess liquidity of banks, their impact is limited because the central bank is a net debtor of the commercial banks. Indeed, the efficiency of monetary measures in general is limited on account of the high degree of euroisation in the banking sector. The commercial banks' foreign currency liabilities have been growing significantly since 2002, and accounted for almost 60% of total liabilities at the end of 2005. This has largely interrupted the transmission mechanism of the central bank's monetary policy via interest rates. The central bank therefore focused on changing the minimum reserve requirements for foreign currency holdings with a view to curbing the foreign borrowings of the commercial banks, which serve to finance the expansion of lending activities of private households and companies. To this end, the central bank took two measures: it broadened the computation method to include all liabilities of banks associated with foreign loans, and it raised the foreign exchange minimum reserve ratio from 21% to a current level of 38% in several steps. Despite these measures, the central bank's policy has so far not really yielded the hoped for results. Business loans have continued to grow by about 40% year-on-year, while loans to private households, in the final months of 2005, fell only slightly to just under 100% year-on-year.
The central bank is therefore continuing to pursue its restrictive monetary policy in the current year.

After the M2 money supply expanded by over 30% in 2005, the central bank has set itself the goal of reducing M2 growth to around 15% year-on-year in 2006. The contraction of the money supply is to take precedence over an open market policy as a means for curbing inflation. The 2-week repo rate, which has been moving upward since the end of 2005, is replacing the discount rate as the key interest rate of the central bank. The bank introduced treasury savings bills as an additional policy instrument at year-end 2005. Leasing companies are moreover required to make a 10% mandatory deposit for funds borrowed abroad. Additional, more rigorous measures relating to the minimum reserve requirements for foreign currency holdings of commercial banks may be taken in the current year.



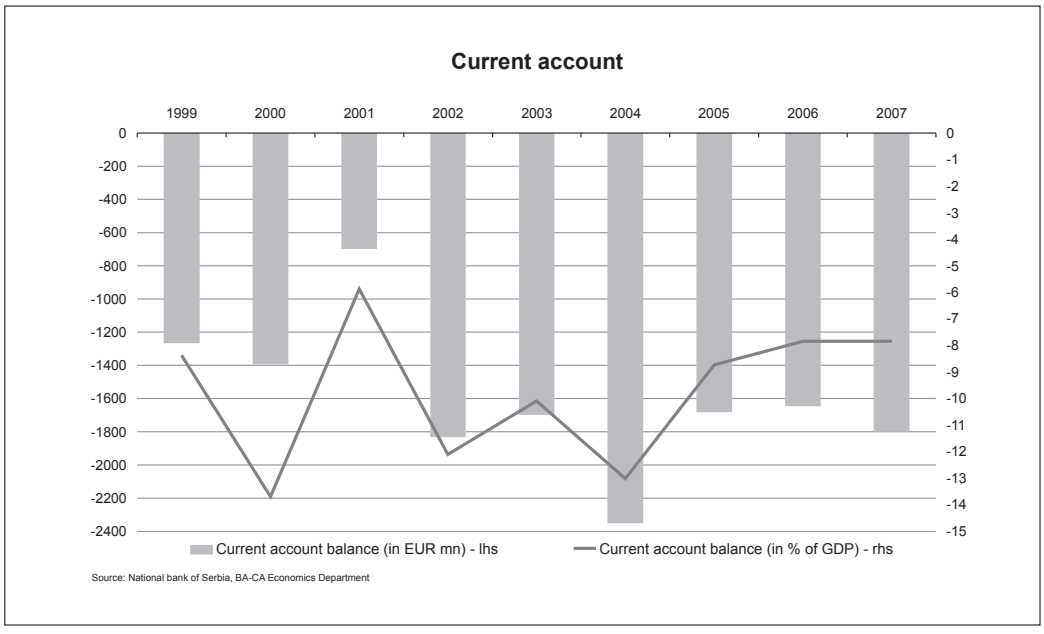
In this way, the National Bank of Serbia hopes to push inflation back into single-digit figures in 2006. Inflation has, in fact, started to fall since the beginning of this year. This is however prompted more by the disappearance of the inflation-induced effect following the introduction of value added tax in 2005 than by the measures of the central bank. Furthermore, the government had pledged to exercise restraint in raising controlled prices in the first three months of the current year. An important factor was also the relative strength of the dinar against the euro at the turn of the year. As many prices are currently indexed in euros, changes in exchange rates have a significant impact on inflation. For example, the average 15% depreciation of the dinar in 2005 was in large part responsible for the rise in inflation in 2005. With its managed floating exchange rate policy, the central bank is targeting a constant real effective exchange rate for the dinar. Any targeted – but most probably efficient –



appreciation of the dinar to curb inflation remains unlikely as the central bank wants to avoid any measures that could have negative consequences for the country's foreign trade. The downward trend in inflation since the beginning of the year will therefore be only very gradual as the year progresses. After falling to an average 12.2% in 2006, the inflation rate will not drop to below 10% until the following year.

Current account deficit a key weakness

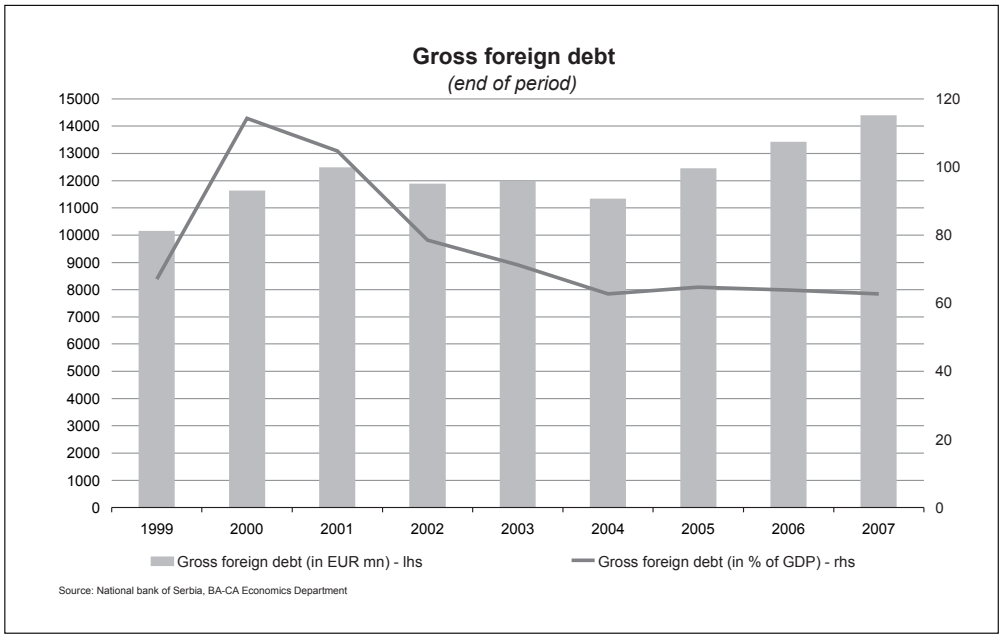
While efforts by the government and the central bank to curtail demand have so far had little impact on inflation, the significant imbalance in the country's foreign trade – the second major macroeconomic problem facing the Serbian economy – has been improving since the previous year. In 2005, exports grew by above 18% (nominal, in euros) to EUR 3.7 bn year-on-year. The introduction of VAT at the beginning of 2005 created an added incentive for business owners to declare their exports. It is therefore apparent that this strong growth in exports is in large part merely a statistical effect. With industrial output stagnating in the past year, there is little indication, if any, that exports are in fact experiencing a fundamental improvement. The level of international competitiveness of many Serbian companies is still very low, despite progress in productivity. Labour output in industry rose by about 8% in 2005, after the number of employed persons continued to fall in the wake of restructuring measures. However, with real wages growing by about 10%, unit labour costs in industry even rose slightly.
The restrictive monetary and fiscal policy dampened demand for imports. In 2005, imports contracted by almost 7% year-on-year (nominal, in euros) to EUR 8.2 bn. Here, too, the development was more pronounced due to the statistical effect related to the introduction of VAT (high level of accelerated imports towards the end of 2004 and very low import levels at the beginning of the year). The trade deficit narrowed to EUR 4.5 bn from EUR 5.7 bn in 2004, but still amounts to 23% of GDP. On the other hand, the country has a very positive balance of transfer payments, largely on account of the substantial volume of transfers by guest workers. In 2005, this balance recorded a surplus of almost EUR 2.8 bn. This helped to reduce the current account deficit to about 9% of GDP last year.



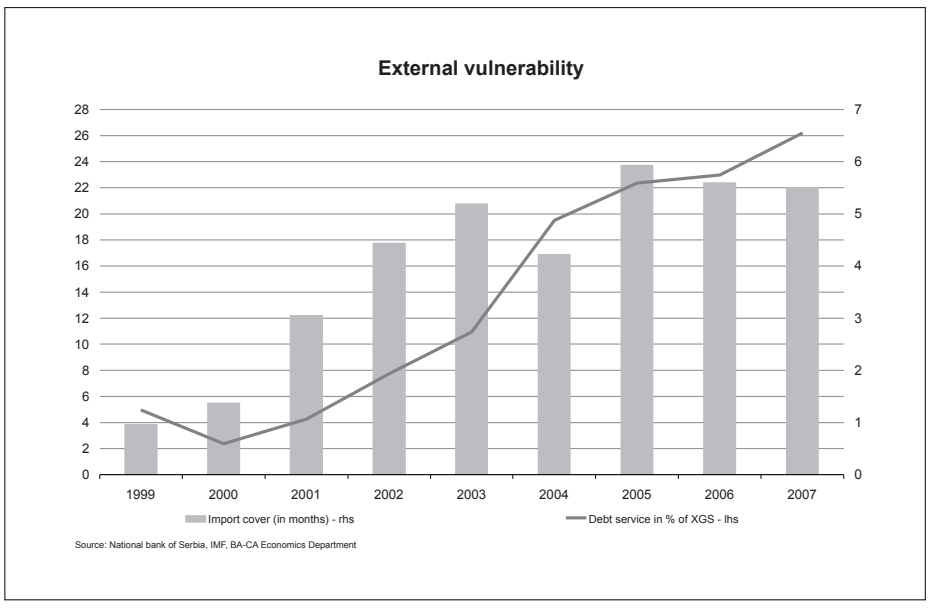
Record inflows of FDI

The narrowing of the gap was accompanied by an improved financing structure of the current account deficit in 2005. Inflows of foreign direct investment (FDI) climbed to a record EUR 1.5 bn, which sufficed to finance almost 85% of the deficit.
Most of these inflows were generated by a transfer in ownership, while greenfield investments only played a subordinated role. The privatisation of state-owned companies yielded about EUR 500 mn in 2005; the bulk of these privatisation proceeds came from the sale of financial institutions such as Jubanka, Novosadska, Continental and Niska Banka.
2005 also saw a significant rise in inflows of capital in the form of foreign loans. Serbia's gross foreign debt jumped to almost EUR 15.5 bn or 65% of GDP as a result of the rapid rise in private sector debt.

While the rise in short-term debt was fairly substantial, it accounts for about 10% of total foreign debt and as such it is not really a cause of concern.



Foreign debt servicing requirements however increased significantly in 2005 and exceeded 20% of exports in the broader sense. But due to the strong rise in foreign exchange reserves, Serbia's liquidity position is still largely tenable in the medium term. The import cover ratio has risen to almost six months and foreign exchange reserves are almost four times as high as the short-term foreign debt. Standard & Poor's, which awarded Serbia its first rating at the end of 2004 (B+), in July 2005 upgraded the rating to BB-. This will facilitate the management of Serbia's debt by reducing financing costs. The burden imposed on Serbia through the debt servicing requirements in the coming years should however not be underestimated as the amounts involved are likely to continue to exceed 20% of exports in the broader sense.



The successful conclusion of the stand-by agreement with the IMF at the beginning of 2006 will significantly ease Serbia's debt position. The second stage of the debt remission programme agreed with the Paris Club will now become operative following the fulfilment of the conditions imposed by the IMF, such as a restrictive budget policy, the implementation of structural reforms (especially for the social security system) and an acceleration of the privatisation process (e.g. in the oil industry). The debt rescheduling agreement provides for a 66% reduction of Serbia's debt, of which 51% in 2001 and a further 15% after the conditions of the IMF agreement have been successfully fulfilled. Serbia's gross foreign debt will consequently fall by about EUR 600 mn or approximately 3% of the annual GDP.

Outlook

Serbia's economy made good progress in 2005 in the face of difficult political and global conditions. The more strenuous efforts of economic policy makers to get the current macroeconomic deficits under control will slightly dampen economic growth in 2006. Continued inflows of capital from privatisations, the positive effects of the initiated structural reforms and a not unfavourable international environment could enable Serbia to achieve economic growth of up to 5%. At the same time, we consider the downside risk to be high.

The stricter fiscal and monetary policies aimed at lowering inflation would need greater exchange rate policy support in order to be more effective, given the high degree of euroisation of the Serbian economy. For this reason, inflation will probably fall only slowly. The current account deficit will continue to narrow in 2006, but less noticeably than in the previous year, when the process was assisted by statistical effects (introduction of VAT in 2005). Although the imbalance in foreign trade has improved somewhat, the external position remains a weakness of the Serbian economy, with current account deficits well above the critical value of 5% of GDP. While the economic policy pursued by the government and the central bank is conducive to stabilising the macroeconomic environment, in the medium term the current problems can only be successfully resolved if adequate progress is made in implementing structural reforms. The slow improvement of the business environment could accelerate with efforts to draw closer to the EU, but Serbia's troubled political landscape constitutes a permanent risk for the reform process.

Serbia - Selected Indicators

Change against previous year in %	2000	2001	2002	2003	2004	2005	*Forecast* 2006	2007
GDP (real)	5,2	5,1	4,5	2,4	9,3	**6,0**	**5,0**	**5,2**
Industrial output (real)	11,4	0,1	1,8	-3,0	7,1	0,8	**7,0**	**6,5**
Inflation (yearly average)	79,6	93,3	16,6	9,9	11,4	16,2	**12,2**	**8,8**
Unemployment rate (yearly average)	25,6	26,8	29,0	31,7	31,7	32,6	**32,5**	**32,0**
Budget balance (in % of GDP)	-0,2	-0,5	-3,6	-2,9	0,0	1,1	**2,2**	**1,0**
in EUR mn								
Exports	1.849	1.965	2.197	2.522	3.135	3.743	**4.529**	**4.960**
Imports	4.577	4.783	5.945	6.601	8.804	8.224	**9.059**	**9.600**
Trade balance	-2.729	-2.817	-3.748	-4.079	-5.669	-4.481	**-4.529**	**-4.640**
Current account	-1.394	-700	-1.833	-1.698	-2.351	-1.682	**-1.647**	**-1.800**
Current account (in % of GDP)	-13,7	-5,9	-12,1	-10,1	-13,0	-8,7	**-7,8**	**-7,9**
FDI (inflow, net)	27	185	514	1.201	777	1.193	**1.235**	**1.040**
Gross foreign debt (end of period)	11.634	12.487	11.892	11.991	11.342	12.458	**13.423**	**14.400**
Gross foreign debt (in % of GDP)	114,2	104,7	78,5	71,3	62,8	64,7	**63,9**	**62,8**
Import cover (in months)	1,4	3,1	4,4	5,2	4,2	5,9	**5,6**	**5,5**
CSD/EUR (yearly average)	34,87	59,38	60,70	65,14	72,57	83,20	**89,40**	**93,30**
CSD/USD (yearly average)	37,46	66,65	64,28	57,54	58,38	67,02	**73,62**	**74,64**

Source: Bank Austria Creditanstalt Economics Research, NBS, Statistical office RS, IMF

Chapter 1

Legal and Regulatory Framework

Company Law

There have been no substantial changes in the legal framework relating to Company Law in Serbia in 2005. The Company Law came into force on 30 November 2004 and in 2005 we saw the first cases of its application. This law regulates the incorporation of companies and entrepreneurs, corporate organization and governance, affiliations and changes to corporate status and legal forms of companies, and the liquidation of companies. The provisions of the old Company Law are no longer applied, except for those dealing with socially owned companies and regulating corporate governance of companies that entered privatization procedures.

Particular laws are in effect in specialized areas such as insurance, banking and the stock exchange. In these areas, the general provisions of Company Law are applied only as a supplement to other legislation dealing with that area.

There are four types of companies that may be established in Serbia, as was the case under the previous Company Law. These comprise: partnership, limited partnership, Limited Liability Company and Joint Stock Company. All of these have the status of a legal entity in Serbia.

There are no requirements with respect to the minimal amount of the share capital of partnerships and limited partnerships, but since their founders are liable with all their assets for the company's obligations, these types of companies are rarely seen in practice. The Company Law does not introduce any significant changes to the legal regime of partnerships and limited partnerships, except the possibility for legal entities to be founders of these types of companies.

The most commonly used legal form in Serbia is a limited liability company. The liability of the owners is limited to their share in the company, and they cannot be liable for obligations of the company itself, except if they misuse the company for unlawful or deceptive purposes. A shareholder may have only one share in the company, which is expressed as a percentage. The share capital may consist of cash and contributions in kind, such as equipment, goods, know-how etc and, according to the new law, work and services. The value of contributions in kind can be assessed by the shareholders themselves. The new Company Law provides that limited liability companies can have between one and 50 members, and that the minimum share capital is EUR 500.

There are two types of joint stock companies: closed and open (public) joint stock companies, that can be listed and unlisted. Currently, there is no developed market for the exchange of shares, and most of the joint stock companies are banks and insurance companies because, according to specialized laws, they have to be established in this legal form. The minimal amount of initial share capital for joint stock companies is significantly higher than that prescribed for limited liability companies, and amounts to EUR 10,000 for closed, and EUR 25,000 for open, joint stock companies.

Foreign entities are permitted to open representative offices in Serbia. The opening and operation of representative offices is regulated by a special Decree and by the Law on Foreign Trade. As well as companies, representative offices are registered at the Business Registration Agency. Representative offices are not legal entities and are not permitted to be engaged in commercial activities within Serbia.

Representative offices can be used for the purposes of surveying the market and providing assistance in concluding agreements.

Foreign legal entities are also entitled to open branches in Serbia. Branches are not separate legal entities and are also registered at the Business Registration Agency, but can engage in all legally permitted activities on behalf of their founders, without limitations that relate to the activities of representative offices. This vehicle for doing business still needs to prove its effectiveness in practice, but it seems that it provides foreign investors with a wider range of options in deciding in which manner to perform their business operations in Serbia.

Positive Signs

- The new Company Law facilitates business and allows owners of companies more freedom to regulate their mutual relationships, and those with the company.

- There is a significant decrease in the minimum share capital required for the incorporation of limited liability companies, in the new Company Law (EUR 500).

- There is no longer a requirement for employees' representatives in companies' bodies.

- Only one founding act (the Memorandum of Association) is needed for the incorporation of the company under the new Company Law.

- The Business Registration Agency has seen a marked increase in the number of companies being registered and is showing signs of acting in a more efficient way.

FIC Recommends

- There are inconsistencies between the Company Law and other laws that regulate conditions for doing business in Serbia, especially with the Law on Securities and other financial instruments. These inconsistencies mostly relate to the status of closed joint stock companies, since the Law on securities does not make any clear distinction between closed and open joint stock companies, and therefore fails to provide the necessary conditions for using some advantages, prescribed by the Company Law, that exist if business operations are performed through closed joint stock companies. These inconsistencies should be removed by amendments to the Law on Securities and other financial instruments.

- The provisions of the Law regulating notification of financial documents to minority shareholders should be amended so that companies are not required to reveal sensitive information or go through onerous procedure for minority shareholders.

- The new Company Law leaves some legal vacuums and contains unclear provisions. The greatest concern relates to the process of conforming existing companies with the new Company Law, which must be carried out within two years from the date when the Law came into force, i.e. by 30 November 2006. However, it is still not completely clear whether the old Company Law should be applied during this term and, if yes, in which cases. There are some reported cases that the Commission for Securities directly applied the provisions of the new law relating to share capital increase of open joint stock companies, without taking into account the companies' Articles of Association, and practically forced them to harmonize with the new law, even before the expiry of the legal prescribed term. The judicial practice and the practice of the competent state bodies should interpret all of the unclear provisions uniformly, in order to prevent legal uncertainties and interpret the law in a way which will facilitate companies' business, and attract foreign investments.

Law on Foreign Trade

The main purpose of this Law is to develop a legal basis for external trade relationships, together with the Customs Law and the Law on Foreign Currency Transactions (2002) as the old Law, enacted in 1992 was considered too restrictive and obsolete. Hence, the guiding principles are: (1) harmonization with the WTO and EU rules as a part of the accession process; (2) deregulation; (3) liberalization; (4) transparency and (5) providing the government with the necessary economic policy instruments.

The proposed regulatory scope of the new Law is narrow for the trade of goods (transnational). The provision of services by or to foreigners in Serbia is left to other specific Laws (e.g. Law on Advocacy or Insurance Law). As for business activities abroad, this is an area that is vastly liberalized and thus regulated only by a few general provisions.

The Law deals mostly with non-customary measures for the protection of the national market (anti-dumping and countervailing measures; increasing import safeguards; balance-of-payments protective measures; import/export quantitative restrictions; licences in some cases; technical, sanitary and phytosanitary conditions, etc.). The Law also refers to domestic companies interested in doing business and making investments abroad, but generally due to deregulation and liberalization principles. Rules applying to foreign companies are compounded in a couple of articles.

The key feature of the Law is the promotion of freedom in foreign trade and limiting possible restrictions only to those permitted by the WTO and EU rules. Any legal act that is not in accordance with this Law and aimed to restrict this liberty is deemed invalid. Also, imported goods and foreign business entities are guaranteed national treatment, which is a positive sign. On the other hand, by introducing the notion of permitted restrictions, a crucial balance is satisfied – it is between freedom of trade and the need to protect the national market. The competent institutions for implementing the Law is the Ministry of Foreign Economic Affairs and the Republic Government.

Positive Signs

• Domestic business entities (companies and sole traders) are no longer required to register their engagement in "foreign trade activity". In other words, every company is authorized to exercise its (nationally) registered activity abroad, as it does in national trade. This freedom is accompanied by contracting freedom in foreign trade. Essentially, contracting parties can arrange their relationship as they wish, and unlike the old Law, there are no more suggested types of agreements (e.g. a contract on long-term manufacturing cooperation is certainly outdated).

• Provisions on the non-customary protection of the national market are in line with WTO standards and principles, the main one being that monetary (customary) restrictions are always preferable to quantitative restrictions. The conditions and procedures for these measures are now made simpler and more transparent. For instance, quantitative restrictions are permitted only as an import safeguard and balance-of-payments protective measures. Particular care was given to the development of anti-dumping measures, i.e. measures against the import of a product at a price below its "normal value", and countervailing measures, i.e. measures against imports of subsidized goods. Still, the very essence of these measures (duties) remains the same; only the procedure of implementing them appears more complex.

• Foreign business entities are defined by seat/residence criteria. If they wish to do business in Serbia, they are permitted to have representative offices and branches (the old Law regulated agencies and representative offices).

FIC Recommends

• The possibility of concluding agency contracts (e.g. dealerships) was omitted and should be dealt with in the legislature;

• Permitting foreign branches is inconsistent with the Foreign Investment Law (2002) – if a foreign company wants to establish a full corporate presence in Serbia, it can create a new company or acquire a share in an existing one, but it can not form a branch. The only solution for the latter is to apply a specific rule in favour of this Law, when it is enacted, and using the Company Law (2004), which generally allows foreign branches.

• An issue arises when these provisions are linked to transitional provisions of the Draft Law – the current subsidiary regulation to foreign trade becomes ineffective once the new Law comes into force. That means that there will be a certain period of time while some legal loopholes exist (e.g. in the Decree on Foreign Representative Offices). These should be rectified as soon as possible.

• Provisions on temporary regimes and measures allow some residuals of the old system (compensation arrangements, foreign trade that is free of charge, export improving measures, etc.) until the other

Laws comply with this one, but their application definitely ceases at the moment Serbia becomes a member state of the WTO. This causes an unnecessary lack of clarity.

Court System

Organization of Courts

The Law on the Organization of Courts enacted in 2001 regulates the organization of the court system in Serbia. Nevertheless, the provisions of the old Law on Courts, regulating the jurisdiction of courts, shall remain in force until 2007, and the provisions of the new Law shall be applied as from 2007, due to non-fulfilment of material preconditions for its implementation. There has been no new legislation passed in 2005 relating to the organization of Courts in general.

The court system consists of:

- The constitutional court
- Courts of general jurisdiction
- Courts of special jurisdiction

Courts of general jurisdiction are the following: the Supreme Court, appellate courts, county/district courts and municipal courts. The courts of specific jurisdiction are the following: commercial courts, Higher Commercial Court, newly introduced offence courts, Higher Offence Court, and Administrative Court.

The Supreme Court is the highest court in Serbia and acts as the court of second instance to the Higher Commercial Court, the Higher Offence Court and the Administrative Court. It is the final court of appeal for all decisions that do not relate to constitutional issues.

Appellate courts are the new institutions introduced by the Law on Organization of Courts in 2001. They are to be second instance courts to the municipal and county/district courts. The formation of appellate courts has been postponed until 2007.

County/district courts are established to cover the territory of a county/district. In some matters, they are courts of second instance to municipal courts, and in others, they act as courts of first instance.

Municipal courts are usually courts of first instance and are established to cover one or more municipalities. For example, there are five municipal courts in Belgrade, covering 11 municipalities. The jurisdiction of municipal courts covers all matters not relating to commercial issues.

Commercial courts adjudicate commercial matters. The Higher Commercial Court is the second instance court for these matters.

Offence courts adjudicate offence matters that are not within the jurisdiction of administrative bodies. The Higher Offence Court is the second instance for all offence matters. These courts will commence their activities in 2007.

The Administrative Court is a new institution introduced by the Law on Organization of Courts in 2001 for adjudicating administrative matters. Formation of the Administrative Court is postponed until 2007.

The Constitutional Court of Serbia and Montenegro has the authority to rule on the legality and constitutionality of laws enacted by Parliament and of government and executive actions. The Court is entitled to order the repeal of laws, with or without retroactive effect. The Court may be accessed directly by anyone, but cases are usually brought to the Court through a lower court or during the legislative process. The issue of the status of this Court may be resolved by any constitutional changes which may occur within the structure of the State Union in 2006.

The Law on Civil Procedures and the new Law on Enforcement Procedures came into force in February 2005 and have been applied since.

The new Law on Civil Procedures gives more importance to the preparatory hearing, and prescribes that parties shall provide the court with all the facts and evidence they will present at the main hearing. Due to this, and any other important changes, it is expected that the application of the law will make the court procedures more efficient.

The adoption of the Law on Enforcement Procedures is a big step in the process of reform of the enforcement procedures. The procedures of the enforcement of court decisions are supposed to be accelerated, with improved legal certainty and impetus provided for more efficient functioning of the financial markets.

FIC Recommends

- The systematic and continuous education of judges, particularly on the application of the new procedures, is necessary.

- Better organization of courts continues to be essential. Namely, the new Law on the Organization of the Courts envisages solutions, which will positively influence the faster and more efficient solving of court cases once applied. Therefore, serious preparations for the implementation of this law are necessary, prior to it coming into force.

- The adoption of the Law on Civil Procedures and the Law on Enforcement Procedures represents an important step in the reorganization of the Court system in Serbia and its effects can be felt, albeit inconsistently, throughout the system.

Intellectual property

Intellectual property (IP) rights are protected and regulated on the level of the State Union of Serbia and Montenegro. The relevant institution granting these rights is located in Belgrade, being the Agency for Intellectual Property. In Serbia and Montenegro, the following IP rights are protected: patents, designs, trademarks, indications of the geographical origin, topographies, plant varieties, undisclosed information and copyright and related rights. All of these rights are regulated and protected by a separate law.

Positive Signs

- In order to harmonize the IP rights in Serbia and Montenegro with the relevant provisions expressed in the EU Regulations and Directives, in the TRIPS Agreement and in the International Conventions, a general reform was launched in 2003. To that end, the following laws were adopted by the Parliament of the State Union of Serbia and Montenegro and came into force: the new Patent law, the new Trademark Law, the Design Law, the Law on Topography of integrated circuits as well as the Law on Copyrights and related rights.

- The other relevant laws are entering the stage of the final draft and it is quite reasonable to expect that they will be passed during the first half of 2006.These are the Laws on Geographical Indications, Trade Secrets, and Plant Verities.

- The draft Law on special powers for efficient IP protection (title yet to be defined) will include legal provisions adopted from TRIPS Agreement in order to provide efficient protection of IP rights, by which the authorities will have the right on the spot, by the application of various measures, to stand in the way of the abuse of IP rights. A legal framework will be created, with new solutions for the Executive Authority to reach, according to official duty or upon the request of the holders of the IP rights, who until now had to seek protection on their own, through legal proceedings and private criminal complaints.

- Once all of the relevant laws regulating the protection of the above mentioned IP rights in Serbia and Montenegro are passed and come in to force, there will be a fully harmonized legal system of regulation and protection of IP rights attractive for foreign investors, providing full legal security for protection of their rights.

FIC Recommends

• For the implementation of the measures prescribed by the TRIPS Agreement, which provide for efficient protection of IP rights, it is very important to ensure the adoption of the Law on special powers for efficient IP protection (title yet to be defined), which will provide for better functioning of the relevant bodies authorized for the inspection and protection of IP rights.

• The prevention of infringement of IP rights is the most important IP issue for a foreign investor in Serbia and Montenegro. It is very important to introduce more severe sanctions for the violation of IP rights, discouraging piracy or other forms of infringement, in order to present the intent to fight piracy and other forms of IP infringements. This will require a reorganization of the current judicial system, by establishing a separate department in relevant courts, specializing in IP cases. A strong media campaign is necessary in order to educate the general public on the main IP issues, to raise IP awareness, and to create an atmosphere of prevention of violations of IP rights.

Securities

The Serbian Law on Securities and Other Financial Instruments Market (the Law on Securities) was adopted in November 2002, but entered into force in September 2003. The Law on Securities were amended couple of times, and last amendments were enacted in 2005. This Law is followed by series of by laws and regulations, adopted by the Securities Exchange Commission (SEC) and the Central Securities Deposit and Clearing Register(the Central Registry of Securities).

Generally, Law on Securities regulates three main fields: the process of distribution of and trading in securities by public offering, the activities of authorised participants on the market and the role of the SEC.

Distribution of and trading in securities

Issuing of new shares through public offering

The process is initiated by publishing a public announcement and prospectus on the issuance of new shares (subject to prior approval by the SEC), followed by a series of actions required for subscribing and paying for the shares and obtaining the authorisation on issuance of shares from the SEC. It ends with the transfer of shares to the securities account of the new owner.

Trade in securities through the stock exchange

Trade in securities on the stock exchange can be performed only through broker-dealer companies or authorised banks through public offering.

Take-over bids

Purchase of more than 25% of voting shares of a company can be carried out only through a take-over bid, which must obtain prior approval of the SEC.

Authorised Participants on the Market

Authorised participants on the market are the Stock Exchange, the Central Registry of Securities, authorised banks and broker-dealer companies and the custody banks. The Law on Securities provides the general framework for their foundation and operations, as well as rights and obligations. These issues are more closely regulated through by-laws and rulebooks of the SEC.

Security Exchange Commission

A crucial role and significant power was given to the SEC. The SEC is responsible for, among others, the rules related to the application of the Law, issues licences and supervises the operations of authorised participants in the market, sets standards for registration of stock exchange trade operations, establishes contents of mandatory information that is to be submitted to it and published, monitors the state of and trends in the securities market and undertakes corrective actions.

FIC recommends

Apart from the Law on Securities and bylaws related to, it is necessary to adopt the Law on Takeover of the Companies and the Law on Investment Funds.

Draft Law on Employment of Foreigners

A draft law on employment of foreigners was released in late 2005. The draft is a concern as it will introduce annual quotas for work permits for employing foreigners and, once the quota is filled, all new applicants will be denied. Additionally, the procedure for employing foreigners will be more complex. A company wishing to employ a foreigner must establish with the National Employment Service whether there is a Serbian citizen with the same qualifications and, if there is such a person, the Serbian citizen will have priority for the position.

Chapter 2

Law on Competition

The Competition Law (Law on Protection of Competition) was adopted on 16 September and became effective on 24 September 2005. It resembles similar pieces of legislation in the EU, its member states and in the countries aiming to become members. Hence, the Competition Law covers three main areas of potentially negative effect on competition:

1. Prohibited agreements;
2. Abuse of a dominant market position;
3. Concentrations, i.e. mergers, acquisitions and joint-ventures (jointly referred to as: *concentrations or mergers*).

Although the previous Anti-Monopoly Law did cover some of the above topics, it remained practically ineffective. Despite some material flaws of the new Law, it is unlikely that it will face the destiny of its predecessor.

The new Competition Law aims to restrain and control such business practices and corporate governance strategies that may prevent, deter or impede competition in the market. It calls for the establishment of a Commission for the Protection of Competition, the intended instrument of regulatory control.

Prohibited agreements are such contracts, agreements, mutual understandings and similar business practices (either horizontal or vertical) containing provisions that may harm competition in the marker (e.g. setting prices, dividing markets, establishing cartels, assigning exclusivity etc.). The competition authority may exempt certain agreements from being prohibited, either by approving individual exemptions or, if subjecting to block exemptions, on a time-limited basis.

Similarly to the prohibited agreements, an abuse of a dominant market position is defined as exercising a dominant position in the market (defined as having a market share of 40% or more individually, or 50% or more collectively), in a manner which involves demanding unfair trading, which is also generally defined in the Competition Law.

Finally, the Competition Law introduces merger controls over the market participants, requesting them to notify any act of concentration that may prevent, deter or impede competition. The mandatory notification is triggered by a merger, wherein the total combined annual turnover of the parties exceed EUR 10 million domestically, or EUR 50 million worldwide. The FIC is of opinion that these thresholds are set too low and hence trigger the mandatory notifications too often. Moreover, these thresholds are mistreating foreign investors, most of which have a turnover exceeding the EUR 50 million trigger.

It should be noted that the Competition Law mandates severe sanctions for violations thereof, with pecuniary fines ranging from 1 to 10% of the total combined annual worldwide turnover of the parties involved. Furthermore, responsible person(s) in the parties face similar pecuniary fines and the prohibition to perform certain activities.

Implementation of the Competition Law

One of the main concerns that the Competition Law had raised was the capacity to implement this rather sophisticated piece of legislation. And although the correct approach would consist of dedicated capacity building and adaptation, the too short vacatio legis period (of only eight days) and the failing of the legislator to meet its own deadlines can compromise some positive efforts in regulating the competition area.

Until the Commission for the Protection of Competition is established (the deadline expires in January 2006), the Ministry of Trade, Tourism and Services assumes its competencies. To date, several concentrations have been notified, but evidently, some have not.

Positive Signs

- In an effort to harmonize Serbian legislation with the EU standards, in perspective of the integration processes, the Serbian law-makers commenced drafting this law in 2004. Most of its provisions are drafted as a mirror image to the EU merger regulation, Polish, Croatian, Slovenian and French competition laws.

- Therefore, this law should generally be welcomed in Serbia. It introduces checks and balances that are aimed at raising fairness and competition in the market and also at restricting monopolies. The establishment of the Commission for the Protection of Competition should provide a solid, unbiased regulatory authority – an instrument for the accomplishment of the above goals.

FIC Recommends

- Block exemptions for certain concession-like projects or Public – Private Partnerships should be allowed either for an unlimited or long-term period (e.g. up to 25 years or more), as some infrastructure projects demand longer periods of exclusivity to become profitable.

- Bylaws prescribing block exemptions should be adopted in the near future. Further, exclusivity agreements (as being rather common and competition-friendly) should be exempt.

- Mandatory notification thresholds should either be set at a higher level or prescribed cumulatively (both domestic and worldwide), instead of alternatively (either domestic or worldwide).

- The commercial courts or a similar, more competent authority should be responsible for mandating sanctions for violations of the law, instead of the misdemeanour courts.

- The deadline for the establishment of the Commission for the Protection of Competition should be met.

Chapter 3

Labour Law

A new Labour Law was adopted in March 2005 and amended soon thereafter, in July 2005. While the previous Labour Law, which was adopted in 2001, was free-market oriented and in general widely praised by the investment community, the new Labour Law represents a huge step back for Serbia in this area.

The new Labour Law mandates a rather complex salary structure. In that regard, it reintroduced certain elements of the salary from the socialist period, such as allowances for years of service, food, annual vacation, etc. These changes resulted in higher labour and administration costs for the employers. In addition, the new mandatory structure of the salary is so complex that employers face difficulties explaining it to the employees and, as such, it represents an additional and unnecessary source of labour disputes.

As before, employment is established by concluding an employment contract in writing. The new law limits the duration of fixed term employment to a maximum of one year, which makes it more difficult for the employer to adjust to fluctuations in the market. The Law envisages a basic working week of 40 hours, and guarantees at least 20 days of vacation per year to the employee.

Termination of employment by the employer can be only for a just cause concerning the employee's working capability, skills or conduct, and the employer's needs. A just cause is deemed to exist in case of unsatisfactory working results, lack of the required knowledge and skills, breach of the working obligations, breach of working discipline, criminal acts in connection with work, absence from work upon termination of unpaid leave, misuse of the right to sick leave, or layoffs due to economical, technological or organizational reasons.

The employer is obliged to negotiate a collective agreement with a representative union, but not to conclude one. If the employer and the relevant union do not come to an agreement, labour relations can be regulated by an unilateral act of the employer (employment handbook).

Implementation of the Labour Law

FIC members are facing numerous problems regarding the implementation of the Labour Law by competent judicial and executive bodies: the courts are applying legal concepts from previous laws, various ministries have incompatible positions regarding the same issues, the courts have a completely uncoordinated practice, administration officers usually do not have the required knowledge of basic regulations, etc. Therefore, much more effort has to be taken regarding the education and training of judiciary and administration.

FIC Recommends

- We find that, in many aspects, the newly adopted labour law does not meet the needs of a free market economy and is not favourable for the further development of the labour market in Serbia. The FIC addressed numerous letters with specific proposals to the Ministry, both before and after adoption of the law. In recent public statements, the Ministry has announced new amendments to the law to be presented to the Parliament for the spring session. Some of these amendments should resolve certain

practical problems, but we deem that additional changes are required. What the scope of the expected amendments will be and whether they will improve the situation in this area remains to be seen in the near future.

Chapter 4

Privatisation

An overview of the privatisation process in Serbia since 2001

The privatisation process in Serbia is defined by the Law on Privatisation and is mainly based on the model of direct sale. Under this model, up to 70% of the capital of a firm is sold either by public tender or public auction to a private buyer, except in those companies which undergo restructuring, where 100% of the capital is sold to private investors.

The privatisation process was launched in 2001 and the first tangible results were achieved in 2002. The process almost tripled its speed in 2003. A total of 696 privatisations were completed via tender and auction procedures (the success rate is 85%), while 121 minority packages held by the government were sold to private buyers via the capital market. The total generated privatisation receipts of EUR 947 million in 2003 far exceeded projections[1]. The pace of privatisation in 2004 was much slower compared to 2003, when large companies, such as Beopetrol (oil company) and two tobacco factories (one in Vranje and the other in Nis), had been sold to Lukoil, British American Tobacco and Philip Morris International. The three tender sales realised 63% (EUR 554 million) of the total sale in 2003. In 2004, mainly small and medium enterprises, i.e. the least problematic ones, were targeted. 2005 was marked by the privatisation of a number of state owned banks, which continues in 2006.

The table below shows privatisation results achieved in the period 2002 – 2005[2]

	OFFERED	SOLD	SUCCESS RATE	SALES PRICE (000 EUR)	INVESTMENT COMMITMENT (000 EUR)	SOCIAL PROGRAMME (000 EUR)
PUBLIC TENDER	93	51	55%	888,286	720,415	271,995
PUBLIC AUCTION	1,542	1,206	78%	563,566	153,692	
CAPITAL MARKET	738	483	65%	313,036	5,902	
OVERALL	2,373	1,740	73%	1,764,888	880,009	271,995

The restructuring and privatisation of large conglomerates and utilities is still pending. The privatisation of big companies, such as the Petrol Industry of Serbia (NIS), Electric Power Industry of Serbia (EPS), Railway Transport Company (ZTP), PTT Post, Producer of Electronic Devices (EI NIS), Belgrade Airport and JAT Airways, is planned for 2006.

Positive Signs

• In light of the anticipated finalisation of the privatisation process in Serbia, amendments to the Law on Privatisation were adopted in 2005. They may be identified as a contributing factor to ending the social and state ownership of companies. The amendments introduce changes which are expected to speed up the process of privatisation and make state and socially owned enterprises more attractive. For instance, one of the major changes is the stipulated obligation of all state creditors to write

1 Source: IMF country Report 03/296 of September 2003.
2 Source: www.priv.yu

off debts towards an enterprise in the privatisation process, to be repaid from the funds raised by the sales. Other creditors may, but are not obliged to, do the same. The effect of the write-off is a better equity-debt ratio for the company in privatisation, and the increase of its attractiveness for potential investors.

• On the other hand, better regulation of issues is presently covered by Articles 41-41g of the Law, regulating the transfer of shares from the buyer of the socially owned capital to the Share Fund in case of termination of the Sale Purchase Agreement, as they could not be easily implemented in practice (especially with Commercial Courts).

• The Law on Bankruptcy Procedures, and related legislation, is expected to contribute to better and more efficient procedures for the protection of creditors in those companies undergoing bankruptcy before the leftover capital/property, if any, is privatised.

• Furthermore, the Law on Bankruptcy Procedures, together with Company Law, will reinvigorate the restructuring of large conglomerates and utilities, and foster the creation of plans for selling the assets of bankrupt companies.

FIC Recommends

• Laws and regulations in the area of securities and financial markets should be passed to cover incompletely regulated segments.

• Foreign entities should be entitled to own construction land.

• The land registries should be updated.

Chapter 5

Taxation

A. Taxation of Corporations

Tax Residents

A legal entity is considered to be resident if it is established or has its place of effective management in Serbia. Residents are taxed on their worldwide income, while non-residents are taxed only on their Serbian sourced income.

Taxable Entity

A taxable entity may be a joint stock company, a limited liability company, a socially owned company, a general partnership, or a limited partnership, as well as any other legal entity selling goods and services.

Tax Rate and Tax Base

As of 1 August 2004, the tax rate is 10% and the tax year is the calendar year. The tax base is determined by adjusting the taxpayer's accounting profit before tax determined according to IFRS (from its profit and loss account) and in accordance with the Corporate Income Tax Law.

Areas where adjustments of the tax base may arise include:

- Inventory (valued at average cost or FIFO method)

- Costs of employment (e.g. salary, social security contributions): fully deductible, excluding severance payments that are calculated but not paid out

- Depreciation: allowances are granted for intangible long-term assets, tangible fixed assets which have a useful life of longer than one year and a purchase price higher than average gross wage in Serbia at the time of purchasing. All tangible fixed assets are classified in five groups, according to the depreciation rates. The straight-line method applies to the purchasing price of fixed assets classified in the first group (separately on each asset) and the declining balance applies to the whole group value for those classified in the remaining four groups

- Provisions: the write-off for specific doubtful debts is tax deductible only if it is documented that collection was attempted through the Court, while provisions are tax deductible upon expiring, 60 days from the due date. Moreover, long-term provisions for the renewal of natural resources, provisions for costs during the warranty period and provisions for retained deposits and caution money are tax deductible.

- Expenses for health care, scientific, educational, humanitarian, religious, ecological and sport-related purposes are tax-deductible up to 3.5% of gross receipts

- Expenses for cultural purposes are tax-deductible up to 1.5% of gross receipts

• Membership fees paid to chambers of commerce and other associations (except political parties) are deductible up to 0.1% of gross receipts

• Advertising, promotional and business entertaining expenses are tax deductible up to 3% of gross receipts

Thin capitalization

Interest on loans from a related company, which exceed four times the amount of share capital and reserves multiplied by 110% of the interest rate of the Central Bank of the respective currency, is not deductible. The excess may be carried forward and deducted in the following year.

Transfer pricing

A company must identify transactions with related companies and compare them with arm's length transactions when filing its tax return. Any unexplained differences are included in the taxable income. The arm's length price is determined by using one of the following methods: comparable uncontrolled price method, cost plus method or resale price method.

Fundamental mistakes

Income or expenses caused by fundamental mistakes or changes in the accounting policy that are not presented in the financial reports for the period of their arising should affect the financial report for that year.

A fundamental mistake is defined by IFRS as a mistake that changes taxable profit/loss by more then 2%.

Tax Incentives

There are a number of incentives intended to attract investors to certain sectors and designated areas and to promote employment.

Tax Holidays

A proportional tax holiday of ten years is available for a taxpayer who makes an investment in tangible fixed assets of at least CSD 600 million and creates additional employment for at least 100 employees during the investment period. The tax holiday begins when these two conditions are met but only from the first year in which taxable income is generated.

The tax holiday is proportionally based on the ratio between the investment concerned and the total fixed assets after the investment. Until the conditions for the tax holiday are met, the taxpayer is entitled to the tax credits mentioned below.

Only new fixed assets purchased in Serbia or imported fixed assets (new or second-hand) are recognized for the holiday. It is not clear whether fixed assets provided as a contribution in kind are eligible.

New employees are not required to be unemployed prior to employment with the taxpayer to satisfy this need.

If a condition for the tax holiday is breached during the holiday period, the taxpayer will lose the holiday. The taxpayer must then pay the tax saved, increased by the relevant inflation rate.

A five-year tax holiday exists for companies investing at least CSD 6 million and employing a minimum of five workers in underdeveloped regions.

Profit earned on the basis of a concession is tax exempt for five years.

Tax credits

A taxpayer who employs additional staff previously registered as unemployed is granted a tax credit for the value of their gross salaries. The tax credit is granted for employment performed in that taxable year.

A company which acquires fixed assets may reduce its tax liability by 20% of the investment, but the reduction may not exceed 50% of its total tax liability. A small company may decrease its tax liability by 40% of the investment, but the reduction may not exceed 70% of its total tax liability.

When acquiring fixed assets, companies registered in particular activities, such as agriculture, fishing, types of textile production, production of motor vehicles, machines, medical equipment etc, may reduce their tax liability by 80% of the investment.

Unused credits for investment in fixed assets may be carried forward for ten years and offset against future tax liabilities.

Accelerated depreciation

Accelerated depreciation is allowed in respect of some fixed assets associated with ecology, scientific research and education as well as computer equipment. Accelerated depreciation rates are up to 25% higher than rates prescribed by the Corporate Income Tax Law.

Employment of Disabled Persons

The tax liability for companies employing disabled persons is decreased in the ratio of the percentage of such persons to the total number of employees.

Exemptions

Non-profit organizations have special rules for tax exemption.

Groups of Companies

Companies are considered to be a group if one company controls 75% or more of the shares of another.

A group has the right to tax consolidation if all companies are Serbian residents. Each company files its own tax return and the parent company files a consolidated return for the entire group.

In the consolidated return, losses of one or more companies are offset by the profits of other companies. Each company is liable for tax proportional to its share of the profit of the group.

Withholding taxes

Withholding tax, at a rate of 20%, is levied on dividends, interest, royalties, capital gains and rent payments for movables and immovables paid to a non-resident.

An applicable double tax treaty may reduce withholding tax rates.

Losses

A company may carry loss forward for ten years.

Assessment and collection

Corporate tax is payable in monthly advance instalments by the 15th of the following month, based on the tax liability of the preceding year using the self-assessment method.

The tax return and tax balance sheet must be filed by 10 March of the following year. The taxpayer establishes his monthly advance tax obligation in the tax return, based on the tax balance and estimation of future years' income/losses.

Developments in 2005

Positive Signs

- Serbia has developed a market orientated and attractive tax system, reflected in a low corporate tax rate and investment incentives;

- The Ministry of Finance clarified several unclear provisions dealing with tax depreciation;

- Dialogue with the Ministry of Finance improved through several meetings between FIC representatives and the Ministry;

- There are a number of examples of tax inspectors adopting a responsible and more educated approach when conducting audits of taxpayers.

FIC Recommends

- Other than corporate tax, the taxes which a company has to pay (e.g. property taxes such as public land use charges and taxes on the transfer of absolute rights, signboard tax, charge for water use and protection, charge for the protection and improvement of the environment, mineral raw material use charge) should be reduced and simplified.

- Many investors have a financial year other than the calendar year. It is necessary to introduce the possibility of having a different tax year to the calendar year.

- Clarification of Permanent Establishment (PE) regulations is required e.g. the registration of PEs with the Tax Authorities, the tax balance of the PE, payment of tax.

- The limited deductibility of advertising costs should be reconsidered. This is more applicable to entertainment costs than advertising.

- Further clarification of deductibility of expenses related to different types of provisions is required. Moreover, it necessary to clarify provisions relating to the costs that have not occurred for performing business activities.

- Draft legislation should be submitted to the FIC or another appropriate forum for comment, before being finalized.

B. Taxation of Individuals: Personal Income Tax

Personal income taxation in Serbia is carried out on two separate levels: when income is earned and (on an annual basis) on the total worldwide income.

Resident vs. Non-Resident

Tax residents are taxable on worldwide income, while non-residents are taxable only on the income derived from Serbian sources.

For tax purposes, a tax resident is a natural person that fulfils the following criteria:
- They are present in the territory of the Republic of Serbia for more than 183 days over a period of 12 months, commencing and ending in the fiscal period concerned
- If they have a habitual abode or centre of vital interests in the territory of Serbia

Taxation Of Serbian Source Income

Serbian source income comprises: employment income (salaries), income from agriculture and forestry, self employment, royalties, real estate (lease), and capital derived in the territory of Serbia, as well as other personal income. The rate is 14% or 20%.

Self-employment income tax is levied at the rate of 10%.

Taxation Of Salary

Only salary paid by a local employer is subject to salary tax on a monthly basis. Salary earned abroad, i.e. paid by foreign employer, is exempt from salary tax (if tax is withheld and paid abroad by the foreign payer of income), but is taxable on an annual basis.

According to the tax legislation, income derived from employment in Serbia is subject to salary tax, at a rate of 14%. Salary tax is withheld at source, when the salary is paid. The employee is the taxpayer, but their employer is responsible for calculating and paying salary tax.

The taxable base is the gross salary, which includes salary tax and social security contributions. Fringe benefits are considered as part of the gross salary and are subject to salary tax and social security contributions.

Subject of Salary Taxation

The following income is also subject to salary tax:

- Compensation received, based on a contract for temporary and occasional engagements
- Use of company car for private purposes
- Premium paid by the employer on behalf of the employee, related to voluntary pension insurance

Salary tax is applied to compensation received based on a contract for temporary and occasional engagements, concluded directly with an employer or with persons employed through the Youth and Employment Centre, except persons who are still at school and are not older than 26.

The use of company car for private purposes is also taxable. The tax base is 1% of the market value of the car.

Premiums paid by an employer on behalf of an employee, related to voluntary pension insurance, is treated as a salary as well. If the insurance premium is withheld and paid by an employer on behalf of an employee, the employee would be tax exempt in the amount of insurance premium paid, up to 3,000 CSD per month. Note that tax exemption is applied only to voluntary pension and disability insurance, excluding voluntary health insurance.

Withholding Tax

Taxpayers will be liable to calculate and pay Serbian income tax on their foreign-sourced salaries, if it is not taxed abroad.

According to the Law on Personal Income Tax (Article 107), the taxpayer is obliged to calculate and pay tax on salary and other types of income generated in or from the sources outside Serbia, if the tax is not withheld and paid by the payer of income.

Thus, if a salary is paid by a non-resident employer, the recipient of the income has an obligation to report the salary himself and file the tax form within 15 days of receiving the salary, unless tax on such income was already paid abroad.

Furthermore, if the tax rate outside Serbia is less than the Serbian rates, tax will be paid on the difference.

Social Security Contributions

Compulsory social security contributions are calculated and withheld by the employer from the remuneration paid to employee. There are three kinds of social security contributions: pension and disability insurance, health insurance and unemployment insurance. All three kinds of contributions are payable by employers and employees at equal proportional rates. The rates of social security contributions are as follows:

- Pension and disability insurance 11%
- Health insurance 6.15%
- Unemployment insurance 0.75%

The amount of payable social security contributions is limited to the amount due for five average gross salaries i.e. should the monthly salary exceeds five average gross salaries, social security contributions are not increased.

Annual income tax

Taxpayer

Tax residents are liable to pay annual income tax on the total net income earned worldwide. Worldwide income consists of the total net income earned in Serbia and the total net income earned worldwide, during the calendar year.

Income subject to annual income tax includes income derived from employment, as well as from other sources. Otherwise, income from capital is excluded and is not subject to the annual income tax.

Tax rate

Annual income tax is levied at a rate of 10%, in addition to the salary tax paid during the year.

Taxable base

Annual income tax is levied on the total net income earned by tax residents in the calendar year. Only the portion of total net income above the non-taxable amount is taxable. The non-taxable amount is established by the law and is adjusted on an annual basis, based on the salary growth rate.

The non-taxable amount for foreign nationals is substantially higher than the non-taxable amount for local citizens.

The non-taxable income is as follows:
- The non-taxable amount for foreign nationals is set at ten times the amount of the average annual salary in Serbia
- For local citizens, the non taxable income is set at four times the amount of the average annual salary in Serbia

In accordance with the non-taxable level, personal allowances are as follows: the basic allowance for taxpayers is in the amount of 40% of the average annual salary in Serbia and 15% of the average annual salary for dependent family members.

Tax assessment and collection

Annual income tax is established by the tax authorities based on the data included in the annual income tax return. The deadline for filing the tax return is 15 March for income earned in the previous calendar year.

The tax is assessed based on the data in the tax return. Once established by the tax authorities, the tax has to be paid within 15 days from the receipt of the tax assessment by the taxpayer.

Taxation of Expatriates

Tax Exemptions Granted To Foreign National

Fringe benefits received by a resident foreign national from his local employer, are exempt from salary tax in the amount equivalent to 35% of the local salary paid to them.

To benefit from tax exemption, the local employment of a foreign national in Serbia should not exceed three years. After three years of local employment, the foreign national is no longer entitled to tax exemption on fringe benefits.

Social Security Contributions of Expatriates

The status of expatriates regarding social security insurance depends on whether the country of the origin has signed the Social Security Convention with Serbia and Montenegro or not. The purpose of this Convention is to avoid double payments of social security contributions by citizens in the countries involved. Provided that expatriates are covered by recognized social insurance, they do not have to pay local social security contributions in both countries.

Comparison with 2005

In 2005, there were no changes to the Law on Personal Income Tax. Some amendments to the Law on Compulsory Social Security Contributions were passed without impact on the social status of local individuals nor foreign nationals.

Positive Signs

- Tax exemption and lower tax rates encouraged foreign nationals to pay taxes in Serbia

FIC Recommends

- The Law should be amended to clarify the criteria to qualify a person as a tax resident in Serbia. The moment when the status of tax resident is obtained also requires needs to be clarified: whether an individual will be considered to be a tax resident from the day he commences his residence in Serbia, bearing in mind his intention to stay, or whether he should wait for a period of 183 days to expire before being considered to be a tax resident

- The Law should be made clearer on the issue of the application of tax credits in the context of annual income tax, i.e. the annual income tax return should be reconciled with the provisions of the law.

- The law needs to be made clearer with regard to withholding tax on income received from abroad (Article 107), when such tax has to be calculated and paid in Serbia by the taxpayer, and when that would not be necessary. Also, Article 107 should be reworded and be consistent with the oral opinion from the Ministry of Finance i.e. the taxpayer does not have to calculate and pay tax if income received from foreign sources was taxed abroad.

- The Law should be amended to be more specific when defining the taxpayer in Article 107.

C. Indirect Taxation

Value Added Tax (VAT)

Regime

VAT was introduced in Serbia on 1 January 2005. The Serbian VAT system is modelled on the 6th EU Directive.

Taxable persons

General

Any person supplying taxable goods or services in the course of business on a regular basis is considered to be a taxable person. The term 'business' refers to all independently carried out activities of producers, traders and suppliers of services.

VAT representative

Foreign entities without a permanent establishment in Serbia but making taxable supplies in Serbia are required to appoint a VAT representative, who will be responsible for fulfilling all administrative obligations and effecting the payment of the VAT due on behalf of the foreign entity. Should foreign suppliers of services fail to comply with such an obligation, beneficiaries are liable to account for/pay the related VAT.

Taxable operations

Transactions subject to VAT refer to the supply of goods and services as well as the import of goods carried out by VAT payers. In order for a supply to be taxable, it should be made (or deemed to have been made) against a consideration.

Supply of goods

The supply of goods refers to the actual transfer of the ownership over goods, or any other transfer which enables the recipient to dispose of such goods in an ownership capacity.

As a rule, the place of supply of goods is the location of the goods at the moment of dispatch, with certain exceptions applying to goods which are destined for transport, installation, or for the delivery of specific goods such as electricity, water, gas and thermal energy.

Supply of services

The supply of services is taxable in Serbia if the place of supply is deemed to be in Serbia. The general rule is that the place of supply is considered to be the place where the supplier has his business, his fiscal establishment or residence. However, there are several exceptions similar to those listed in the sixth EU Directive for which the place of supply is determined in a different way e.g.:

- services related to immovable property – the place where the immovable property is located;
- renting and leasing of movable goods (excluding car rentals), telecommunication services, lawyers, auditors, advisors etc. services – the place where the recipient of the services is located;
- services related to culture, art, science, education, etc. – the place where the service is provided.

The term 'services' applies to all transactions which are not considered to be a supply of goods.

Import of goods

Goods brought from abroad into the territory of Serbia are considered to be imported, thus falling within the scope of VAT. Certain exceptions apply (i.e. supply of goods under customs duty suspension regime).

Reverse-charge VAT

For services provided by a foreign supplier for which the place of supply is deemed to be in Serbia, and in instances where the foreign supplier has not appointed a VAT representative in Serbia (e.g. leasing and rental of tangible assets, marketing, e-services, banking, and other specified services), the law allows for the application of the so-called VAT reverse-charge mechanism by the Serbian beneficiary.

Under the reverse-charge mechanism, the beneficiaries have to simultaneously recognise the relevant VAT as both input and output VAT in the return of the relevant month.

Taxable base

VAT is assessed on the total amount received or to be received by the supplier, as consideration for the supply of goods or services, including taxes and excise duties, commission, packaging, transport and insurance expenses. Pre-agreed discounts provided to clients are not included in the taxable base.

Tax rates

The following rates apply in Serbia:

- 18% standard rate - applicable for most taxable supplies, and
- 8% reduced rate - applicable for supplies of certain goods/services such as food, daily newspapers, communal services, medicines, hotel accommodation services, books, museum tickets, etc.

Exempt operations

Supplies within the scope of VAT are classified as taxable operations and exempt operations.

Exempt operations are divided as follows:

- Exempt supplies with credit for input tax (exemption for exports and other similar supplies, international transportation, as well as specific exemptions related to international traffic of goods, certain transactions within free trade zones);
- Exempt supplies without credit for input tax (e.g. financial, banking and insurance services, healthcare services, educational services, leasing and renting of apartments etc.).

The importation of goods received on the basis of a donation agreement, i.e. humanitarian aid is VAT-exempt.

Also, the legislation provides for specific rules related to goods benefiting from special customs regimes. The following transactions are VAT-exempt with credit for input tax, provided they do not lead to a final use/consumption of goods within Serbia:

- supply of goods placed under a bonded warehouse customs regime;
- goods imported in free trade zones for storage purposes only;
- temporarily imported goods and goods put in the inward processing customs regime
- goods processed under customs supervision regime.

Registration thresholds

Entities and individuals with an annual turnover in excess of CSD 2 million (approx. EUR 23.5 thousand) are required to register for VAT purposes. Additionally, small taxpayers that predict an annual turnover of CSD 1 million (EUR 11.7 thousand) are eligible to register for VAT purposes.

Credit for input VAT

General rule

As a rule, the performance of taxable supplies allows offsetting output VAT against input VAT. Exempt supplies do not allow the recovery of input VAT, except in the event of VAT-exempt supplies with credit, for which it can be recovered. Companies performing a combination of taxable and exempt supplies generally have the right to recover the input VAT on a pro-rata basis. The non-recovered portion of input VAT would generally represent a cost.

Refund of VAT

If the input VAT exceeds the output VAT, the recoverable (negative) VAT balance can be:
- either carried forward to the subsequent period; or
- refunded by the tax authorities, if the VAT payer has opted for the refund in the respective return;

The VAT refund request should be satisfied within a 45-day period starting from submission of the return, or a 15-day period for taxpayers which are predominantly export oriented. Any delay after the these periods entitles the VAT payer to late payment interest.

Payment and filing requirements

Taxpayers must file VAT returns with the tax authorities and pay VAT on a monthly basis, specifying the taxable amount and the tax due. The tax return must be filed and the respective VAT paid by the 10th of the following month. For taxpayers whose annual turnover is less than CSD 20 million (approx. EUR 235 thousand), the VAT returns should be filed with the tax authorities on a quarterly basis.

Customs duty

Improvements to the foreign trade regime were introduced by a number of changes in the customs and foreign trade legislation, concluding with the introduction of the new Customs Law in January 2004, and the new Law on Foreign Trade, which was introduced in December 2005. The aim of changes in the mentioned legislation is to simplify the customs procedure and harmonize the foreign trade regime with the EU legislation and World Trade Organisation (WTO) requirements. As a result of this liberalisation and the ongoing process of harmonisation of Serbian customs and foreign trade regimes with the EU system, the import and export of commodities are generally not subject to special authorisation. Exceptions apply to quantity restrictions or control requirements imposed through the different agreements entered into by Serbia.

Restrictions on the free import of certain goods can be imposed by the Government, motivated by reasons of public health and the protection of the environment, the national security, public order etc.

Customs duties

Customs duties are payable at the rates determined by the Serbian Customs Tariff. Primarily, the customs basis is established as the transaction value of imported goods (i.e. as the price for goods and related expenses which are to be borne by the buyer). Serbia has adopted the Brussels Harmonised System for the nomenclature of goods and follows the WTO's valuation rules for the assessment and declaration of the customs value.

Other taxes, duties and levies may be required to be paid upon importation in, addition to customs duties, such as import VAT, excise duty and customs clearance fees.

Preferential rates apply to a wide range of products imported into Serbia based on certain free trade arrangements.

The legislation provides for two definitive procedures – import for free circulation, and export. A definitive import triggers the payment of import duties (unless a specific relief is available); the export of goods is exempt from duties (the exemption, however, exists in respect of metal scrap and raw leather).

The Serbian Customs Law provides for several customs suspension regimes, which may be granted for definite or indefinite periods of time:

- inward processing;
- outward processing;
- bonded warehouse;
- temporary import;
- processing of goods under customs supervision; and
- customs transit.

The suspension regimes do not require the payment of customs duties, although a bank guarantee equal to the amount of such duties might be requested.

In addition to the general customs clearance system, Serbia has adopted simplified customs clearance procedures, similar to those applied in the EU.

Customs regime for individuals

Customs regulations provide for a customs duty exemption for the personal belongings of individuals establishing a domicile or residence in Serbia (except for cars), inherited goods, and items shipped by individuals via parcels and postal services.

Also, import duty exemption applies for goods in the personal luggage of travellers, brought into Serbia without commercial intentions.

Excise duty

Excise duty is a consumption tax payable on certain categories of goods including oil derivatives, tobacco products, alcohol beverages, imported non-alcoholic beverages and coffee. The tax liability is due at the moment of dispatch from the producer's facilities and upon import. Excise duty rates are set in fixed CSD amounts (adjusted semi-annually for inflation purposes) per unit or as a percentage of a specified taxable base.

The excise duties in respect to the main categories of goods are given in CSD in the table below (current data):

CATEGORY OF PRODUCTS	EXCISE DUTY RATES
OIL DERIVATIVES	CSD 16.34-32 per litre
TOBACCO	CSD1,.7 per pack for cigarettes produced in Serbia CSD12.73 per pack for imported cigarettes
ALCOHOLIC BEVERAGES	CSD 9.71-147.4 per litre
IMPORTED NON-ALCOHOLIC BEVERAGES	CSD 4.14-6.41 per litre
COFFEE	40% of the declared customs value

Taxpayers are required to pay the excise duty on a bi-weekly basis i.e. by the end of the month for the first half month and by the 15th of the following month for the second half. Tax returns are submitted quarterly and annually when the final reconciliation is prepared. For imported goods, the related excise duty should be paid at the same time as the customs duty and no tax returns are filed.

Excise warehouse regime

The fiscal warehouse regime allows storage of products subject to excise duties without the payment of related excise duties. A special licence is required in order to operate such warehouses.

Chapter 6

Accounting and Auditing

The Law on Accounting and Audit is based on The Official Gazette No. 71/2002, dated 26 December 2002

International Accounting Standards

The implementation of International Accounting Standards (IAS) is obligatory for all legal entities; for Banks, from 1 January 2003, and for other companies, from 1 January 2004.

Annual Financial Statements

Annual financial statements should comprise the following documents:

- balance sheet
- income statement
- cash flow statement
- a report on the changes in equity
- notes to the financial statements

For small companies, only the balance sheet and the income statement are obligatory.

Submission of Financial Statements

Only Annual Financial Statements must be prepared (as at 31 December) and submitted to the National Bank of Serbia (NBS).

Legal entities must submit their financial statements as follows:

- Annual Financial Statements by 28 February
- Consolidated Financial Statements by 31 March
- Approved Financial Statements together with the auditor's opinion by 30 June

Additionally, all companies requiring an audit (see below) are requested to publish their financial statements, together with the auditor's opinion, on their website at least seven months after the B/S date. However, there are two exceptions to the rule relating to the preparation of Annual Financial Statements as at 31 December:

- Foreign company subsidiaries, for which the financial year differs from the calendar year. Such companies may prepare and submit their Financial Statements coterminous with the financial year of the Parent company. However, approval from the Ministry of Finance is obligatory.

- Entities undergoing a change of status, for example a merger, liquidation or bankruptcy. Such entities are required to prepare their financial statements at the date on which the procedure is completed.

Audit Requirements

An Annual Financial Statements audit for big and medium-sized companies is obligatory. A rotation of medium-sized company auditors is compulsory every five years, while the rotation of large company auditors is required every three years.

Chart of Accounts and Accountants

Records must be kept in accordance with the prescribed Chart of Accounts. A new Chart of Accounts has been applied to opening balances and transactions since 1 January 2004.

For tasks such as keeping the book of accounts, and preparing and presenting Financial Statements, all Legal Entities are requested to engage professional staff holding certification.

The new Chart of Accounts has been designed to ensure the classifying, recording, measuring and presenting transactions and balances in accordance with IAS and International Financial Reporting Standards (IFRS) requirements.

The Provisional Regulations of the Rules on the Chart of Accounts, incorporated as Article 77 of the said Rules, prescribe ways of transferring balances from old to new accounts, as well as ways of making reclassifications and accounting adjustments where necessary.

The New Chart of Accounts also prescribes the accounting treatment of certain balance sheet items in the opening IFRS balance sheets, subject to the reconciliation of equity as at 1 January 2004 and the reconciliation of the relating profit and loss.

Legal entities were not required to prepare comparative figures in accordance with the IFRS for 2003. As such, the first Financial Statements in accordance with the IFRS shall be prepared for 2005.

Additionally, the Ministry of Finance has prescribed the format of Financial Statements, comprising the following documents:

- Balance Sheet,
- Income Statement,
- Cash Flow Statement, and
- Statement of Changes in Equity.
- Notes to the financial statements

For small companies, only the balance sheet and income statement are obligatory.

The same format of financial statements is prescribed for statistical purposes.

Classification criteria - Company size

Medium-sized companies

(1) Average number of employees: 50 - 250;

(2) Annual total income: EUR 2 million - 10 million in CSD equivalent;

(3) Average asset value: EUR 1 million - 5 million in CSD equivalent.

Small companies - if the value of at least two of the above criteria is lower than that mentioned.

Large companies - if the value of at least two of the above criteria is higher than that mentioned. Banks, insurance companies, stock exchanges and stock brokers are considered to be large companies.

Requirements for Preserving Records

- salary records containing important employee information — Permanently
- financial statements — 50 years
- the general ledger — 10 years
- supporting documentation — 5 years

Financial institutions are obliged to keep data on payment clearance for 5 years.

Draft Law on Accounting and Audit

A new draft Law on Accounting and Audit is pending adoption. Some of the more significant proposed changes relate to the elimination of problems that arise in the practical implementation of the current Law on Accounting and Auditing:

(1) Foundation of Chamber of Auditors i.e. Chamber of Certified Public Accountants

(2) Improved compliance with the revised EU Eighth Directive relating to Audit.

Comparison with 2004:

No significant changes occurred during 2004/2005

Positive Signs

- The fast implementation of IAS/IFRS is a key step toward transparency and will certainly facilitate foreign investment

- The implementation of IAS/IFRS will position Serbia ahead of other countries in the region in regard to the accounting framework

FIC Recommends

- Implementation of IAS implies and requires significant training and a high degree of knowledge. In the course of 2005, there was evidence of a gradual knowledge improvement. However, there remains insufficient understanding and practical experience relating to IAS/IFRS. Tax authorities, finance department staff and professional organizations still need to gain a thorough knowledge of IAS/IFRS.

- The role and independence of auditors has been clarified in the Draft Law on Accounting and Audit. However the law is still pending adoption

- The Ministry of Finance must give approval to foreign company subsidiaries for which the financial year differs from the calendar year, to prepare and submit their Financial Statements coterminous with the financial year of the Parent company.

Chapter 7

Banking and Financial Sector

Governance Issues – Bodies, Members of the Board of Directors

Current Situation

Subject to the new Banking Law, Article 71, last paragraph, to be applicable as of 1 October 2006, at least one member of the Board of Directors is required to have a good command of the Serbian language and reside within the territory of the Republic of Serbia.

FIC Recommends

The issue of membership and/or the appointment of members of the Board of Directors falls solely within the authority of shareholders, as a bank's owners, subject to the compliance with Article 72 of the Law, which makes the imperative requirement under the last paragraph of Article 71 unnecessary and it should, therefore, be deleted.

In particular, this refers to the banks with foreign shareholdings, as it necessarily involves the obligation of the foreign shareholder to employ such a member of the Board of Directors, which in turn may cause problems in constituting the Board of Directors of such a bank.

Governance Issues – Meetings of the Board of Directors

Current Situation

The new Banking Law, Article 74, paragraph two, to be applicable as of 1 October 2006, requires a meeting of the Board of Directors, to be held at the premises of the bank's head office or other offices within the territory of the Republic of Serbia, at least once every three months.

FIC Recommends

It is unusual for a law to include a requirement relating to the place where the meetings of the Board of Directors should be held, especially under the current circumstances, with shareholders and board members including non-residents. In particular, a problem will be the fact that the meetings of the Board of Directors in banks involving foreign capital are, as a rule, held abroad where the appointed members live and work. This is an unnecessary requirement and should be removed.

On-Site Bank Supervision

Current Situation

Subject to Article 105, paragraph three, of the Banking Law, the NBS shall not take into consideration any comments made by a bank and relating to any changes in actually reported accounts that have occurred after the period in which the supervision was conducted (cut-off date).

FIC Recommends

This provision of the Law is inconsistent with the 'principle of truth', as one of the underlying principles of general administrative proceedings, whereby the procedures should ensure that all facts and circumstances of relevance to the legal and proper decision are properly and fully established (decisive facts) – Article 8 of the Law on General Administrative Proceedings. Notwithstanding this reason of a formal and legal nature, the NBS should encourage and welcome any and all positive changes in the operation of banks, irrespective of the time they have occurred.

Treatment of Bank Share Capital

Current Situation

According to Article 9 of the Law on Securities and Other Financial Instruments, corporate entities are allowed to issue only shares in the national currency. With debt securities, any issue of foreign exchange denominated debentures are subject to the NBS' approval.

On the other hand, the minimum capital requirement for a newly founded bank is EUR 10 million in dinar equivalent, as of the date it is paid in. In addition, subject to Article 22 of the Banking Law, commercial banks have to maintain their share capital above such minimum requirements in their operations, at the middle rate of exchange.

In cases where the capital is paid in foreign currency, the share capital is defined in the national currency and is subject to any negative effects of its future devaluation. The cumulative nominal depreciation of the dinar against the euro, reported at 28.2% in 2003 and 2004, in addition to 17% in 2005, shows how the bank might fail to comply with the capital requirement unless no additional shares were issued in the meantime, even without any other effects being taken into account.

A further issue is the fact that the registration certificate formerly issued by commercial courts, and now issued by the Company Registries Agency, specifies the amount of capital in foreign currency, noting the liability of shareholders for the operations of a bank up to the amount of subscribed capital, in foreign currency.

Positive Signs

- Amendments to the Law on Securities and Other Financial Instruments are currently being considered by the authorities of the Republic of Serbia.

FIC Recommends

- The Law on Securities and Other Financial Instruments should be amended to allow the issue of securities in foreign currency.

- Furthermore, the NBS is under obligation to issue the supporting bylaws for the implementation of the new Banking Law - by 1 July 2006 at the latest - whereby banks would be allowed to translate a portion of their share capital paid in foreign currency by applying FX indexation. This would be a way to prevent the impairment of any capital originally paid in foreign currency.

Setting a Capital Adequacy Ratio Higher than Currently Required

Current Situation

Subject to Article 23, paragraph three of the new Banking Law, the NBS may set a capital adequacy ratio exceeding the current requirement for a particular bank in cases where, taking into account the reported performance ratios, the NBS finds that such a bank is exposed to any risks inconsistent with the volume of its business.

FIC Recommends

• Since the NBS is under obligation to issue the bylaws for the implementation of the new Banking Law by 1 July 2006 at the latest, the supporting decision should precisely specify the requirements and the circumstances when such requirements are complied with for the NBS to take a measure setting a capital adequacy ratio for a bank higher than the required level (currently 12%).

Mandatory Reserve Requirement

Current Situation

Subject to the Decision on Required Reserves Held by Banks with the NBS, the reserve requirement is applied to all deposits. Since 18 December 2004, the calculation of required reserves has included external loans. In 2005, the required reserve ratio applicable to external loans increased on several occasions, and since 10 December 2005 it has been set at 38%.

This measure resulted in the increased cost of refinancing, and further inevitable effects have included the rising interest rates applicable to bank lending.

In the current situation, where access to the international financial market is still restricted for Serbia and Montenegro and while any local long-term funding sources are highly limited, such a measure could hardly be seen as fully compliant with the domestic needs for financing, and it will not lead to the expected reduction in interest rates.

Furthermore, it is a mistake to have consumer loans and refinancing loans directly correlated, as each bank has a differently structured credit portfolio.

Positive Signs

• There are hardly any currently identifiable positive signs. These measures are yet to produce the results anticipated by the NBS.

FIC Recommends

• The increase of the mandatory reserve is not an appropriate measure to regulate consumer lending. We recommend not using this monetary tool, especially not retroactively. Furthermore, it discriminates against local banks and favours foreign direct lending, as well as intercompany lending.

Legal Lending Restrictions

Current Situation

Subject to the new Banking Law, one of the compliance criteria for commercial banks is the maximum exposure to a single counterparty, equal to 25% of a bank's share capital ('the largest exposure'). The definition of a single counterparty involves the overall exposure to all individual clients understood as related parties. In addition, the aggregate amount of all largest exposures may range from 400% to 800% of the share capital.

In the period from 2001 to 2004, the Serbian banking sector experienced significant changes as it was joined by more than ten new banks, established or acquired by foreign banking groups. The process will continue in 2006, both through the privatisation of domestic majority owned state banks and increasingly through mergers of banks, with either the same or different shareholders, due to the intensified competition in the banking market.

The transition in the financial sector was accompanied by changes in the shareholding structure of the most propulsive sectors in the Serbian economy, such as pharmaceuticals, cement, tobacco, construction, and household chemicals industries. Consequently, a new segment emerged in Serbia's economy involving businesses focused on growth, and strongly supported by their multinational mother companies.

In addition to the breakthrough of multinationals through direct or portfolio investments, there is also an increasing group of propulsive domestic companies which are successfully expanding their presence in the local and international markets.

For further growth of their business in the local market, these companies need to be supported by banks coming from the same market. Such support is, however, currently limited by lending restrictions. One of the solutions applied to overcome the problem was to have any excessive amounts carried by the headquarters of such local banks. However, this solution has not proved to be beneficial to local banks in many respects.

Positive Signs

- In Spring 2004, the NBS introduced changes in the calculation of permissible exposure to a single counterparty. Furthermore, a number of deductibles also became applicable: cash security deposits, short-term deposits up to seven days with prime rating banks, loans guaranteed by prime rating banks.

- In November 2005, the new Banking Law was passed. Article 33 of the Law changed the limit for a bank's aggregate exposures from 400% to the range from 400% to 800% of its capital. The provision will be effective as of 1 October 2006, and the NBS is under obligation to issue the supporting bylaws for the implementation of the Law by 1 July 2006 at the latest.

- Subject to the currently valid Decision on Detailed Requirements in Implementing Articles 26 and 27 of the Law on Banks and Other Financial Organisations, it remains determined by the NBS that no guarantees provided by mother banks may be applied as deductibles in calculating the legal lending limit.

- Taking into account that the country's current rating is still inadequate, possible guarantees provided by mother banks make a significant factor for locally promoted credit activities.

- Mother banks of the subsidiaries in Serbia are, in most cases, rated much higher than required by the NBS (BBB by Standard & Poor's, Fitch-IBCA or Thompson BankWatch; Baa3 by Moody's).

- Any exempted possibility to use such collateral means creating a more difficult environment for local companies, and makes the readiness of foreign mother banks to support the operation of their subsidiaries in Serbia rather uncertain.

FIC Recommends

- The NBS should allow any receivables guaranteed by mother banks to be fully deductible in calculating the legal lending limit.

- Exposures guaranteed by prime rating banks should not exclude mother banks if their rating is as required by the law. The requirement to obtain prior approval from the NBS should be removed.

Issue of Loan Loss Provisions

Current Situation

The criteria applied to the classification and calculation of loan loss provisions on a bank's assets and off-balance sheet positions are currently specified by the NBS Decision on Classification Criteria for Balance Sheet Assets and Off-Balance Sheet Positions requiring the provisions under categories B, C, D and E to be recognised as expenses. On the other hand, by the Accounting Law, banks are required to prepare and deliver their financial statements in accordance with the International Accounting Standards (IAS). Taking into account paragraph 45 of IAS 30 (Disclosures in the Financial Statements of Banks and Similar Financial Institutions) stipulating that:

"Local circumstances or legislation may require or allow a bank to set aside amounts for impairment losses on loans and advances, in addition to those losses that have been recognized under IAS 39. Any such amounts set aside represent appropriations of retained earnings and not expenses in determining

profit or loss. Similarly, any credits resulting from the reduction of such amounts result in an increase in retained earnings and are not included in the determination of profit or loss."

It may be concluded that some of the provisions under the mentioned NBS Decision do not comply with the IAS (nor, consequently, with the Accounting Law). Therefore, no audits of the statutory financial statements for 2003 and 2004 contained any reports, nor will the audits of financial statements for 2005 "...in compliance with the International Financial Reporting Standards (IFRS)", which reflects a severe setback in the implementation of IAS/IFRS. Banks are also exposed to the additional cost of preparing and auditing the IFRS compliant financial statements needed in their relationships with international counterparties.

FIC Recommends

• Taking into account the importance of the IAS compliance, particularly in the banking sector, the NBS should amend Article 2, indent (a), of its Decision on Classification Criteria for Balance Sheet Assets and Off-Balance Sheet Positions, to the effect that banks would be allowed to have the effects of loan loss provisions properly recognised in their financial statements.

Calculation of special provisions for receivables with pledge like collateral

Current Situation

The NBS' Decision on Classification Criteria for Balance Sheet Assets and Off-Balance Sheet Positions Article 13, regulated that "The basis for the calculation of banks' 'special provisions' shall be equal to the bookkeeping value of receivables reduced by 50% of on-balance sheet receivables of a bank secured by mortgage on real estate whose value..."
The collateral of pledges is not treated.

FIC Recommends

• The NBS Decision should be amended with a solution for the reduction of the basis for the calculation of banks' special reserves by the value of pledged equipment, as it has already been regulated in the case of mortgages, considering that the Registry of Pledges on movable assets has been established. Moreover, a pledge is, as a rule, a more liquid form of security than a mortgage. In addition, a mortgage on property and a pledge, for example, on equipment located in the particular property are often established simultaneously.

Syndicated Loan

Current Situation

The NBS is persistent in its position that syndicated loans are still treated as:

• Foreign exchange loans involving Serbian residents, irrespective of the fact that the loan administrator (agent) may be a foreign bank;

• Foreign exchange credit transactions within the country, as provided by Article 20 of the Law on Foreign Exchange Operations.

FIC Recommends

• The NBS should be far more flexible in interpreting the Law on External Credit Transactions, taking into account:
(a) the solutions already included in the Law on Foreign Exchange Operations,
(b) modern (new) forms of international lending;
(c) interests of borrowers and lending banks.

• The relevant legislation, i.e. the Banking Code, as a background for payments received, payments made and transfers under current and capital transactions, should be supplemented by the NBS, to the

effect that the following type of activity should be inserted: "Participation, purchase or sale of participations in syndicated loans".

• The first modification and amendment to the Law should make it possible for local banks to act as lead managers and underwriters for syndicated loans disbursed to foreign or local borrowers.

• The FIC would be ready to provide its expert support to the government in order to assist in creating the adequate framework for syndicated lending.

Interbank Foreign Exchange Market

Current Situation

Subject to the NBS Decision on Requirements and Procedures for Foreign Exchange Market Transactions, a licensed bank is not allowed to take part in sessions of the Interbank Foreign Exchange Market (IFEM). This applies to the cases where it is directly involved in foreign exchange or currency buy/sell transactions with another licensed bank, or a bank whose foreign exchange risk ratio exceeds 30%. This also applies if it has failed to report such a ratio to the NBS. In such cases, a bank is not allowed to take part in the IFEM sessions for the period of one business day. The system produces a great deal of hesitancy and uncertainty among dealers who do not know in advance whether their counterpart complies with the NBS requirements or not.

FIC Recommends

• Some other regular controlling mechanism should be used by the NBS to avoid the adverse effects of bureaucracy on the foreign exchange market operations. The same reporting mechanism should be made available to be used by banks as, for example, the liquidity reporting mechanism.

Category of commission	Debt securities				Shares	Proposal
	NBS bills	Government T bills	Government FX Bonds	Corporate bonds		
1) At BSE – two options:						
Option I - BSE trading fee	-	-	0,0833%		0,10%	
Option II - Free BSE trading fee	-	-		0,05-0,10%	0,15%	
2) With the Central Registry – two options:						
Option I - Central Registry' fee for **OTC**	0,10% max CSD 5000	0,10% max CSD 5000	-	0,10% max CSD 5000		
Option II - Central Registry's fee at **BSE**	-	-	0,10% max CSD 1000	0,10% max CSD 1000	0,10% max CSD 1000	**To adjust to the RTGS costs**
SWIFT charges	300 CSD	300 CSD	300 CSD		300 CSD	
3) Taxation						
	-	-				
	-	-	-		-	
Tax on absolute right's transfer (0,3%) – on seller's charge					0,3%	
Tax on capital gain – on seller's charge		10 % on margin for legal entities 20% on margin for individuals			10 % on margin for legal entities 20% on margin for individuals	**To reconsider tax policy**
Tax on interest (only for individuals)	-	20% after reducing for tax on capital gain	20% after reducing for tax on capital gain		20% after reducing for tax on capital gain	
TOTAL 1+2+3	**Min 0,10%**	**Min 0,10%**	**Min 0,1833%**	**Min 0,15%**	**Min 0,23%**	

Current Situation

For the overall cost of secondary market transactions, in addition to the fees specified in the table above, the proportionate amount of the following fees should be taken into account:

Fees payable to the Securities Commission:

- Fee for licensing applications submitted by brokerage and dealing companies: equal to 3% of the minimum capital requirement applicable to the activity specified in the application, subject to Article 87 of the law governing such activity;
- Fee for licensing applications to allow any expanded and/or discontinued activities of brokerage and dealing companies: CSD 70,000;
- Fee for applications to approve any amendments to the articles of association and rules of brokerage and dealing companies, licensed banks and custodian banks: CSD 35,000;
- Fee for applications to approve decisions nominating and/or appointing members of the management of stock exchanges, and brokerage and dealing companies: CSD 10,000;
- Fee for applications to approve decisions appointing officers responsible for any organisational sections of banks and custodian banks: CSD 10,000;
- Fee for applications to approve mergers and split-ups of stock exchanges, and brokerage and dealing companies: CSD 35,000;
- Fee for annual reports submitted by stock exchanges, brokerage and dealing companies, licensed banks, custodian banks, and the Central Securities Registry: CSD 35,000;
- Fee for interim reports submitted by public companies (annual accounts, auditors' reports, interim reports): CSD 35,000;
- Fee for licensing applications submitted by banks to act as custodian banks: CSD 150,000;
- Fee for certificates of registries kept by the Commission: CSD 10,000;
- Fee for issued decision transcripts: CSD 3,000;
- Fee for opinions provided by the Commission: CSD 10,000;
- Fee for supervision conducted in brokerage and dealing companies: CSD 50,000;
- Fee for supervision conducted in licensed banks: CSD 50,000;
- Fee for supervision conducted in custodian banks: CSD 50,000;
- Fee for teaching courses for certified brokers: CSD 70,000;
- Fee for teaching courses for certified investment advisors: CSD 120,000;
- Fee for teaching courses for certified portfolio managers: CSD 200,000;
- Fee for examination tests for certified brokers: CSD 7,000;
- Fee for examination tests for certified investment advisors: CSD 12,000;
- Fee for examination tests for certified portfolio managers: CSD 20,000;
- Fee for issued transcripts of broker, investment advisor and portfolio manager certificates: CSD 3,000;
- Fee for legal counsel services in court procedures taken by the Commission to protect the interests of investors and other parties whose specific rights or interests based on such rights, and related to securities and other financial instruments, are found to have been violated: subject to the applicable Law Society rates;
- Fee for other applications submitted to the Commission: CSD 10,000.

Fees payable to the Central Securities Registry:

- Annual clearing membership fee: CSD 240,000;
- Securities account opening and operation: CSD 10,000;
- Client application installation and servicing: CSD 30,000.

Positive Signs

- Positive signs are reflected in the fact that the monetary authorities have started creating an adequate environment in which to develop the securities market.

- In 2003, the Ministry of Finance began issuing treasury bills, at first every three months, and then every six months, whereas the participants (both banks and brokerage companies) have been allowed a fair scope of freedom to define the real market price of money. The quarterly discount rate has actually been the only real price in the money market.

• Another positive sign is that in the second quarter of 2005, the Central Bank started securities auctions to sell long-term bonds issued by the Republic of Serbia through repo agreements and at variable/multiple repurchase rates in 14-day transactions.

• In November 2005, the NBS announced that the repo rate applicable to sold securities in 14-day transactions would be the reference parameter for the future monetary policy. By each increase in the rate, the NBS will signal to the market that monetary policy becomes more restrictive and that it is ready to additionally sterilise any excess liquidity, using the market rather than administrative instruments.

• In late December 2005, in order to encourage dinar savings and further develop the securities market, the NBS launched a new product: discounted securities. Savings bills are intended to be sold to individuals, with a maturity period of six months and at an interest rate of 25% p.a. Furthermore, no fees are charged to the buyers either at the time of purchase or payment, and they are not subject to any turnover taxes or other charges relating to these securities.

• The Belgrade Stock Exchange (BSE) has successfully launched the progressive electronic trading in securities supported by simultaneous activities of the Central Securities Registry which operates as a national clearing house.

FIC Recommends

• To pursue further tax reforms. In particular, to repeal the tax applicable to the transfer of absolute rights (turnover tax and financial transaction tax are repealed), as well as the tax payable on interest after deducted margin profit, as the current tax burden is effectively discouraging secondary trading in securities;

• To reconsider the excessively high fees charged by the Securities Commission;

• To reconsider fees charged by the Central Registry which might, for example, be adjusted to the RTGS charges;
• To improve the transparency at the BSE and flow of information, in particular, relating to OTC trading.

Training of Compliance Auditors

Current Situation

As the central monetary institution in the Republic of Serbia, the NBS supervises the local banking sector. The main components of its supervising function include the off-site and on-site supervision of banks; taking corrective measures in respect of banks; issuing operating licences and required approvals; preparing and issuing regulations governing the operation of banks; day-to-day communication with banks and permanent proactive/preventive monitoring of the existence and scope of undertaken risks.

Positive Signs

• The NBS made efforts to modify its overall supervisory role for the purpose of complying with the Core Principles for efficient banking supervision of the Basel Banking Supervision Committee. It has, therefore, become an institution monitoring the way in which banks manage the risks they are exposed to and their risk management systems, rather than a watchdog simply focusing on the compliance criteria.

• The Academy of Banking and Finance was founded at the initiative of the NBS to improve the competence of specialists employed within Serbia's financial sector through ongoing and highly professional training, as required by the country's financial system and the world trends in the area of banking and finance.

• The initiative was launched to establish the Bank Compliance Auditors Association, which would particularly address the issue of money laundering.

FIC Recommends

• To endorse the shift made in terms of the supervising role, it would be necessary to further insist on adequate training and development of the NBS compliance auditors.

Role of Banking Association

Current Situation

The Serbian Banking Association was established to make improvements in banking and align activities within the banking industry. Its objective is to support and represent the interests of its members towards the government, central bank and other institutions.

Positive Signs

• Local banks involving foreign capital are represented both in the Executive Board and working committees of the Association, thus having the opportunity to communicate the standpoints relating to their particular segment of banking industry. They made a valuable contribution to the public debate on the newly proposed Banking Law and constructive solutions included in the draft, but were not taken in as a partner of the NBS.

FIC Recommends

• The Serbian Banking Association should take a more proactive role in creating a favourable banking environment, which would be further reflected in the development of both the overall banking sector and enhancements of particular segments (launching of new products, improvements in organisation and processes, and their alignment with international standards and practices, etc.).The NBS should treat the Serbian Banking Association as the primary partner.

Chapter 8

Leasing

Current Situation

Despite the number of developments in the Serbian economic environment which significantly affected the growth of the leasing business, 2005 was a rather successful year for the leasing industry.

At the time of writing, there are twelve leasing companies operating in Serbia, ten of which are international, and two local. In 2006, the total amount of finance for vehicles and equipment was approximately EUR 400 million (a 21% percent increase on the 2004 figures), with 30% of this figure being plant and machinery financing, and the rest vehicles (passenger and commercial). More than 20,000 contracts were activated in 2005, with an average value of the contract of approximately EUR 17,000, showing clearly that leasing is a financial tool very much accepted by the SMEs in Serbia.

On 1 January 2005, VAT was introduced in Serbia. This resulted in a slowdown of the economic activity, especially in the first quarter of 2005, as the companies were going through a liquidity squeeze in the initial cycle. However, later in the year a recovery was seen, with a more level playing field being created and competition developing in a positive direction.

Unfortunately, VAT is charged on leasing transactions, which is a disadvantage compared to the treatment of a bank loan. The VAT must be paid up-front for the leased object and for the interest component of the financial leasing transaction altogether, which requires more investment at the beginning of the transaction.

In July 2005, the Law on Changes of the Financial Leasing Law was passed. It effectively put lessors under the control of the NBS. It introduced the licensing of leasing companies and their management, supervision by the NBS, minimum conditions for entering into financial leasing contracts (minimum down-payment, financed amount etc.) and the requirement to publish the effective interest rates. It also allowed the NBS to introduce a mandatory reserve for leasing companies, which it did in December 2005. A mandatory reserve of 10% was introduced on all borrowings drawn from abroad after 10 December 2005. In addition, leasing companies are again restricted in borrowing from a shareholder bank in Serbia – lessors can borrow up to 5% of such shareholders' capital, compared to 25% previously.

Real estate leasing finally started in 2005. Very few deals were done, but it shows a promising start - this segment is likely to develop in 2006. The development of real estate leasing was rather slow in Serbia, however it started much sooner than in other CEE countries.

The Register of Leasing Contracts started operations on 1 January 2005. Its aim is to provide information to third parties on objects financed via financial leasing, thereby decreasing the risk of potential misuse of leased objects when dealing with third parties. The drawback introduced by the Register is that it is heavily paper-based and increases the paperwork needed for registration.

As a final note, a shift to rather more restrictive monetary policies is occurring in Serbia as 2006 begins. The issues described above are the ones which the leasing industry will try and work through together with the relevant authorities, taking into account both the requirements to regulate the business to a larger extent than before, but also the benefits leasing creates for the economy as a whole.

Positive Signs

- Further development of the leasing industry
- First real estate deals activated in 2005

FIC Recommends

- Removal of the mandatory reserve requirement as soon as possible. This complicates the leasing business and makes it more expensive.
- Increase of the Legal Lending Limit. Borrowing from shareholder banks in Serbia should be increased back to 25% of the banks' capital as soon as possible.
- A Register of Leasing Contracts should simplify the registration procedure. The necessary paperwork should be greatly reduced, and the system of using an electronic signature should be implemented as soon as possible.

Chapter 9

Real Estate

Land Ownership

Changes vs. last White Book

We emphasize a proactive government initiative to change Article 60 of the Constitutional Act allowing freehold status over urban land properties, even before the New Constitution's parliamentary procedures commence. We expect this process to be finalized by the end of this year, shortly after the constitutional issues concerning Kosovan territory and between Serbian and Montenegrin republics are resolved.

Remaining problems

Unfortunately, the main problems related to land ownership, which are impediments to foreign investment, remained unchanged:

- Lack of possibility for freehold ownership of land within the central city areas, where the majority of land remains in the ownership of the Government even if the rights of use are transferable

- Prevailing governmental control over the supply of larger pieces of land within the central city areas, which results in:

  - a process of land acquisition that lacks transparency and is long and bureaucratic
  - insufficient supply of land
  - no information on past transactions and prices achieved

- Minimum prices of the majority of urban land remains determined with governmental ordinances instead of the market

- The Law on Urban Planning and Construction was not fully enforced with regard to undeveloped land

FIC Recommends

- A change of the Constitution of Serbia to allow freehold ownership of land; introduction and completion of the process of Restitution, and completion of the land registry system.

- Develop a publicly available database with all urban land available for construction following the adopted Master Plan, as well as including complete information on past transactions.

- Introduce a system that allows for forming of prices based on free interaction of supply and demand.

- Enforce the Law on Urban Planning and Construction with regard to undeveloped land with regard to land that has not been developed until the specified by the law deadlines. Execute this in a transparent manner and under a tight schedule.

Construction

Changes vs. last White Book

The new Mortgage Law that was adopted in December 2005 will strengthen creditors' power to market pledged real estate, thus decreasing the time to collect receivables, creditor's risk and interest rates. Unregistered properties, as well as properties under construction are now suitable for mortgage purposes. We expect this Law to reinforce construction activity and overall real estate market fundamentals.

The Serbian government was also very active in introducing measures aimed at resolving housing problems, as this is a key issue for improving the local population's standard of living. In order to assist in the resolution of the housing problems, the Value Added Tax (VAT) rate on new apartments was decreased in June 2005 from 18% to 8% and the National Corporation for Housing Loans Insurance was established.

Remaining Problems

- The Law on Urban Planning and Construction was not properly introduced and it did not lead to speeding up of the procedures.

- The construction industry (construction companies) remain predominantly state-owned.

- The processes of acquiring construction permits remain corrupt, long and bureaucratic .

FIC Recommends

- The training of relevant institutions to allow for the proper enforcement of the Law on Urban Planning and Construction

- Privatization of the construction industry

- Developing an 'office-expediter' or 'one-stop' office within the Government whose role is to assist large real estate developers with projects in excess of EUR 5,000,000 million as a way of having 'success stories'.

Municipal Real Estate

Remaining Problems

A large number of real estate properties in prime locations in Belgrade and in other Serbian cities remain under municipal ownership. Those of them with attractive locations, especially on the prime retail streets of Belgrade, are being let by the municipality at rents that are several times lower than the market rates charged to their legal occupants through semi-legal or pro-forma agreements with third parties. These processes contribute largely to the grey economy and reduce income to the budget, while at the same time they deter quality retailers from entering the market.

FIC Recommends

- The FIC recommends organizing a transparent process of asset disposal for all municipally owned properties.

Restitution

Remaining Problems

In the last White Book, we emphasized that the lack of clarity on the issue of restitution continues to create uncertainty and deters many real estate investors from investment in Old Belgrade.

In October 2004, the Serbian Government made a decision to appoint a Commission for the preparation of the Law on Retrieval of Taken-Away Property and on Restitution. The task of the Commission was to prepare the Law by the end of October 2004. However, in November, it was announced that the Law on Restitution would come before Parliament by the end of 2005, or by March 2006 at the latest.

FIC Recommends

• The FIC recommends that the Law be introduced without further delays from the last announced dates. The restitution of properties alongside with the privatization of all state and municipal owned land and properties will lead to the creation of a free and well-functioning real estate market, which is a good base for increasing investment in all sectors of the economy.

Chapter 10

Insurance, Pensions and Social Reform

A. Insurance

The continuing instability of the insurance sector in Serbia has been attributed to a wide range of microeconomic and institutional failings. The Serbian insurance market is underdeveloped. It is currently far behind not only developed countries, but transition countries as well. The main reasons for poor performance of the insurance sector may include the low standard of living, general distrust in financial institutions, lack of an insurance tradition (especially life assurance), lagging regulations, lack of skilled human capital.

The estimated total premiums for 2005 are approximately EUR 400 million, half of which are contributed by general non-life insurance, over 40% by motor insurance and approximately 7% by life insurance. The two driving growth factors for 2005 belong to the newly created life portfolios and products, and the Casco insurance due to increased leasing activities. Property insurance has shown stagnation and increased price competition for the last few years. Health insurance products have emerged this year, and are expected to grow in the next few years.

Approximately 70% of the annual premium is concentrated in two state owned companies. The rest are small and medium local companies, some of which are connected to local private groups. The market is still very concentrated with limited competition. This is reflected by the products offered, as well as the slow entry of foreign players. According to the Government decision, the market is expected to go through an intensive change in 2006, with one of the two state insurance companies to undergo privatization, while the other will remain state owned.

Positive Signs

• The entire burden of external control falls on the insurance supervisor, namely the NBS, introducing an integral supervision of the entire financial sector. The number of insurance companies significantly decreased in 2005 to 16 insurance and two reinsurance companies, with one company being registered as insurance and reinsurance. The NBS revoked the operating licences of 16 insurance companies, while three companies voluntarily decided to suspend their activities. This had an enormous impact on the stabilization of the market and introduction of new discipline in the sector.

FIC Recommends

• The insurance supervisory authority should establish a reliable claims database that will assist insurers and supervisors in developing the right price for various categories of products;
• The insurance supervisory authority should:
  - obtain and independently verify relevant information;
  - engage in remedial action and execute portfolio transfer;
  - have broad and ample knowledge and experience, ranging from actuarial science to contract law, drawn from wide experience;
  - have a reliable and stable source of funding to safeguard its independence and effectiveness;
  - have the powers and sufficient resources to co-operate and exchange information with other authorities both at home and abroad, thereby supporting consolidated supervision;

- establish an employment system to recruit, train and maintain professionally qualified staff. At the same time, the insurance supervisory authority must be bound by strict professional secrecy and the legislation must exclude any arbitrary intervention of the administration.

• Except in cases stipulated in the law, the insurance supervisor should under no circumstances be allowed to interfere in the management of insurance companies;
• The supervisory authority should establish good cooperation and undertake coordinated schemes with other related government bodies or insurance institutions, such as ministries, tax offices or insurance guaranteed funds so that the given tasks are properly carried out.;
• Subject to prudential regulations and supervision being met, competition in the insurance sector should be fostered by removing unnecessary restrictions and allowing the participation of sound insurance companies in the insurance market. In particular, the establishment of foreign insurance companies should be based on prudential but non-discriminatory rules;
• Ensure information disclosure is also essential for consumers to be able to select appropriate insurance products from the right insurance company. The most important information concerns the financial condition of an insurance company, the nature of its insurance products and the character of an insurance intermediary;

B. Pensions and social reform

The pension system continues to face challenges in terms of its sustainability. The low level of employment and continuing presence of the grey economy in the area of employment, along with longevity and the low birth rate create unfavourable grounds for financing the state pension system.
However, 2005 was marked by a new wave of pension reforms and the introduction of supplementary voluntary pension assurance.

Positive Signs

Answering the repeated demands of the International Monetary Fund, a set of five laws regarding pension reform was developed in 2005. Four of them refer to state pension insurance aimed at tightening the deficit in the public pension system, introducing:
• further parametric changes (gradual retirement age shift from 58w/63m to 60/65 accordingly; dynamics of pension adjustment change from quarterly to semi-annual, and from living expenses and wages to living expenses only);
• merger of the three funds into one (commencing 2008);
• methods, cases and assets for financing unpaid employees' contributions in the period 1 January 1991 – 31 December 2003, etc.

Law on voluntary pension funds and pension schemes (to be implemented on 1 April 2006) finally introduces the third pillar the in Serbian pension insurance market. The law was prepared by the Government with the assistance of the World Bank and it will govern:
• organization and management of voluntary pension funds;
• establishment, activities and operations of voluntary pension fund management companies;
• activities and responsibilities of custody banks;
• competence of the NBS in the conduct of supervising voluntary pension fund management companies;
• other issues of significance for the functioning of voluntary pension funds.

FIC Recommends

In order to further develop retirement income security in Serbia and boost the economic growth, the Government must create a sound, consistent and long-term pension strategy and adhere to the following:

• Provide stable rules that encourage the voluntary creation and maintenance of soundly financed employer-sponsored plans;

• Introduce efficient means for individuals to acquire adequate retirement income;

• Support the dynamic needs of employers;

- Encourage capital formation;
- Educate the Serbian worker, so that they have the necessary skills to equip them for retirement;
- Provide more opportunities to use modern technology for disseminating information to employees about their plans and in providing employee education;
- Encourage redundancy programs with a pension saving plan over cash benefits;
- Create tax and contribution incentives for both employers and individuals;
- Introduce the Government's commitment to mandatory employment-based retirement programs.

Chapter 11

Health Sector

The Law On Health Insurance

Compulsory health insurance is being implemented by a single budget of the Health Insurance Fund (RZZO), which causes a monopoly structure of health care financing and de facto direction of the Fund's activities by the Government of the Republic of Serbia, i.e., the Ministry of Health. It is necessary to create a proper environment in which other legal entities engaged in insurance will also be able to engage in basic health insurance, i.e. to enable the citizens (policy holder) to independently direct the compulsory 12.3% of the contribution into a state (public) owned or private insurance institution.

The main principles of de-monopolization of a modern health care sector, comprise the free choice of a physician in either the state or private sector, and money following the patient. This has not been envisaged by the Law, because the decision on individual contracts is at the discretion of the Republican Institute for Health Insurance. The Republican Institute for Health Insurance is a public fund, not a private one, and it cannot discriminate against insured tax-payers who have their chosen physicians, as well as the right to direct their contribution to where they are treated.

When arranging contracting conditions, partners have been poorly defined, because the interest of both state and private service providers is implemented through organizations (associations of health institutions: chambers in which the state and the private, employers and employees, are varied). This article represents a paradox from a legal-economic aspect and it prejudices poor quality solutions in the two systemic laws. The same problem is noted with respect to arbitration, where there is a possibility of the occurrence of majorization and decision-making by the state sector representatives on the competition from the private sector. This creates an unsustainable situation in which all have the same obligations through compulsory contributions, i.e. tax, but not all have the same rights of access to the financial means of the public fund!

It may be concluded that, besides the changes in the sense of improved control in part of the right to compensation during temporary inability to work and the reduction of other non-medical rights (transportation, funeral expenses), this draft law does not create conditions for the elimination of non-rational conduct and non-productive extensive consumption in the health sector. In addition to the existing ones, it introduces new discretion and discriminatory mechanisms towards organizations and service providers. Due to the monopolistic position of the RZZO, a concrete and efficient organization of modern regulated health services market is systemically prevented, thus also preventing the development of the private health sector.

The Law On Health Protection

One of the major slogans of this law is "the patient chooses a physician". However, due to the way in which the law has been written, the choice is possible only within a state institution, so that the citizen cannot be truly free to choose between the state and the private sector. In theory, they can choose, but if visiting a private physician, they will repeatedly bear the expenses of treatment, despite having already paid the compulsory health contribution. A true choice means something completely different: the possibility of the patient being treated where chosen, receiving reimbursement from the health fund, and having the scope and contents of services guaranteed within the rights from the basic service

package, in accordance with compulsory insurance funds. Otherwise, the new laws will also ensure that millions of citizens treated by private physicians repeatedly pay for their treatment twice, which represents an unacceptable discrimination, as well as a waste of money for a state aspiring towards Europe.

The law on health protection determines that by its decision, the Ministry issues a permit for the utilization of new health technologies at a health institution, i.e. private practice, based upon the opinion of the Committee for Health Technologies Assessment.

Such solutions stated in the law are not acceptable. Namely, it is generally known that new methods and procedures in all sciences, and therefore in medicine too, receive their scientific verification on the basis of research and experience-acquired knowledge applied in practice. With the increase in extent of this empiric knowledge and more positive treatment results, the more they represent new contributions to scientific knowledge, and in this way they become part of the scientific method of treatment, diagnostics, prevention, and rehabilitation.

It is possible that our society does not achieve new scientific knowledge in the field of medicine, and that its scientific activity is based on rather surpassed scientific methods while, at the same time, scientifically and industrially highly dev eloped countries apply new methods as part of new scientific knowledge in medical activities. In such a situation, requesting the consent of the Ministry of Health for the implementation of new methods in the field of medical science may affect the health of a large number of people. Our society may then become a victim of conservative conceptions in medicine, which lead towards the deterioration of the health of a large number of inhabitants.

The chapter entitled "Licence Issuing" of the Law on Health Protection regulates the issue of a licence (work permit) to a health worker with qualifications.

In principle, the immediate question is what purpose is served by the issue of a licence to health workers with qualifications. If a health worker has graduated from a certain university, completed specialization in a certain field of medicine, and then also passed a qualification exam, the question is why he shouldn't be issued a licence, when such a health worker is already qualified to work in the field of health. This licence, as a work permit, is not limited to health workers in private practice, but is related to all health workers. It is, therefore, even more peculiar, when its purpose is to emphasize the qualifications of such health workers. What benefit is there for patients in issuing such licences? The impression is that the issue of a licence is a purely bureaucratic act assigned to a competent chamber, e.g. one with its director as a person in charge of issuing licences.

The stipulations of the Law on Health Protection are directed to the possibility of arbitration by the chamber director, and bringing discriminatory resolutions with respect to certain health workers without authentic reasons. The envisaged possibility of initiating a contentious dispute before the competent court, against the resolution of the director of the competent chamber, represents poor protection. The possibility of gaining court protection would be a good solution, but it represents insufficient protection from moral and material mistreatment, which a health worker may be exposed to in the course of issuing, extending, and denying a permit for independent work.

In part of the Law on Health Protection, 'Information for the Public', it is envisaged that the citizens of the Republic have the right to the information necessary for the preservation of health and acquiring of healthy living habits, as well as information on detrimental factors of the living and working environment, which may cause negative consequences for the health. It has also been envisaged that the citizens have the right to be informed about the protection of their health in the case of epidemics and other major disasters and accidents (danger from ionic radiation, poisoning, etc.).

This gives the impression of a slogan, a vain right of the citizens to information, because this right to information is related to the process of education, which would be available to children and not to adults, who should provide the relevant information to their children. As seen from the stated stipulation, nothing is said of the citizen's right to be informed of expert medical procedures and methods of patient treatment against various diseases, and particularly those which represent the latest achievements in medicine.

Thus, according to this Law, it is clear that the patient cannot acquire any knowledge from a health institution with respect to the implementation of expert medical procedures and methods applied in

treatment, diagnostics, and generally, with respect to health protection, which is of interest to each citizen. This particularly applies to those with health problems: patients have a right to correct information as to which health institution performs certain expert medical procedures and methods of treatment. This prohibition of advertising represents a severe infringement of the citizen's rights to be informed of the possibilities of treatment of various diseases, amounting to a complete lack of information on the state of the health institutions they need to address for treatment.

This prohibition of advertising, as stated in the Law, is related to all health institutions –under state ownership or private ownership, including private practices. It is, therefore, clear that the citizens will remain completely uninformed where information on the possibilities of health protection is concerned.

The law also envisages the prohibition of experiments performed by private practices, according to the conditions and procedures in force for the state health institutions. This represents a severe violation of Article 57 of the Constitution of the Republic of Serbia, which envisages that business and other activities are performed freely and under equal conditions.

Article 48, paragraph 3, of the Law prevents private capital from being used to found institutions that provide emergency medical assistance, blood and blood derivates supply, taking, keeping, and transplantation of human organs and parts of the human body. This is again a severe violation of Article 57 of the Constitution of the Republic of Serbia.

Article 56 prohibits private capital from being used to found any kind of health institution higher than a polyclinic.

In this Article, the Law prohibits private practices from providing medical emergency assistance, but Article 62 of the same Law obliges private practices to provide such assistance. The Law even envisages a penalty for the offence in Article 62. The determined penalty amounts to 100,000 – 500,000 Dinars.

The Law further envisages that physicians and civil servants may work for the same employer. The civil servant will always favour his private interests. The possibility that they also work for the state service immediately creates waiting lists, by redirecting patients to the private sector, in which the state physician also works. On the other hand, this concept of conflict of interests inhibits the development of the private sector because it does not create the economic motivation for a physician to be a private practitioner, and to risk and invest funds.

The Law on Health Workers Associations

This Law mixes joint decision-making bodies, employees and employers, civil servants and entrepreneurs and private sector employees, and treats expert and professional issues in a legally and economically contradictory manner. This will create permanent conflicts of interest, majorization and work blocking. Since the Law envisages that the Association will also grant and revoke licences/work permits, this creates conditions for the employees to decide on the employer's right to work. This will create situations in which physicians and civil servants working with private practices decide, together with their employer, on economic and legal issues (negotiations with insurance, labour cost, service cost, etc.), which represent an economic paradox. The Association, claimed by the proposing party to be an independent professional organization, although including civil servants as members, is in contradiction with the Constitution and labour and company laws. Physicians employed by state institutions and those working as private entrepreneurs have different statuses and professional interests and, therefore, such a model of association is opposed to the norms of the right to syndicate organization, i.e., the right to free entrepreneurship.

FIC Recommends

The Law on Insurance

- The Law should include that those with health insurance may be treated in both privately owned health institutions and in private practices, at the expense of the Institute for Health Insurance, in a way that the amount of expenses for such treatment recognized by the insurance will be compensated to the insured person upon submitting the treatment invoice.

• Private local and foreign insurance companies should be enabled to provide citizens' health insurance services, so that by choosing the insurance company the citizens will, in fact, also choose their physician for their money.

The Law on Health Protection

• The Law on Health Protection should envisage a possibility that those with health insurance may be treated in both privately owned health institutions and in private practices, at the expense of the Institute for Health Insurance. This should be accomplished in a way that part of the amount of expenses for such treatment will either be paid to the insured upon submitting their treatment invoice or paid to health institutions, i.e. private practices, in accordance with the price-list in force for state-owned health institutions. The difference, up to the actual cost of treatment, will be borne by the patient, having chosen to be treated either at a private practice or a privately-owned health institution.

• The Law on Health Protection should introduce a possibility that new methods in the field of medicine, that have been scientifically proven in other highly developed countries, may be applied in implementing health protection here. This should be based on evidence provided by the ministries of health of the respective countries or their other scientific institutions, confirming the scientific viability of these methods and their application in practice.

• The cancellation of stipulations from the Law on Health Protection, would represent an unnecessary assessment of something that already exists and does not have to be specifically proclaimed by a resolution of the association director. These stipulations anticipate the issue, renewal, and revocation of independent work permissions, bearing in mind that the health workers have previously, by their qualification, acquired all conditions to be able to independently exercise health activity, and the subsequent issuing of licences, their renewal or revocation.

• The right to information in Article 41 should be completed, so as to state that the citizens of the Republic have the right to be informed of all expert medical procedures and methods of health protection in use in health institutions and private practices. The stipulation on the prohibition of advertising public information about expert medical procedures and methods of health protection, in use in all health institutions and private practices, should be removed.

The Law on Health Workers Associations

• Establish a private medical association for those health workers performing medical activities within private practices or privately-owned health institutions as professional organizations, which will provide both an ethical approach to performing medical activities and the improvement of private practices as a special form of health service.

• Membership of the private medical association would be compulsory for all health workers working in private practices or privately-owned health institutions, and would represent a condition for running a private practice.

Chapter 12

Telecommunication Sector

General overview of the sector

An essential obstacle to a more developed telecom sector and more efficient business operations is the lack of phone lines and the poor quality of connections. Due to the present situation, where Telekom Serbia still practically enjoys a monopoly position in the field of land line networks, international calls are still very expensive. Internet connections are under-developed and expensive as well. The number of Internet users in Serbia has reached 1 million (or 13.3 % of the Serbian population excluding Kosovo and Metohija).

Market players

Telekom Serbia remains the only fixed line operator in Serbia, even though its monopoly officially expired on 9 June 2005. Also, Telekom Serbia is one of the two mobile operators in Serbia. The digitalization rate of the fixed line network in Serbia has grown from last year's 60% to about 80%, but is still low compared to a majority of European countries (100%).

Remaining issues

Some of the burning issues in the telecom sector in Serbia remained unsolved in 2005 and therefore represent key tasks for 2006:

Adoption of the Amendments and Revision of the Law on Telecommunications

In the course of 2005, the Law on Telecommunications was a subject of further review and amendments, mostly with the aim of further improvements in the area of efficient implementation mechanism. This process is still ongoing. The Ministry for Capital Investments and its teams are working on the harmonization of the Law on Telecommunication with other systematic laws.

Key regulator

The formation of the Telecommunication Agency which was absolutely necessary for further development of the telecommunication sector in Serbia came through after more than two years.
The State appointed members of the Telecommunication Agency (TA) on 23 May 2005, two years after the Parliament passed a law to create this independent regulatory body that undertakes the role of managing the telecom sector.
The TA was established on 2 August 2005, but due to technical and financial issues, only became partially operational on 19 December 2005. It is to be expected that it will start to issue licences by the end of January 2006. The first licences granted by the TA will relate to Radio taxi stations, followed by cable TV distributors, and Internet providers.

Adoption of the Telecommunication Policy Document and the Strategy for the Development of Telecommunications in Serbia

The Ministry for Capital Investments continued development of the Telecommunication Policy Document, initiated in 2005. Also, it is still working on the revision of the Strategy for the Development of Telecommunications in Serbia, in order to be fully aligned with the Policy Document. The remaining issue is when the completion of these processes will take place.

State cross-ownership

The problem of the state cross-ownership remained unsolved throughout 2005. By the end of the year, the State's dominance of Serbia's telecom sector had actually increased.

The state owned company, PTT, is the majority owner of both mobile operators: Telekom Serbia and, as of December 2005, Mobtel.

In May 2005, BK Trade (the co-owner of Mobtel) was acquired by an Austrian consortium led by Martin Schlaff. In late December 2005, the Serbian Government revoked Mobtel's licence over a 2003 deal under which the Company allegedly transferred its Kosovo licences to another mobile operator, Mobikos, without the Government's prior permission. In addition, the Government of Serbia has cleared state postal company PTT Serbia's decision to take over Mobtel's debts to Raiffeisenbank and Hypo Alpe Adria Bank of EUR 19.7 million and EUR 71.6 million respectively. By taking over the obligation to repay Mobtel's loans, PTT became Mobtel's largest creditor. The situation with the competitor, Telekom Srbija, running Mobtel's network seems to be a strange and unacceptable solution.

After the authorities revoked Mobtel's licence, the Austrian consortium announced it will take the government to court. Consequently, in January 2006, the Serbian Prime Minister and Austrian Vice-Chancellor have agreed that Serbia and Austria will establish a joint working group to try to resolve the situation. At the time of writing, it was uncertain in which manner the situation of Mobtel's revoked licence will be solved and whether there will really be an international tender to grant Mobtel's GSM licence in the first half of 2006, as announced by Serbian Government officials.

In January 2006, the Court Arbitration of the Zurich Chamber of Commerce launched a final hearing in a dispute between state postal Company PTT Srbija and BK Trade over Mobtel's ownership structure. The decision is not expected until the second half of 2006 at the earliest.

Selection of a strategic advisor in the Serbian telecom industry

In May 2005, the Government of Serbia launched an international tender for a strategic advisor in the telecom industry. The advisor's mandate includes both fixed and mobile telephony. It is expected that the Privatization Agency of the Republic of Serbia will select the final bidder in this process by the end of January 2006. The selected advisor is expected to advise the Government on calling a tender for new mobile licences and propose the best sell-off model for state telecom provider Telekom Serbia.

Process of deregulation and full liberalization of the Serbian telecom sector

Based on the law, the liberalization process of the fixed telephone line market officially happened on 9 June 2005, when Telekom Serbia's land line monopoly expired. However, in practice no changes took place in the fixed line market, due to the fact that the TA has not yet started the process of issuing the operator's licences.
The restructuring of state-owned companies, including spin-offs of the non-core businesses, and the sale of non-core assets, again continues to be one of the key priorities for the Government in 2006.

FIC Recommends

General recommendations relate to the completion of the above mentioned tasks without further delays from the previously announced deadlines.

- An acceptable intermediate and final solution for mobile operator Mobtel;
- Adoption of the amendments and revision of the Law on Telecommunications;

- The Telecommunication Agency must start to issue licences for both wired and a third wireless operators;

- Speedy adoption of the Telecommunication Policy Document and the Strategy for Development of Telecommunications in Serbia;

- Elimination of the state-cross ownership in the Serbian telecom sector;

- Further liberalisation of the fixed line market and the data transmission sector;

- Further liberalisation of the mobile line market.

Chapter 13

Environment

Addressing environmental considerations in the privatization process reduces investment risks and uncertainties about potential costs in the future. Foreign investors are still concerned about possible unfair treatment regarding liability for inherited damages, and about unexpected environmental requirements on a local level. Economic instruments that are in place are mostly directed to generate revenue, instead of being related to environmental performance.

For most of the foreign investment industries, compliance with local legislation is a minimum requirement for environmental performance, having even more strict internal standards. At the same time, many industries in Serbia operate without compliance with environmental standards, generally providing the excuse of the difficult economic situation. Even though inspections are carried out, there is a low risk of being caught. Only a few inspections result in administrative or legal charges, fine levels are very low, and court procedures are too long. Considering the various fees and charges required for full compliance with local legislation, it is easy to come to the conclusion that the business environment in Serbia is unfair.

Waste management is still a burning issue in the country. The problems are the same: an absence of proper waste management practices; the lack of sanitary landfills; exposure to a significant health risk due to the inadequate disposal of hazardous, medical, chemical and animal waste; no systematic solution for waste recycling; and others.
The Government's objective is to obtain compliance with EU legislation. The current practice in waste management makes it clear that with the existing institutional and legislative set-up, it will be hard to reach the objective.

Positive Signs

- Government bodies are working intensively on new legislation, according to the Action Plan for EU compliance.

FIC Recommends

- Further compliance with EU environmental regulations.

- To redefine public and private cooperation on environmental protection issues, in a way to support the establishment of a fair business environment.

- Development and implementation of economic instruments which provide incentives for environmentally responsible behaviour.

- Continue with institutional strengthening and capacity building, in order to avoid monopolization.

Chapter 14

Energy Sector

Current Situation

Foreign investors started entering the Serbian oil market in mid-2001. They have made a significant addition to FDI, created numerous jobs and generated additional tax revenue. They have also brought a high level of know-how and European retail culture, setting the standard for the market.

Nevertheless, many aspects of the oil market remain unchanged, despite the difficulties which this sector faces:

Inadequate Supply

The Serbian fuel market is not liberalized. Domestic refineries (Pancevo and Novi Sad) often cannot meet the local demand for fuel, and consequently fuel stations run dry.

Late in 2004, the government recognised this problem and temporarily allowed fuel imports. However, due to the artificial fuel pricing system, none of the retailers resorted to importation, as the total purchase price (including transport and customs) would have been higher than that set by the state.
Since the second half of 2005, even temporary imports of ready products (Eurodiesel) have been allowed, since the government understands that the local refineries can no longer fulfil the local demands which was hindering the normal life of the Serbian economy.
The problem of fuel supply nevertheless remains unsolved and this will continue until the market liberalization comes.

Margin problem

The state sets the maximum retail prices. Furthermore, the state petrol company, Nis Jugopetrol, is the main - and very often only - fuel supplier in Serbia. This means that the state effectively defines the retail margin, since it sets both the wholesale and retail prices. Unfortunately, this is very often done in an inflexible way, without taking into account the price developments of crude oil on the world markets. Historically, these margins are low, and discernibly lower than in neighbouring countries.

This problem could be alleviated through higher volumes, but this presupposes the continuous availability of fuel. Ultimately, this has a negative impact on the profitability of fuel related investments.

Delays in Approvals

The necessary authorisations for the construction and operation of fuel stations are granted by different bodies, often in a protracted manner. Consequently, the period between securing a site for a fuel station and commencing operations is unnecessarily long.

Little Co-operation in the Market

There is very limited cooperation and collaboration between competitors. Alliances within the industry should help take action on matters of common interest and exchanging know-how.

Other difficulties faced by the industry include real estate ownership issues and contradictory regulations of different Ministries.

FIC Recommends

• Reconstruction/upgrading of the two refineries, and better conditions for companies importing crude oil, within the framework of the approved quotas and through deregulation of the market, could solve the issue of inadequate supply.

• Modification of the pricing policy through the decrease of excise rates or price liberalization to combat the margin problem.

• The industry recognizes that fuel prices have a major impact on the budget. It would help, however, to have more frequent corrections of retail fuel prices reflecting changes in the world crude oil price. It would also help if the pricing system allowed all market players a reasonable margin not influenced by inflation.

• Establishment of an Agency to oversee the process of granting different permissions, to counter delays in approvals.

• Formation of alliances on strategic issues of common interest to improve co-operation in the market.

• Privatization of the two refineries and opening the oil derivates market will ease the supply and margin problems. Retailers will see major improvements in their business, which will benefit the whole economy.

Chapter 15

The Law on Postal Services

Current Situation

The Law on Postal services was adopted by the National Parliament on 17 February 2005. Amendments proposed by DHL were not taken into account.

Issues

The Law on Postal services determines that an Agency for Postal Activities be formed as an independent regulatory body. The Agency shall be managed by the Council. The members of the Council, in accordance with the Law, should have been elected and nominated within a two-month period from the Law adoption date. When formed, the Council should adopt the Bylaws within a six-month period. None of these processes have taken place.

It is expected that the Agency and its Council, when formed, will adopt the Bylaws, which will make a clear distinction between the Licence and Registration fee requirements. Further issues still remain in force:

The Law on Postal services proposes that DHL and other express courier companies pay a Licence fee (up to an amount of 0.5% of the operator's annual turnover) for the provision of their activities. This is a direct non-compliance with EU Directives. The EU Directive proposes that Express Courier companies pay a Registration fee, not a Licence fee, since their activities are Value Added Services, and not within the scope of the Universal Postal Service. As per the European jurisprudence and EU Directive, the Universal Postal Service provider (the national Postal operator) is the only one to be granted a long life, exclusive Licence.

Positive Signs

In 2006, the Ministry of Capital investments has a mandate to organize a series of meetings with relevant bodies within the process of accession to the World Trade Organisation, focusing on the postal services sector. In January 2006, the Ministry for Capital Investments will announce a long term National Postal services strategy document.

FIC Recommends

- Clearer distinction between Universal and Non-Universal Postal Services/Providers, to be implemented by adopting Bylaws within the first stage of the Agency for Postal Services' activities.

- Clear licensing and registration procedures for operators of Value Added Services, to be implemented by adopting Bylaws within the first stage of the Agency for Postal Services' activities.

Chapter 16

The New Mining Law

The Government can eliminate unnecessary legislative risks by providing clear mining legislation and effective and efficient administrative authorities to deal with mineral affairs.
The provisions listed in this paper are those that investors seek in a Law on Mining and other regulations relevant to mineral operations. When adopted, they will remove much of the legislative risk.

General provisions

The security of tenure and clearly linked and guaranteed transitions from exploration to mining is absolutely essential to an investor. This issue has been relatively satisfactorily dealt with in the latest draft of the Law on Changes and Amendments to the Law on Mining, currently in parliamentary proceedings.

The Law should be transparent in its application, with minimal, if any, use of discretion.

Geological exploration

- Geological exploration should be regulated within the Law on Mining, rather than within separate legislation, as is currently the case.

- The regulation should implement internationally recognized standards for regulatory and public reporting of exploration results, mineral resources and ore reserves, such as the Joint Ore Reserve Committee Code.

- The explorer should be permitted to obtain rights to large areas of land, but only for a limited period and subject to minimum annual expenditure requirements per unit area.

- Exploration licences should be issued for an initial period of at least two years with two guaranteed renewals available of two or three years each, the latter accompanied by the surrender of, for example, 25% of the total area on each renewal. The Law should also allow the exploration licence holder to extend the period of the licence for a reasonable period, if this is necessary to complete a full feasibility study.

- A licence holder should be allowed to freely transfer all or part of its rights to one or more other parties.

Mining

- A mining licence should be granted for at least 30 years, renewable for as many further 10 year periods as are necessary until the resource has been economically exhausted.

- If levied, royalties should not be based as a percentage of gross revenue or on a charge per unit of volume or weight.

- The royalty rates should be known in advance of exploration work commencing and not be withheld until the point of the investment decision for a mine development.

• The Mining Law should make clear and specific reference to other applicable laws and supporting regulations. Other relevant legislation should not inhibit the application of the Mining Law.

• The Mining Law will include a provision against state expropriation or nationalization of any or all of an investor's assets. The Law will also include a provision for fair and reasonable compensation to the investor under those extreme and exceptional circumstances in which expropriation or nationalization might still occur.

Chapter 17

Media: Law on Advertisement

Current Situation

In spite of advancement in many spheres, the media in Serbia and Montenegro still faces numerous obstacles. The main problem is the lack of application of the existing regulatory system, whereas the problems with issuing licences and frequencies represent the framework for other unsolved questions.

On the regulatory side, the Advertising Law has finally been adopted, although without some of the input suggested by professional associations (Group of Marketing Agencies within the Serbian Chamber of Commerce). The Advertising Law had a great impact on media buying (increase of the price per second on television as well as on the price of advertising space in printed media), and it will have more influence on the editorial policies, especially of the broadcasting media, and television in particular.

On the other hand, growing tabloid press and the rise of sensationalism, primarily in print media, concerns media experts and professionals. The UNESCO-supported Press Council (Media Watch Serbia Research Group), having monitored the mass circulation daily newspapers and weekly news magazines for eight months, has concluded that the main media trend is emerging of a new sort of political tabloid, whereas serious political news is less covered even in reputable newspapers. In addition, campaigns against individuals or political and other groups founded on half-truths, harangues against political opponents, swearing, and even untruths, characterize a significant part of the press. Hence, this Press Council declared the need for a New System of Ethical Journalism in Serbia.

2005 was marked by the introduction and implementation of a subscription for National Television in the amount of CSD 300 per household possessing a power supply. This raised public debate, where many organisations and experts challenged this solution. However, the implementation of subscription invoicing started together with the December invoices for electricity consumption.

Latest news and developments

At the end of December 2005, the Government announced rates for the annual usage of frequencies. However, the Republic Broadcasting Agency (RRA – www.rra.org.yu) hasn't released the tender for frequencies, as the Republic's Telecommunications Agency (RATEL – www.ratel.org.yu) was not able to access the data belonging to the control centres of the former Federal Ministry for transport before mid-January 2006 – which was one of the key preconditions for preparing the Plan for the Distribution of Frequencies.

On 16 January 2006, the Ministry of Capital Investments renounced the necessary computing equipment, software and databases to RATEL for temporary usage. This equipment was needed for RATEL (i.e. its Sector for radio-communications) in order to start the planning and distribution of frequencies, as well as issuing the licences. The equipment was transported on the same day, which enabled this process to start.

On 31 January 2006, RATEL's Managing Board announced their decision that the location of all economic subjects should be found and, at the same time, the collection of the basic technical and economic indexes of status in the Serbian telecommunications market.

What could be improved?

Print:

- The Information Law should be consistently enforced.

- The tabloid press has to be sanctioned by the law when publishing untruths, defamatory statements or pornography, allegedly involving well-known people, and particularly when performing attacks on a person's private life in an attempt to raise circulation (e.g. cover pages with intimate details, explicit photos, etc.).

- Journalists and editors-in-chief must recommit themselves to democratic values and accept a Uniform Code of Ethical Conduct.

- Generally, all printed media should make an effort to resist the drive for circulation increase at the cost of professionalism and ethical standards..

Electronic Media:

- Harmonisation of regulatory bodies and speed-up of the whole legal process.

- The transformation of the Serbian Broadcasting Corporation (RTS) into a public service. As stated in the Radio Diffusion Law, the deadline for the transformation of RTS into a public service is 30 April 2006. Apart from the subscription issue which has finally been solved, RTS has to implement legal procedures and to transform its program according to specific legal obligations common for public service media.

- Defining the number and category of emitters, following the recommendations of RRA.

- Privatisation of electronic media whose founders are local governments of the municipalities, in order to decrease potential political pressures.

FIC Recommends

Electronic Media

- Integral broadcasting system.

Transmitters that belong to commercial emitters are located without any strategic plan and with some regard to legal acts and technical standards, whereas RTS's system was destroyed during the NATO bombing in 1999. Establishing an integral system of transmitters, based on the restored infrastructure of RTS, would contribute to the regulation of the situation in broadcasting media.

- Organizing the cable and satellite system

Due to unregulated system, there is no precise data on the number of Cable Television Systems, broadcasters, service providers (KDS), and subscribers, nor on the number of KDS operators. Therefore, RRA has to list existing KDA operators, as well as the number and the type of program they broadcast. Operators are also responsible for providing a transmission licence. Also, specialized operators (educational, scientific, local municipalities) have to be stimulated.

- Subscription for National Television

Exemptions should be more precisely declared and implemented: For example, based on the current article of the Law, enterprises that have a TV set, should pay one subscription for each 20 employees, which is not sustainable. There should also be exemptions for enterprises operating in areas where there is no RTS signal.

- Finally, we wish to point out that the FIC and its member companies are ready to assist and contribute to the development of this sphere as well, helping both related Serbian institutions and the Serbian Media to keep the level of professionalism and standards, as this area is also of an crucial importance for the development of Serbia and its further accession to the EU and other integrations.

Chapter 18

Agriculture and Food Processing Industry

This is the first time that the White Book has dealt with these sectors. The problems are numerous and every branch has its own particular issues. The situation will be drawn on the example of brewing barley production and its further transformation to malt for the needs of the beer industry.

General overview

Agriculture, together with the food processing industry, plays an important role in the Serbian economy, not only by its financial input in the country's GDP but also by the number of working places it represents.

Agricultural surfaces occupy 5,718,599 ha of which cereals represent 43% including 109,900 ha of barley and 636,300 ha of wheat (2004). Brewing barley accounts for only 45000 ha, less than a half of all barley surfaces, with yearly production of roughly 81,000 tons.

The capacity of the malting industry is twice that of the local barley production: about 164,000 tons in barley equivalent, for 105,000 tons of the domestic brewing industry's estimated needs.

The Serbian malting industry suffers not only from the lack of domestic brewing barley, but also from its inadequate quality. This makes this gap between production needs and quality local barley on offer much wider.

The negative impact on the whole chain is evident:

- Farmers lose profits from brewing barley that could potentially have been grown locally. There is no support compared to wheat producers for example, including the refusal of some tonnages for malting, due to insufficient quality;
- Malting plants are obliged to import barley, leading to high production costs due to important custom taxes and numerous other taxes and related fees and so reduced investment capacities;
- Breweries are forced to import malt, which has the same consequences as for the malting industry.

High direct import taxes

Barley, malt and seeds have the same taxation level of 20%. Although import duties for barley were decreased from 30% to the same current level as for malt in 2005, it is still not enough, especially bearing in mind that barley is not a transformed product and should normally have lower import taxes.

Insufficient quality and impossibility of multiplication in the second generation

Protection of local barley producers by customs duties is not a solution in Serbia because of the quality factor, which lies in the genetics of local varieties.

The introduction of new brewing barley varieties is the way to overcome this problem. Some varieties have already been approved and gave very promising results on an industrial scale (Vanessa, Scarlett).

Although a two-year trial period is justified before the official approval of completely new unknown varieties, for other varieties which showed good results in the same agro-climatic conditions (tested in neighbouring countries) this period could have been reduced to one year. For example, in Romania, approval is automatic in this case and all economic factors benefit from it.

A much more prohibitive factor is the ban on multiplying second generation seeds, in order to offer them to farmers at the same price as local varieties. Indeed, after the first multiplication, the brewing barley obtained must go directly to malting.

Thus the malting industry suffers from the double negative impact on its production competitiveness:

- High import taxes on barley;
- High purchase costs of locally grown imported varieties multiplied in the first generation.

In this situation, farmers are not guaranteed to sell their produce and cannot buy expensive seeds of imported varieties. As a result, they turn to other cultures, reducing their range and increasing risks:

- The risk of overproduction leads to prices falling after the harvest;
- The risk of bad climate conditions on the main culture(s) may lead to a dramatic financial impact.

The way out for farmers lies in diversifying and producing quality goods according to the requests of their clients in the processing industries.

Numerous unjustified indirect taxes

During import/export operations, a lot of different taxes and fees are collected, which dramatically increase the manufacturers' costs. A lot of problems related to this issue are observed:

- The system is complicated, and both money and time-consuming;
- Numerous taxes and fees are difficult to understand, are expensive and unjustified;
- The number of samples is not defined, legal texts being unclear and imprecise on the subject;
- Laboratory choice for analysis in not done systematically on an economic, customer oriented basis: samples may be sent to the most distant laboratory, rather than to the closest one;
- Some border crossing points do not provide the full range of services, with one or several types of inspectors not being accredited. This leads to longer distances to the destination and higher costs.

Moreover, instead of eliminating and decreasing these taxes and fees, the costs of phyto inspectors were increased by 17% in 2005.

Tables 1 (malt export) and 2 (barley import) reflect concrete examples of the operations realized in 2005. The Euro exchange rate is as at end January 2006.

Tab 1: Taxes & fees related to malt export operations

			1 truck	1 wagon	1 barge
		Tonnage	**22**	**38**	**500**
Customs - Carina	**Customs - Koletarna taksa**	Dinars	650	2,190	20,590
		Euros	7	25	237
		Euros/to	**0.34**	**0.66**	**0.47**
Phyto inspector - Fitopatolog	**Tax on phyto decision - Taksa na zathev fitopatologu za resenje**	Dinars	3,950		
		Euros	45		
		Euro/to	**2.06**	**1.19**	**0.09**
	Tax on sample taking - Troskovi pregleda	Dinars/to	30		
		Euros/to	**0.34**	**0.34**	**0.34**
	Phyto inspection - Zahtev fitopatologu za pregled	Dinars	300		
		Euros	3.4		
		Euro/to	**0.16**	**0.09**	**0.01**
Other taxes - Druge takse	**Specifikacija za razduzenje uvezene robe**	Dinars	300	300	300
		Euros	3	3	3
		Euros/to	**0.16**	**0.09**	**0.01**
	CMR	Dinars	400	400	400
		Euros	5	5	5
		Euros/to	**0.21**	**0.12**	**0.01**
	Bank guarantee 0.3 % of goods value & VAT - Troskovi garancije 0.3 % od vrednosti robe i PDV				
		Euro/to	**0.75**	**0.75**	**0.75**
	Troskovi administrativne takse	Dinars	590	1,090	1,340
		Euros	6.78	12.53	15.40
		Euro/to	**0.31**	**0.33**	**0.03**
TOTAL (Eur / ton)			***4.33***	***3.58***	***1.71***

Table 2 shows that various costs could reach EUR 21 per ton if transported by truck.

Tab 2: Taxes & fees related to barley import operations

			1 truck	1 wagon	1 barge
		Tonnage	**22**	**40**	**500**
Customs - Carina	**Customs - Koletarna taksa**	Dinars	1,710	2,190	20,590
		Euros	20	25	237
		Euros/to	**0.9**	**0.6**	**0.5**
Analysis - Analiza	**Laboratory - Laboratorija**	Dinars/analyse	10,119		
		Euros/analyse	116		
		Number of analysis	1	1	5
		Euros/to	**5.3**	**2.9**	**1.2**
	Radioactivity - Radioaktivnost	Dinars/analyse	3000		
		Euros/analyse	34		
		Euros/to	**1.57**	**0.86**	**0.07**
Phyto inspector - Fitopatolog	**Tax on phyto decision - Taksa na zathev pitopatologu za resenje**	Dinars	3,950		
		Euros	45		
		Euro/to	**2.1**	**1.1**	**0.1**
	Tax on sample taking - Troskovi pregleda	Dinars/to	30		
		Euros/to	**0.3**	**0.3**	**0.3**
	Phyto inspection - Zathev fitopatologu za pregled	Dinars	300		
		Euros	3.4		
		Euro/to	**0.16**	**0.09**	**0.01**
Radiologist - Radiolog	**Radiologist's inspection - zahtev za za radioloski pregled**	Dinars	500		
		Euros	100		
		Euro/to	**4.55**	**2.50**	**0.20**
	Fees for radiologist's inspection -Troskovi radioloski pregled	Dinars	3000		
		Euros	34.5		
		Euro/to	**1.57**	**0.86**	**0.07**
Market inspector - Trzisni inspektor	**Demand for inspection - Zahtev trzisni za pregled -**	Dinars	300		
		Euros	3.4		
		Euro/to	**0.16**	**0.09**	**0.01**
	Market tax for inspection - Taksa za trzisni pregled	Dinars	550		
		Euros	6.3		
		Euro/to	**0.29**	**0.16**	**0.01**
	Fees for market inspection - Troskovi trzisnog pregleda	Dinars	188	260	2100
		Euros	2.16	2.99	24.14
		Euro/to	**0.10**	**0.07**	**0.05**
Sanitory inspektor - Sanitarni inspektor	**Demand for inspection - Zahtev za pregled**	Dinars	300		
		Euros	3.4		
		Euro/to	**0.16**	**0.09**	**0.01**
	Tax for demand for decision delivery - Taksa za zahtev za izdavanje resenja	Dinars	3500		
		Euros	40.2		
		Euro/to	**1.83**	**1.01**	**0.08**
	Fees for sanitary inspection - Troskovi sanitarne inspekcije za pregled robe	Dinars	160	250	2550
		Euros	1.84	2.87	29.31
		Euro/to	**0.08**	**0.07**	**0.06**
Other taxes - Druge takse	**Sending of goods for custom clearance - Upucivanje robe na carinjenje**	Dinars/to	54.5		20
		Euros/to	**0.6**		**0.2**
	Sending from the border under control - Upucivanje sa granice pod nadzor	Dinars/to	10	10	10
		Euros/to	**0.1**	**0.1**	**0.1**
	Administrative custom tax for goods sending from the border - Administrativina carinska taksa za upucivanje robe sa granice	Dinars	720	1,470	1,220
		Euros	8.28	16.90	14.02
		Euro/to	**0.38**	**0.42**	**0.03**
	Wagons acceptance on the railway station, filing the demand, presence - Prihvat vagona na granici, podnosenje zahteva, prisustvo	Dinars/to		17.5	
		Euro/to		**0.2**	
	Sending of goods from the border for custom clearance - Upucivanje robe sa granice na carinjenje	Dinars/to			8.5
		Euro/to			**0.1**
	Samples taking for phytopathologist, market inspector - Uzorkovanje robe na granicnom prelazu za racun fitopatologa, trzisnog	Dinars			3000
		Euros			34
		Euro/to			0.07
	Bank guarantee 0.3% of goods value & VAT - Troskovi garancije 0.3% od vrednosti robe i PDV				
		Euro/to	**0.45**	**0.45**	**0.45**
	Import custom clearance - Uvozno carinjenje	Dinars/to		27	
		Euro/to		**0.31**	
	Custom taxes - Carinske takse	Dinars	1,060		
		Euros	12.2		
		Euro/to	**0.55**	**0.30**	**0.02**
	Filing of demand for temporary import of goods - Podnosenje zahteva za privremeni uvoz robe	Dinars	500		
		Euros	5.7		
		Euro/to	**0.26**	**0.14**	**0.01**
TOTAL (Eur / ton)			**21.42**	**12.76**	**3.66**

Finally, complicated and time consuming procedures are discouraging, with official authorizations and certificates to be delivered by Ministry of Health for the import of some products (three weeks or more).

FIC Recommends

- To reduce import tax on barley to 10% and reduce it progressively to 0% ;

- To simplify, correct and clarify legal acts pertaining to import/export operations with the objective of cancelling unjustified taxes and fees, protecting the rights of market operators, optimizing their costs, and speeding up the acquisition of authorizations and licences;

- To introduce brewing barley support by the State (as for wheat);

- To eliminate import tax for seeds (from 20% to 0%);

- To authorize approved imported varieties of second generation seed multiplication;

- To reduce the trial period to one year for new varieties which have shown good results in the same agro-climatic conditions (already tested and being successfully produced in neighbouring countries).

These measures aim to build healthy, economically stable and competitive chain 'farmer – malting industry – beer industry' in Serbia and promote the export of their products in the Balkan area.

Chapter 19

A Practical Approach to Corporate Social Responsibility Projects

From Theory to Reality

There is a lot of talk about Corporate Social Responsibility (CSR), but much of it is rhetoric and lacks substance. Some companies are not going beyond PR activity - the social responsibility version of 'greenwash'. Recent research questions whether the apparent progress toward more responsible behaviour is actually taking place and is any more than tokenism. It is true that some organisations are involved in public spirited activities under the CSR banner, but many of these activities, while making a genuine community contribution, are peripheral to the corporation's core business.

There are a few corporations making CSR integral to their business strategies, which is the future direction CSR must take, but how can the momentum to accelerate this move be intensified? What does a strategically relevant CSR strategy look like? How can we be sure that there is reality behind the rhetoric? Where is the payoff for the community and for the corporation?

What is CSR?

Organisations now realise they must embed CSR into the business rather than positioning it as simply an 'add-on' function. In a world where stakeholders demand that businesses operate in a responsible way, with ever-increasing standards of accountability and transparency, the way that businesses respond to the community and the environment in which they operate is now more real than ever.

CSR aligns business operations with social values. It integrates the interests of stakeholders - all of those affected by a company's conduct - into the company's business policies and actions. CSR focuses on the social, environmental, and financial success of a company - the triple bottom line - with the goal being to positively impact society, while achieving business success.

In the past, a company's merit was based solely on its financial performance. Stakeholders are now beginning to better understand how corporate behaviour affects social, political, and natural environments. With this increase in understanding comes increased pressure from investors, consumers, and employees for companies to consider social and environmental criteria when making business decisions. This has created momentum for using a 'triple bottom line' or 'sustainable' approach—i.e., looking at social, environmental, and financial data when evaluating business operations. Increasingly, stakeholders are concerned that any companies they support have business practices that positively impact society while achieving financial success.

CSR embraces two main concepts: accountability and transparency.

Today, stakeholders expect companies to perform well in non-financial areas that involve human rights, business ethics, environmental policies, corporate contributions, community development, corporate governance, diversity, and workplace issues. Social and environmental performances are considered side by side with financial performance. From local economic development concerns to international human rights policies, companies are being held accountable for their actions and their impact.

Companies are also expected to disclose and communicate their policies and practices that impact upon employees, communities, and the environment. In the global economy, companies that are responsive to the demands of all of their stakeholders are arguably better positioned to achieve long-term financial success. Stakeholders, regulators, and NGOs demand information about a company's social and environmental impact, and corporate communication about these issues has become critical for sustainable business growth.

Many companies are making significant efforts to decrease their environmental footprint and better serve their various stakeholder constituencies. Investors, consumers, and employees are more sophisticated than ever before. While they understand that every company can do more to be more socially and environmentally accountable, stakeholders are rewarding companies who make strides to improve their performance in these areas.

CSR can involve almost any aspect of a company's operations. Every company has a story to tell that sets it apart. It is important for every company to find its story and to tell it. A company that is considered a good corporate citizen is one that demonstrates a commitment to its stakeholders through socially responsible business practices and transparent operations.

What are the developments in that field?

ISO 26000 social responsibility guidelines

The future ISO 26000 standard giving guidance on social responsibility has taken a significant step forward with ISO deciding on the structure and overall contents, as well as fixing a target release date of the last quarter 2008.

The ISO Working Group on Social Responsibility (WG SR) laid the foundations of ISO 26000 at its second meeting, 26-30 September 2005, in Bangkok, Thailand. ISO 26000 will give organizations harmonized, internationally agreed guidance for social responsibility, drawing on best practice and consistency with relevant declarations and conventions by the United Nations and its constituents, notably the International Labour Organization (ILO). The standard will not contain requirements allowing ISO 26000 to be used for certification.

One of the principal achievements in Bangkok was developing the "design specification" (structural outline) for ISO 26000. The WG SR agreed on the following structure to organize the content of the future standard:

0 Introduction
1 Scope
2 Normative references
3 Terms and definitions
4 The SR context in which all organizations operate
5 SR principles relevant to organizations
6 Guidance on core SR subjects/issues
7 Guidance for organizations on implementing SR
Guidance annexes
Bibliography

Another outcome of the Bangkok meeting was a draft project plan that targets publication of a draft ISO 26000 in November-December 2007, a final draft in September 2008 and the fully fledged International Standard in October 2008.

What is the payoff for the community and for the corporation?

There are nine common drivers that are the motivators to CSR-Projects:

- Reputation and brand management
- Business risk management
- Employee recruitment, motivation and retention
- Access to capital

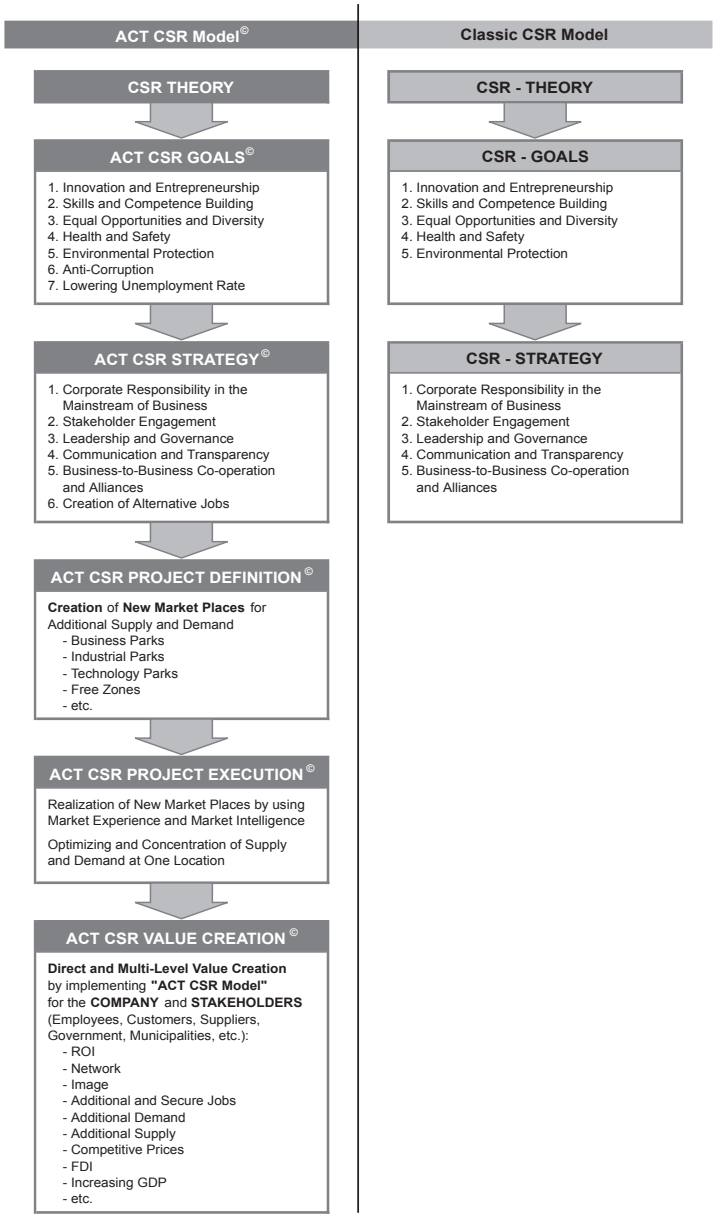
- Learning and innovation
- Cost savings and operational efficiency
- Competitiveness and market positioning
- Social licence to operate
- Improved relations with regulators
- Organizational transformation and continued improvement

What does the community need most to maintain and increase living standards and conditions? Jobs!

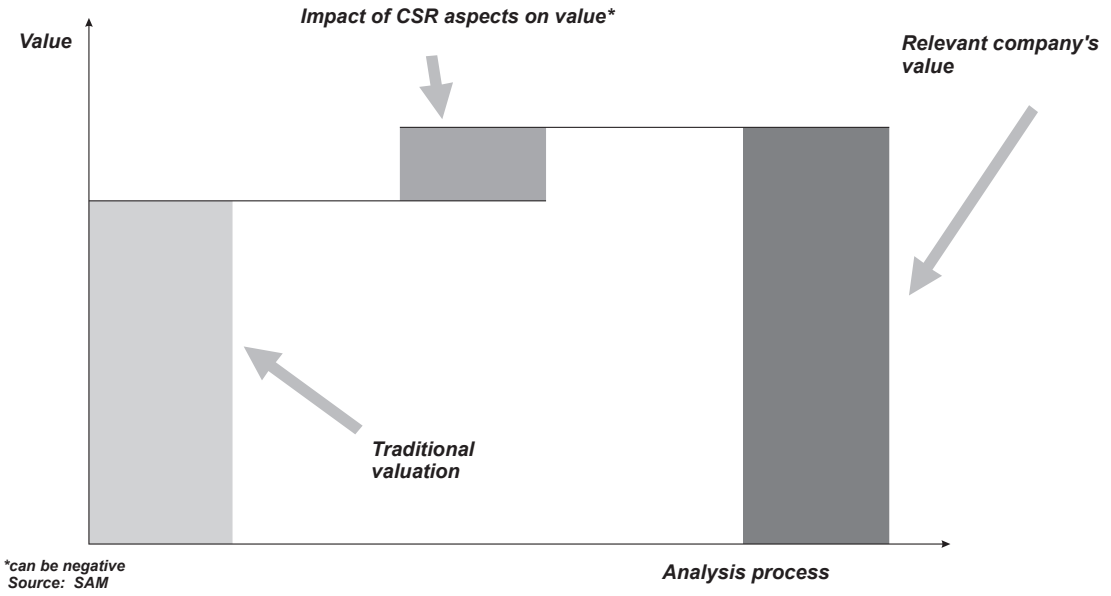
A CSR-Project, designed according to the ACT-CSR-Model©, is to the benefit of both the company and the stakeholders, since it is creating new and alternative jobs and thus is creating additional value for all parties. If the CSR-Project is not focused on only the internal and external soft facts, it is possible to create a real and long-lasting business project, as the ACT-CSR-Model© shows.

This can be achieved by using spare land near to brown- or green-field investments for the development of business parks, technology parks, industrial parks, free zones, etc. Each and every location has it's own USPs (though mostly not recognisable at first sight) that can be used as the base for the development of a new market place. Of course, it is important to involve all authorities and representatives at a very early stage. Again, this will be beneficial for all involved parties, as it opens doors and improves the image of the company.

And, last but not least, it is important that the project is a "Non-Profit-Project"! What does that mean? The project should not be aiming to make money, but only to minimize costs for the company and, at best, to cover all the costs! This makes the project a real CSR-Project and helps the community most.



Using the ACT-CSR-Model©, it is possible to calculate the ROI of the project and to accomplish real added value to the company.



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