WHITE BOOK

Proposals for improvement of the business environment in Serbia

2008

Foreign Investors Council

FOREIGN INVESTORS COUNCIL

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Proposals for improvement
of the business environment in Serbia

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FOREWORD

This book is being brought to the attention of the public during the early days of functioning of the new Government in Serbia. The aim of this White Book remains the same as in previous editions: to point out the desired changes so as to improve conditions for doing business, and to provide concrete suggestions on how to improve them. It is meant to serve as basis for constructive dialogue between the private sector and the authorities on overcoming the remaining obstacles for investing.

Looking back at the last year, in a rather general way, we can note several important events, which will undoubtedly have a strong impact on the Serbian business environment. Firstly, regional free trade agreement CEFTA came into force, opening a much wider market and providing better opportunities for growth. While full harmonization of the national markets stays ahead, first year of implementation sends a clear signal of positive effects on the economic development.

After lengthy period of negotiations, Serbia has signed the Stabilization and Association Agreement with the European Union. In its essence, this free trade agreement paves the way for further introduction of international standards and common mechanisms to the domestic market, thus strongly contributing the predictability of the business climate.

Thirdly, Serbia authorities launched an important energy project with the Russian Federation, in the attempt to provide a long-term solution to the energy dependency Serbia suffers. While ensuring sustainable supplies and building energy infrastructure are foreseen as undisputable goals, striving to achieve them needs to be accompanied with the transparent decision-making and safeguard processes and mechanisms.

The announcement of one more project caught the eye of the business community in the previous period. The so-called "regulatory guillotine", namely the process of eliminating obsolete regulations and streamlining the complicated procedures, was enthusiastically greeted by the foreign investors. Enacting contemporary legislation, even though beneficial, is not enough for creating a favorable business environment unless two other things happen at the same time: getting rid of obsolete and redundant legislation, and putting in place adequate by-laws and modernization of administration that go hand in hand with adoption of modern laws.

We also need to mention the significant political developments over the last year since they also influenced the business environment. Just the mere fact that this edition of the White Book comes out in autumn, points to one of the political factors influencing the economy – elections. They carry a twofold effect. Initially, they cause a slowdown in reforms, and a reduced interest of administration to push for modernization. Beside this direct impact, there is another not as direct, but also essential in the long run. Frequent elections diminish predictability and minimize the ability of the private sector to develop business strategies and establish plans of future operations. Therefore, long periods of consecutive election cycles resulted in the overall slowdown of reforms and reduced the interest of potential new investors.

Process of Kosovo resolution has continued throughout the period, and Serbia invested major efforts in presenting its positions and building international support around its proposals. Proclamation of Kosovo independence in mid February was followed by unfortunate scenes on the streets of Belgrade. Soon after, Government of Serbia took steps to ensure stability and in direct communication extended guarantees of safety and stability to all investors, specially the foreign ones. While final outcome of Kosovo status remains unclear, it is worthy to note that in general terms business conditions are not directly affected by this process.

Looking forward, with the new government in place, the society at large and the business community is eager for the continuation of the reform process.

The foreign business community awaits formulation of a clear economic policy, which would provide basis for economic outlook of the future period. This is the milestone of predictable business environment, crucial for attaining and attracting foreign investments.

Let us reiterate some of the measures which would support maintaining of macro-economic stability, such as introducing prudent public spending, amending the fiscal policy,

reshaping the anti-monopoly and public procurement legislation, adapting advanced securities market regulation. The new Government should conclude the privatization process of socially-owned enterprises, and revive the strategy of privatization/restructuring of state-owned public enterprises.

However, the economic policy should not be constricted solely to macro-economy, but rather entail a broad spectrum of measures tackling the real life conditions for doing business.

Difficult issues seek long-term solutions, and should be discussed today in order to secure their resolution in the years to come. A comprehensible plan and decisive set of actions needs to be put in place to address growing concerns about scarce resources: land, infrastructure, and human resources, as basis for any economic development. Finding systemic solutions for each of these issues is a complex and financially consuming process. However, even in these areas, one identifies a number of small obstacles that create big impediments to doing business, barriers which could be overcome and lead to significant and rapid improvement in a short timeframe.

To that end, more efforts need to be invested in restructuring the implementation mechanisms of the existing legislative framework. Even though innovative and contemporary legislation are being enacted, their impact is limited by the jungle of formalities, hidden in the by-laws. This issue also relates to enhancing of the administrative capacity and quality of public service. Foreign investors put special emphasis on this subject as its resolution carries multiple positive effects – more predictability, more efficient administration, and of course less potential for corruption.

The overall reform agenda ought to introduce systems which promote equal treatment of all, thus fostering new investments, regardless whether they are foreign or domestic, big or small.

By publishing the White Book, the Foreign Investors Council strives to be an active partner in creating a better economic and business environment in Serbia. The formula of the White Book is simple. First we define the current status in a particular area of interest. Then we review the achievements between the previous and current White Book. This is followed by a listing of remaining problems. Finally, we propose concrete solutions to the remaining issues at hand.

We express hope that the authorities, both at the Republic and local level, will find these proposals useful in pursuing the goal of increasing the competitiveness of this market. We, the foreign investors, remain open to continuing the dialogue on all issues relevant to attaining economic growth of Serbia.

Stein-Erik Vellan
FIC President

FIC OVERVIEW

Six years ago, 14 major foreign investors in Serbia, with the support of the OECD, gathered around the common idea of contributing to the improvement of the investment environment in Serbia.

Throughout past years, the Foreign Investors Council has proven to be a powerful, constructive and, therefore, respected reference tool on matters related to the development of the overall business climate. Today, the FIC counts more than 120 members with representatives from more than 20 different countries. Involved in a wide range of industries, FIC members account for more than three-quarters of total foreign direct investment in Serbia and employ significant number of the local labour force. The organization is alive and continually growing.

Following its mission and striving to fulfil its aims, the Council has always worked in close partnership with the relevant government authorities, international organizations and institutions. Its main purpose is to share positive international business practices with local authorities and support their reform activities. Therefore, the FIC is constantly involved in both formal and informal dialogue between willing stakeholders. Activities in the past year included partnerships in organization of various round tables, panel discussions and conferences; participation in and support for many non-FIC events; ongoing and continuous servicing of the membership; and, of course, dedicated work on the White Book.

Most FIC activities are initiated by the members themselves and developed through the work of specialized committees that cover most of the members' interests and needs: Legal, Human Resources, Insurance, and Detergents and Cosmetics. The past year was marked by re-activation of three specialized committees: Corporate Social Responsibility, Exploration and Mining, and Taxation. These are some of the topics that bring together FIC members on a regular basis. The FIC provides a good platform for the exchange of experiences and opinions among its membership.

Working on building solid partnerships, the FIC continued cooperation with the Serbian Chamber of Commerce in preparation of the White Book. The Council is grateful to the Chamber for the valuable contributions to this year's publication. In the years to come, the White Book will remain to be a cooperative effort. After all, foreign investors are also members of the Serbian Chamber of Commerce and, hopefully in several years, the FIC will have no reason to exist as Serbia readies to join the EU.

In the future, the Council will continue in striving to build-up good partnership relations both with state authorities and other relevant stakeholders. The FIC has already engaged in close cooperation with like-minded business-oriented organizations such as the American Chamber of Commerce and others, with the aim to contribute to the overall improvement of investment and business climate, through joint activities. We also intend to pay much more attention to the follow-up, and revigorate working with governmental institutions in converting our recommendations into reality.

CORPORATE SOCIAL RESPONSIBILITY MANIFESTO

As leading foreign companies operating in Serbia and members of the Foreign Investors Council, we are fully aware of our duty and obligation to support responsible business practice within Serbian society at large. By promoting and implementing the concept of corporate social responsibility (CSR), we are trying to build trust among citizens and demonstrate our ability and willingness to contribute to the society with our insight and expertise and, most of all, with our commitment to the local community.

We are very pleased to see that the idea of the corporate social responsibility in Serbia evolved in a very short time from a totally unknown concept to one of the most frequently mentioned topics, irrespective of the certain confusion surrounding the definition of the phrase. From our side we can contribute to the creation of a local definition of the term. CSR is not some additional programme or campaign aimed to charm or impress media or consumers. It is more about how we are doing our day-to-day business operations by taking responsibility for the impact of all our activities. This surpasses statutory obligations, existing legislation and activities aimed to build seductive corporate reputation. CSR is not about what we must, but rather what we want to do. It is about behaving ethically and contributing to economic development by improving the quality of life of the workforce and their families as well as of the local community and society at large, including the environment.

We are a part of the community, and as such we take responsibility for its development. Serbia is a country with great potential and it is our real pleasure and privilege to be here. The concept of corporate social responsibility also includes endeavours to preserve local traditional values, not only to impose global standards. From that point of view, we can say that we see corporate social responsibility as a perfect mixture of the sustainable growth, social philanthropy and responsibility for all social issues and problems that may or may not be considered as our liability as individual companies. The concept of corporate social responsibility goes beyond individual interests. The mutual interest all of us is to live in the responsible community that is capable to face any challenge.

In our opinion, one of the key qualitative changes in the understanding of socially responsible business in Serbia is reflected in the increasing shift away from the traditional corporate donations of the fine arts and established institutions, and towards addressing real social problems to have a meaningful impact on the society in which we are operating. Such issues include environmental concerns, as well as business diversity to incorporate the inclusion of socially marginalised groups.

Examples of best practice, such as the Safe House for Victims of Domestic Violence and the Drop-in Centre for Street Children, which were implemented alongside strong media campaigns, were significant attempts towards managing acute societal problems. In these projects, the support of socially-aware companies, among which are numerous members of the Foreign Investors Council, was not reduced to mere donations of funds. These were excellent examples of how socially responsible companies can positively engage on critical issues.

Being part of the foreign investment community, we believe that it is crucially important to unify the available potential, achieve consensus on the appropriate role of business in society, and develop local methods to accelerate positive change. The Foreign Investors Council is ready to lead this social initiative with the premise to include all who have the will, power and desire to improve the quality of life for people in Serbia.

In this respect, we see our role as a point of confluence for positive intent, a source of the necessary knowledge and experience to deliver change, and with the potential to leverage resources of Council members.

WE BELIEVE IN

- Introducing ethical obligations that each company in Serbia prepare annual CSR reports analysing its activities and their impact on the community;
- Improving dialogue at all levels of society, including competent government authorities, the media, non-governmental organisations, social groups and movements for the purpose of further promotion of the concept of socially responsible business in accordance with the principles of sustainable development;
- Analysing current legal regulation and proposing new legal solutions in accordance with EU standards and initiating the adoption of concrete measures that will stimulate socially responsible behaviour;
- Improving corporate governance standards in terms of business transparency and information availability;
- Active involvement in solving acute societal problems, such as employment policy, environmental programmes and similar;
- Creating of an efficient network that would include all actors on the social scene which are able to promote CSR, including relevant government institutions and non-governmental organisations;
- Initiation of university education programmes relating to CSR, sustainable development and other relevant issues.

INVESTMENT AND BUSINESS CLIMATE

Viewed in the light of macroeconomic performance, the year of 2007 presents a quite diversified picture. Without a doubt, the greatest success of the previous year was the very high growth rate of gross national product of more than 8%. Given the fact that this GNP growth was accomplished with a minimum increase of employment, this means that the growth was achieved primarily due to the increase in productivity, which is also good. The export has also risen by more than 30% and reached almost $9 billion, which is 6 times more than in 2001.

On the other hand, after the decrease during 2006, inflation rose in 2007, reaching a two-digit amount of 10.2%. Export of goods was growing rapidly and it finally reached the total amount of $18.8 billion. This has lead to an enormous foreign trade deficit which in fact is the main cause of payment balance deficit. The unemployment rate is still very high and amounts to 18.2%.

Besides the growth of GNP and productivity, other macroeconomic indicators still do not indicate that the transition, and above all economy restructuring have entered the mature phase of stable economic trends.

In 2007, and in the first six months of 2008, business climate in Serbia did not undergo any major changes, since the country was focused on solving political issues. Reforms have continued, but due to long pauses in the work of Parliament during the last year and a half, enactment of new laws and their harmonization with EU and WTO legislation and rules has been significantly slowed down. Ratification of a number of contracts concerning foreign credits approved for the construction and modernization of transportation infrastructure has been postponed.

From the standpoint of legal security, slow and lingering procedures for court cases still are a great obstacle; arbitration procedure has not been sufficiently developed, and the impossibility to acquire property right for construction land development also represents one of the key obstacles for creating a business climate that could attract FDI. There is also a problem with the real estate cadastre and land register. In some fields, administrative procedures are still complicated and hardly understandable for foreign investors. The existence of numerous and complicated procedures for obtaining license for the construction of different facilities and the long time needed for their approval, increase the risk of corruption in this field, decrease predictability and represent significant obstacles for investments in Serbia.

Efficiency in implementing bankruptcy proceedings has been significantly improved through adoption of the new Law on Bankruptcy, as well as through training of bankruptcy managers, court personnel, etc However, it is necessary to speed up bankruptcy proceedings so as to finish off the large number of bankruptcy proceedings that have piled up before the adoption of the new Law.

Late in 2007, the Free Trade Agreement between the countries of Western Balkans and Moldova (CEFTA) was ratified, thus replacing and improving earlier bilateral agreements. The Agreement will contribute to intensification of trade between Serbia and countries of the free trade zone. This is of great importance for Serbia, since it has positive balance with most of these countries (excluding Croatia with which negative balance has been decreasing, and partially Moldova with which the scope of trade is very small).

Early in 2008, an energy agreement with Russia including the sale of the greater part of NIS's shares, and construction of gas pipeline throughout Serbia was signed. The energy arrangement with Russian Federation envisages construction of a gas pipeline and completion of construction of gas storage facilities as a basis for distribution network development. Introduction of new technologies would contribute to improved energy efficiency, and generally speaking, the agreement would result in a long-term energy stability that is of special importance for a stable development of Serbian economy.

A big step towards the integration of Serbia into the EU has been made by signing of SAA. It is realistic to expect that in the second part of this year Serbia could meet the requirements for enforcement of the SAA. The fact is that it will not have instant positive effects on the economy, having in mind the costs of adapting the Serbian legislative framework and its economy to business activities in EU. But this means investing into the future and Serbia needs to speed up this entire process and implement it at the lowest possible expense. These expenses should be viewed as invest-

ments that will in the long run bring much greater benefits through a significant economic growth and an increased standard of living for Serbian citizens. Regulating the relationships with the EU through this Agreement would itself contribute to the improvement of credit rating of Serbia and attract new foreign investments

Privatization process is in its final stage. The Law on Amendments of and Supplements to the Law on Privatization adopted late last year stipulates that by the end of 2008 privatization shall be completed in the remaining 750 socially-owned enterprises. The joint venture model, so called "flexible model", that has been announced for the privatization of Zastava in Kragujevac, will probably be applied to other enterprises as well. This model means privatization through strategic partnership and aims to provide new investments, modernization, employment growth and export.

Privatization of public enterprises has actually only begun. In the past seven years, certain progress has been made in restructuring public enterprises, the result of which was improvement of their financial performances. In the forthcoming period, it is expected that a number of public enterprises in the Republic will be privatized: NIS, JAT Airways, Telekom Serbia, JP PEU-Resavica, Belgrade Airport Nikola Tesla and joint-stock company Galenika. For the purpose of carrying out these privatizations, a law that stipulates distribution of shares free of charge to all citizens of Serbia at legal age that had not already exercised their right during the privatization process was adopted late in 2007.

There were no changes in the investment incentives system in the previous year. The existing tax and customs incentives are still in force, as well as incentives in the form of granting financial aid for new employments in the course of the realization of investment projects. Investment incentives through granting financial resources have been especially promoted. By May 2008, investors were granted 29.4 million EUR for their investments in the value of 430 million EUR which have provided the jobs for 13,667 people. In 2007, most companies that were granted these resources were in the textile sector, food processing industry and electronics industry.

Serbia's position in the international financial market has been aggravated due to instability caused by the price rise and current deficit, with an increase of a political risk. Such trends have somewhat contributed to the decrease of credit rating of Serbia. Serbia has, according to the sum coefficient of the Freedom House for 2008 (but actually for 2007) aggravated its score among countries in transition by 0.11 points (from 3.68 down to 3.79), and all this due to aggravation of three indicators (state administration, media freedom, independent regulatory infrastructure), whereas other indicators remained unchanged. Credit rating of Serbia recorded a small drop (Standard & Poor's – VV-/stable, BB-/negative).

According to the World Bank's Doing Business 2008 Report, the position of Serbia is not the ideal one (ranking 86 in the world – composition index). A significant improvement has been accomplished in the field of "Getting credit" (ranking 13 in the world), whereas rather good position is recorded in the category of "Trading across borders" (58th position). According to the most other indicators, position of Serbia is considerably worse: with index "Starting a business" – 90 position, "Employing workers" – 110 position, "Paying taxes" – 121 position, as well as "Dealing with Licenses" – 149 position.

The fact is that assessment of rating of a country can to a certain extent affect future trends in foreign direct and portfolio investments, increasing dependence on foreign credits at higher interest rates, as well as increasing interest rates in the country.

The main macro-economic risk that Serbian economy will be facing in the forthcoming years would be abrupt and significant decrease in foreign capital inflow and balance of payment balance crisis. For several years now, Serbian economy has been recording high and ever growing deficit in the current payment balance that has been covered by foreign investments and loans. In such circumstances, an abrupt and significant decrease of foreign capital inflow would launch the mechanism of payment balance crisis (decrease of foreign currency exchange reserves, depreciation of national currency, difficulties in maintaining foreign liquidity) resulting in disturbances in macro-economic stability (inflation, etc) and probably in a decreased economic activity as well.

In addition to the aforementioned, the economy is facing some other risks on macro-economic level: decelerated growth of the world economy (smaller FDI, slower growth of export), financial crisis in the world (high interest rates), growth in oil and other raw material prices in the world market (aggravated balance of payment, inflation), smaller export demand and worsening of trade ratio (about two fifths of Serbian exports consist of metals and agricultural and food products). Demonstration of the aforementioned risks would affect negatively the current balance of payment of Serbia, and cause a decrease in foreign capital inflow for its covering.

FIC RECOMMENDATIONS

Sustainable economic development of Serbia in the forthcoming period will continue to depend greatly on foreign resources inflow. Therefore, expected gradual decrease in resources inflow as a result of privatization, requires creation of stimulating climate for growth in so-called greenfield investments. In this respect, it is necessary to speed up the process of Serbia legislation harmonization with EU regulations, in order to upgrade legal security for business operation and investments.

Particular importance is attached to:

- Regulation of property rights, especially in relation to building land and facilities construction;
- Introduction of competition on the market for infrastructural and utility sector and starting of privatization process (partial or full) for public enterprises operating in this sector;
- Creation of conditions for market competition in a regulated market, by providing equal rights for all competitors, and proper regulation of monopolies;
- Reform of educational system in Serbia and its harmonization with requirements of the economy;
- Stimulation of applied sciences development through appropriate financial support and more intense relationships with R&D institutions from abroad;

For an even development it is necessary to achieve higher efficiency of local self-governments in building of regional infrastructure, which is important for attracting investors;

It is expected that the Government of the Republic of Serbia will simplify its legislation as soon as possible, by applying the method of "regulatory guillotine". This method has already been successfully used in other countries and it aims to increase competitiveness by decreasing administrative barriers for business activities.

PILLARS OF DEVELOPMENT

The three chapters represented in this block, though heterogeneous, represent what we believe to be, together with the legal framework, the essential ingredients for a strong and vibrant business environment. Our general assessment is that the improvements that have occurred in recent years in these sectors are smaller than they could have been, and definitely smaller than necessary to ensure that these pillars of development are not an impediment to new investment and therefore to stronger growth.

Even though an empirical survey of the European Bank for Reconstruction and Development recently showed that physical infrastructure is not at the top of the list of concerns of investors and entrepreneurs in transition countries, the state of infrastructure is, nevertheless, an important factor determining the attractiveness of a country. Perhaps even more, it determines the attractiveness of a town, city or municipality. We do realize that improving infrastructure takes a longer time and involves a lot of financial investment, but we would like to point out that some of the shortcomings observed so far – like the long time elapsed between the announcement of intent to complete Corridor 10 and the actual expected completion, or the fact that new locations are being offered without adequate infrastructure, or even urban and cataster documentation – take administrative effort and not financial capital to be resolved.

In the field of real estate, not much has been done to bring to life provisions of the Constitution from 2006, which recognizes and allows the land title. Amending the legislative framework by introduction of contemporary international standards and mechanisms in this area would represent a major breakthrough in improvement of investment climate. Taking into consideration the sensitivities which are attached to this issue, a strong political consensus needs to be created to enable progress in this regard. We present the list of pending issues, as a contribution of the business community to facilitate and support this process.

The human capital, i.e. the labour force is often cited as a comparative advantage of Serbia when it comes to attracting new investment. Generally, we share that view. However we feel that at little cost, this comparative advantage could be easily and relatively quickly enhanced both in terms of the quality of human capital – knowledge and skills that would meet the needs of the changing business situation – and in terms of the normative framework that companies face when employing labour. Once again, the list of remaining issues and the list of recommendations with respect to labour related legislation is rather long, suggesting that the international business community would welcome more rapid changes. This would make Serbia in this segment comparable to, and competitive with, others markets in Europe.

INFRASTRUCTURE

CURRENT SITUATION

In the field of power engineering, the electrical industry does not possess the necessary generation and distribution capacity, the processing capacity of the oil industry does not include modern technologies, and the gas distribution is not sufficiently developed. The plans for development of the infrastructure systems do not include precise deadlines and defined sources of financing.

Such situation dictates an unbalanced regional development, reduces the range of locations for new investments which in return causes the rise of location prices and has a discouraging effect on investors.

Water supply system and utility sewage systems by and large neither have state-of-the-art technology nor sufficient capacities, or they remain unfinished and often perpetually under construction.

POSITIVE DEVELOPMENTS

Old roadways are being upgraded, and new ones constructed, especially ring roads. Granting concessions for the construction of new highways is one of the current activities along with preparations for completion of the highway on Corridor 10.

Privatization of the Oil Industry of Serbia is currently underway and it implies the introduction of new technologies. Within the framework of the energy arrangement with the Russian Federation, the construction of the gas pipeline through Serbia and completion of gas storage capacities is envisaged as the basis for development of the distribution network.

Also, it is evident that the consumption of electric energy in Serbia is uneconomical both in household heating and per industrial product. This creates prerequisites for achieving significant results within the framework of the development strategy for the improvement of energy efficiency.

The expansion of water supply and sewage systems is mainly carried out in existing urban, investment-active environments with Belgrade leading the way.

REMAINING ISSUES

- Lack of development strategy for the infrastructure systems verified by techno- economic analysis in real conditions with observed completion deadlines;

- Lack of design, urbanistic and cadastre documentation which would make the basis for further planning and construction works, without precise deadlines for the investment completion;

- Existent and new locations are offered without resolved infrastructure, which often means an uncertain and difficult road for the investor before being able to fully use new premises;

- Inclusion of premises into the infrastructure system is a complex administrative procedure including many city-level and government-level subjects, and requiring extremely long time.

FIC RECOMMENDATIONS

- Lack of domestic capital formation imposes a search for new models of involvement of foreign investments into reconstruction and upgrading of necessary infrastructure systems and facilities;

- Construction of new and completion of already initiated strategies and plans for development of infrastructure systems and facilities are to be intensified in accordance with the realistic possibilities of domestic and foreign capital;

- Urbanistic and design documentation must be produced up more efficiently, observing the deadlines, since construction work cannot be executed without these basic documents.

TELECOMMUNICATIONS

CURRENT SITUATION

The lack of telecommunications infrastructure is still an essential obstacle for further development of the telecom sector and more efficient business operations. The poor quality of connections and underdeveloped internet access are the key elements for low utilization of broadband services.

Telekom Serbia, the state-owned fixed and mobile operator, still has a monopoly position in the field of landline network for telecom services.

There are currently three market players in the Serbian mobile marketplace: MTS, mobile arm of the incumbent Telekom Serbia, Telenor and Mobilkom Austria.

The main policy document of this sector is the Strategy for Telecommunications Development for the period of 2006-2010 that was formally adopted by the Serbian Government. The Strategy is based on the previously adopted telecommunications policy document, The Strategy for Development of the Information Society and the Frequency Allocation Plan.

Furthermore, the following laws regulate Serbia's telecom sector: Law on Telecommunications (2003), Law on Broadcasting (2002), Law on Planning and Construction (2003), Law on Life Environment (2004) and Law on Protection of Competition (2005).

The Republic Agency for Telecommunications (RATEL) and the Republic Broadcasting Agency (RBA) are established in accordance with these laws as independent, self-financing regulatory bodies. Both bodies undertake the role of regulating the telecom and the broadcast sectors, including issuance of individual licenses and general authorizations for different types of telecom operators and service providers (fixed and mobile operators or providers, CATV distributors, radio and TV emitters, Internet providers, etc). Members of the respective managing boards are appointed by the Parliament. Conflicts of interest are forbidden by law.

By-laws still do not exist for many relevant areas of the telecom sector. There is a lack of relevant by-laws addressing competition and liberalization of various types of services (fixed telephony, data transmission, wirelesses broadband, digital TV, etc). Also, regulation of new technologies (WiMax, VoIP) is a slow ongoing activity with keeping the remaining protected monopoly of the fixed operator in this field.

POSITIVE DEVELOPMENTS

The new Strategy for Telecommunications Development in Serbia for the period from 2006-2010 contains provisions related to further privatization and restructuring within the telecom sector, with the aim to improve the business operations in this sector.

REMAINING ISSUES

- The Law on Telecommunications contains provisions regulating the liberalization of telecom services except for open network provision (ONP) and local loop unbundling – meaning open for competition to give services to end-users in the fixed telephony network. However, the by-laws are still not in place;

- All existing alternative infrastructure (i.e. optical cable used for utilities purposes, broadcasting or other) should be opened for all kinds of telecom services;

- The New Strategy for Development of Telecommunications Sector for the period of 2006-2010 includes provisions on harmonization of the regulatory framework with appropriate EU legislation. However, the by-laws which should further interpret the Law on Telecommunications, especially those sections related to competition and further development of the telecom sector, have still not been drafted;

- The New Strategy foresees a plan for sector liberalization and defines the conditions and authority for issuance of new operators' licenses. The strategy also foresees: partial privatization of Telekom Serbia, building capacities and improving the level of competences in all state bodies engaged in telecom business, strengthening judicial bodies for resolving disputes in this matter;

- IPO of Telekom Serbia is expected in mid 2009, but state will retain controlling package (51%) according to the proposed model by the Ministry of Economy and Regional Development;

- It remains to be seen how the telecom industry players will accept the proposal of gradual liberalization of fixed network. Also, lack of competition in fixed network will prevent development of the fixed telephony market;

- RATEL's competencies overlap with some of those of the government. For example, telecom operators are subject to double inspections from relevant government ministries and RATEL.

FIC RECOMMENDATIONS

In order to develop the telecom sector and achieve a competitive telecommunications market, one of the basic conditions required is predictable regulation. Therefore, we recommend the following:

- Continue development of the independent and competent regulatory bodies;
- Develop telecommunications by-laws in compliance with the EU regulatory standards, requirements and procedures;
- Develop interconnection regime in line with EU standards in the shortest possible time, given the presence of a number of operators and service providers in the Serbian market;
- Regulatory framework should stimulate development of broadband services which will benefit the whole society by bridging digital divide;
- Encourage the development of alternative infrastructure needs;
- Liberalize internal infrastructure and open up for use alternative infrastructure for all kinds of electronic services, with a focus on telecommunications and broadcasting;
- Liberalize international gateways to allow for competition;
- Introduce general provisions and guidelines for eliminating cross-subsidization in telecom sector;
- Continue efforts for restructuring or privatization of state owned telecom companies;
- Rebalance telecommunications tariffs on a cost-based price structure and using best practices from the EU regulatory bodies and the principles of the Telecommunications Law.

ENERGY SECTOR

CURRENT SITUATION

- The new Law on Energy adopted in 2004 is almost fully harmonized with the respective EU regulations;

- At the request of the buyer, the competent distribution company issues the decision on power mains inclusion through which it defines the installed and time unit electric power as well as the technical prerequisites necessary for the switch to the power mains distribution system;

- The end point of the separation of the ownership rights is the measuring point. All elements and electric power facilities built according to the issued technical construction conditions, but located beyond the measuring point, belong exclusively to the investor, or to the buyer of the electricity.

POSITIVE DEVELOPMENTS

- In compliance with the European practice, an independent regulatory body has been established, i.e. the Energy Agency that became operational in 2005 with the task, inter alia, of shaping the methodology that would regulate the obligations and rights of the electricity producers and distributors with buyers of the diverse types of energy and energy sources.

- Methodology linked to the electric energy has been adopted at the beginning of 2007, while its application, despite many postponements, began on January 1, 2008. For other types of energy the methodology is in preparatory stage.

- When it is necessary to construct an electric power facility, which will also be used by the competent electric industry company, the investor i.e. the buyer of electricity participates proportionally to the needed electrical output, and that is being treated as the participation for the engaged power output.

REMAINING ISSUES

- Insufficient generation capacity and energy import dependency;

- Application of adopted regulations and procedures are not implemented strictly;

- Delaying the implementation of structural changes in electric industry;

- The price of electricity does not stimulate the implementation of the principles apt for energy efficiency.

FIC RECOMMENDATIONS

- Prepare and offer defined and well furbished locations to foreign investors including all the necessary infrastructure;
- Clearly define and fulfill deadlines for construction and switching to the electric power mains system, when there is a number of investors involved;
- Faster definition of electro energy requirements and issuance of energy licenses;
- Faster issuing of licenses and permits whenever the foreign investor has the possibility to place the surplus of electricity into the system i.e. sell the surplus energy hours.

REAL ESTATE AND CONSTRUCTION

A general remark on this subject is that very limited progress has been made in the last two years. This is a sensitive area and its comprehensive regulation in line with current international legislation and practices is essential for the continuing creation of a favorable and attractive investment and business environment. A clear political nationwide consensus should be established and subsequently implemented. In order to help this process we hereby offer a list of issues remaining to be addressed.

LAND OWNERSHIP

- Urban construction land remains the sole property of the Republic of Serbia in spite of commencement of the new Constitution;

- Lack of the categorical application of the provisions of the Law on Urban Planning and Construction, setting forth that if a user of state-owned construction land fails to construct a building within a prescribed period of time, his right of use shall cease. This was particularly notable in undeveloped parts of country due to inability of municipalities to find new investors. In bigger cities (e.g. Belgrade), the problem was solved by granting a possibility of lease of urban land up to 99-years to the captured user under preferential terms. The Law on Urban Planning and Construction (adopted in 2003) is diverging from the Constitution in its present wording and has a shelf life until the end of 2008;

- Legal framework has so far failed to clearly address the presently preferred type of land rights – lease of construction land, since it is not prescribed what will be the status of an investor after the lapse of the lease period;

- In the absence of a reformed law, we note that the process of land acquisition permits several possibilities: up to 99-year lease of construction land, acquisition of a transferable "right of use" vested to a pre-nationalization owner, utilization (even now belatedly under the Law, possible in practice) of the perpetual right of use and freehold of agricultural land that can be transferred into urban land (which enable transfer of privately owned agricultural land into construction land through a relatively easy and cost sensible procedure if it is not included in the Master Plan);

- The new Mortgage Law has introduced a possibility that a construction permit is re-issued following the foreclosure of a mortgage on a semi finished structure to the name of its acquirer. Such a possibility diverges from the Law on Urban Planning and Construction, which insists that the identity of the investor must be maintained throughout the construction venture (if the underlying land is state owned);

- Absence of the Law on Property of Local Self-Governments that regulates responsibilities for the disposition of construction land by local governments;

- Minimum prices of the majority of urban land remains determined through and by Governmental ordinances instead of the market. Moreover, prices differ among municipalities as a consequence of fact that local regulation is vague with imprecise procedures for determining fees for leasehold and site permits.

CONSTRUCTION

- Above all, it is necessary to complete the Cadastre Project in Serbia (currently 77% of immovable property is recorded in the central real estate cadastre). The project is funded by the World Bank through IDA and should be finished in 2010;

- Incomplete land books and other land-related records are indisputably key problem in this area, contributing to the existence of irregularities in a process of obtaining property rights. And although cadastral land registry system for several municipalities in Belgrade (Novi Beograd, Stari Grad, Vracar) is finished and available, this process needs to be completed as soon as possible;

- The overall process of acquiring permits remains non-transparent, long and bureaucratic, primarily as a consequence of difficult and time consuming process of collecting all documents needed for application (notably the documents underpinning the rights to land). Further, adequate information on past transactions is not available;

- The Law on Urban Planning and Construction, which puts local self-governments in charge of spatial planning, puts

construction land at their disposal which further complicates the situation. Therefore, local regulation is vague with imprecise procedures and criteria for determining prices for municipal/city fees for construction, leasehold and site conversion licenses;

- Inaccessibility of needed data due to lack of information and/or unskilled staff. In this regard, some improvement is visible in several municipalities which have established "one-stop" information offices for foreign investors;

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

MUNICIPAL REAL ESTATE

- Municipalities failed to deprive state-owned construction land from investors, in cases where users haven't constructed a building within the arranged period of time, as was prescribed under the Article 86 of the Law on Urban Planning and Construction;

- 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 deter quality retailers from entering the market.

RESTITUTION

- There is no statutory ground for acquiring ownership of land in cities ("urban construction land") from the state, although private ownership of land in cities has been allowed since the enactment of the Law on Planning and Construction of 2003 ("Law of Planning and Construction"), while the constitutional bar on it was removed by the new Constitution of 2006. The legalization of private ownership of urban construction land, though, enabled marketability of ownership titles to such land which had survived or had been acquired on certain specific and extraordinary legal grounds.

- Acquisition of land for development is possible through several legal forms, the principal being lease from city and/or municipality. As prescribed by Article 91 of the Law on Planning and Construction different types of titles are recognized including the right of former owners accorded on the basis of Article 84 of LPC.

- Churches and religious communities are in the process of filing claims for restitution of ownership of urban construction land and agricultural land and forests, among other rights, pursuant to the Church Property Restitution Law of 2006. The deadline for filing the claims is in September 2008.

- Two finalized projects of new laws on privatization of construction land were presented during 2007, both giving priority to restitution in kind over sale.

- The priority of restitution is grounded in its tremendous potential for promoting security of property rights in a symbolic and exemplary manner, since it most clearly shows that the state is returning what it unjustly took away.

- No significant improvements have occurred in the previous year, having in mind substantial achievements made in previous years (Law on Mortgages, Church Property Restitution Law etc).

- The Directorate for Restitution of the Republic of Serbia, competent for deciding upon restitution claims filed by churches and religious communities was finally formed and commenced work in the fall of 2007.

- Implementation of Article 84 of LPC that pertain to restitution of land titles has shown a significant level of inconsistencies and irregularities across the nation, with many situations in which recognition of the right is either unreasonably delayed or, at the end of spectrum, granted to present owners of structures instead to former owners.

- The extent of reforms made in other sectors demand putting in place a clear and transparent process of restitution of construction land, which would lead to a just and efficient system of land titles and add up to the predictability of the market.

LABOUR

THE LABOUR RELATED REGULATIONS

CURRENT SITUATION

The current law was adopted in March and amended in July 2005. It has been the subject of serious criticism both by employers and employees. Because this law is considered particularly important and vital for attracting and maintaining foreign investments, the FIC has a number of suggestions on how to improve the situation.

POSITIVE DEVELOPMENTS

The Government has facilitated the social dialogue between the employers' association and the trade unions, which resulted in the conclusion of the General Collective Agreement in April 2008.

Significant development has been achieved in the area of the Occupational Health and Safety. Although it had been formed recently, the Department for Occupational Health and Safety, as part of the Ministry of Labour and Social Policies has been very proactive. They made progress in the regulatory area, by producing a set of 9 sub-legal documents, aligned with the European Union Directives. Labour inspections have increased their presence in the field, especially at the construction sites, which resulted with significant improvement of the OH&S awareness. Additionally, the licensing system for various OH&S specialists has been significantly improved.

REMAINING ISSUES

- The new Labour Law unnecessarily imposes an obligation on the employer to respect a notice period of five workdays when cancelling an employment contract during a trial period;

- There are several issues regarding employment of foreigners which create serious problems in practice:
  - Temporary employment for foreigners, limited to one year, has proven to be especially problematic since in practice this period has proven to be insufficient;
  - Obtaining business visas and temporary residence permits is an excessively complicated and time consuming process;
  - Each transfer of funds abroad by foreigners entails gathering a large number of documents and evidence that need to be submitted to the bank;

- Pursuant to the current law, the calculation of salary is more complex than the previous calculation;

- The Law unnecessarily burdens the employer with the obligation to pay special benefits to employees for the compensation of food expenses, holiday compensation and work experience. This form of reward or special benefits has no relation to the employee's work performance. This could result in a counter effect whereby the employer can manipulate other components of the salary, especially the basic one which can be reduced to the minimum, particularly as the law obliges the employer in making these payments as of 01/01/2006 without stipulating terms or minimum amounts. Furthermore, the special listing of these payment categories, as well as special payroll lists, additionally complicate the procedure;

- Salary compensation for absence during sick leave, national holidays, annual leave, paid leave etc is calculated on the basis which represents the average salary in the three preceding months (Articles 114 and 115). This is a particularly impractical provision because in cases of high one-off payments in one month (such as annual bonuses) the compensation of salary for the three following months could be substantially higher than the salary itself if the employee had not been absent;

- According to the current provisions of the Labour Law, the employer's claim against an employee can be withheld from the salary only after obtaining a Court's decision, in cases previewed by the Law, or with the employee's consent. This makes it impossible for the employer to realize small claims without acquiring first the employee's consent in order to avoid initiating an unnecessary and costly legal procedure;

- Generally, the employment related paperwork and records that should be kept with each employer are overly voluminous; printing of number of copies of various docu-

ments for minor issues (such as granting of an annual leave) and keeping them on records is required by the law and in practice;

- The employment contract termination procedure is more complicated in the new Labour Law than in the previous one. The employer is obliged to warn the employee, in writing, the reasons for cancelling the employment contract and to provide a period of at least five workdays (from the date that the warning was presented) within which the employee may respond to the written warning;

- An employee whose employment contract is cancelled due to unsatisfactory work performance and/or lack of required knowledge/abilities shall have the right to remain employed for a minimum period of 30 days up to a maximum of 3 months (hereinafter: dismissal period), depending on the total number of years of being insured;

- An employer is required to permit the employee to use the first part of annual leave in time blocks of at least three working weeks;

- An employer is obliged to issue a decision regarding annual leave at least 15 days prior to date the requested annual leave would begin;

- It is not possible for persons on maternity leave to return to work on a part-time basis during the leave and achieve proportional maternity benefits;

- The level of contributions to the regional chambers of commerce which are calculated on the gross salary level varies throughout Serbia: This complicates the introduction of a unified payroll calculation system for companies employing individuals throughout Serbia.

FIC RECOMMENDATIONS

- We believe that additional decreases in labour expenses are necessary in order to boost the employment rate and reduce the so-called "moonlighting." This can be accomplished through either further reductions of the income tax rate and the income amount exempt from taxation, or by a reduction in social security contributions;

- The Labour Law should be amended to enable the establishment of temporary employment agencies that would be supervised by the Ministry of Labour. The agencies would act in an intermediary role, identifying work opportunities with the so-called service users (especially security services, child care, hygiene);

- The changes in the area of employment for foreign citizens must contribute to a positive environment for foreign investments. It is necessary to ensure the greatest possible operational freedom for foreign citizens who invest into the local economy:
  - The temporary work permit time limits should be extended to 3 years; The procedure of issuing working permits must be accelerated;
  - The procedure of obtaining business visas and temporary residence permits should be made far less complicated and time consuming;
  - The procedure for transfer of funds abroad by employed foreigners should be simplified;

- We suggest that the basis for the salary compensation during absence due to sick leave, national holidays, annual leave, paid leave etc is changed and be defined as "agreed salary" or "salary which would be achieved at work";
- We propose that the above listed compensations (as under the remaining issues section) should be treated as discretionary possibilities for employers rather than required obligations;
- We suggest that the relevant article with respect to employer claims against employees be amended to state:

  the employer's claim against the employee could be withheld from the salary only based on a court's decision, in cases previewed by the law ***or the general act of the employer****, or with the employee's consent.*
- Employment related paperwork should be simplified by introducing electronical delivery of documents and electronical data bases and implementation of the electronic signatures rules;
- Given the nature of a trial period, particularly in cases where the trial period is for a shorter time, we propose that the notice period during the trial period be reduced to 24 hours;
- We propose that the contract termination procedure be simplified and the obligation eliminated for the employer to provide 5 workdays to the employee to respond to an employer's written warning. The dismissal period should not be longer than 15 days;
- Amend the Law so as to provide that the usage of outstanding annual leave should be mutually agreed upon between the employer and the employee;
- Amend the Law to reduce the deadline for issuing the annual leave decision to 5 days prior to the commencement of annual leave. In dynamic, fast-changing work environments, such as foreign companies, annual leave is often agreed upon on short notice, especially when it comes to management;
- The employment regulations should provide for the possibility of persons on maternity leave to start working on a part time basis during the leave and achieve maternity benefits on a pro rata basis;
- The contributions to regional chambers of commerce should be unified throughout Serbia.

HUMAN CAPITAL

CURRENT SITUATION

Serbia's labour market and work force are still slow to adjust to the changing economic situation. Therefore, there is a concern regarding the supply of educated, skilled and experienced employees in the market place overall.

The demand for skilled employees is increasing faster than the supply. Competition is rising among companies in the recruitment of experienced and qualified people that are in short supply such as CFOs, financial analysts and controllers, internal auditors, different HR positions, IT and marketing specialists and experts. As a consequence, there is an increased pressure on companies to retain high quality employees. Companies are responding by becoming more proactive in offering personal/professional de-

velopment and incentives – for example, developing compensation and benefits packages built on performance instead of the traditional rigid years-of-service related payroll schemes.

Both the education system and people's mind-set are to change. Previously, employees were accustomed to having a secure, life-time employment with the same company. In such circumstances, education and training was not a priority for neither the employee nor the employer. Additionally, Serbia's work force has never been particularly mobile. Younger, new entrants to the labour market today, are more willing to move to different locations; this attitude improves their employment and career opportunities. There is also a risk for "brain-drain", as many young people wish to leave and work outside the country.

Public universities throughout generations are overburdened with bureaucracy, providing incomplete knowledge. Number of private universities has increased, but not all of them offer significantly different syllabuses than the public universities, making graduates of universities abroad more attractive for Serbian companies. The educational system is still too rigid and cannot cope with delivering the education needed for the new market trends. Even if the university education has improved in numbers of graduates, there is still a need for a more innovative and flexible way of teaching, in order to meet changing demand of the contemporary labour market. Private colleges and other learning institutions are starting up in the training area, but not all are up to the international standards. Moreover, they cannot and should not take over the responsibility for Serbia's educational system.

POSITIVE DEVELOPMENTS

Serbian labour market has been improving but the pace of positive changes has currently slowed down. On the other hand, the labour market has grown by market entries of new international companies. New professionalism creating new competencies has emerged in the market. The unemployment rate is slowly decreasing and the unemployment trend is turning. The government is trying to support the labour market with different actions in boosting employment. In addition, more HR consultants and recruiting firms have entered the market in order to support in locating people with the right competencies, but also offering services like organisational and people development.

REMAINING ISSUES

There is still a lack of the appropriate functional and leadership competencies in the market, both in terms of formal education, but also experience and exposure as well. Labour demand and skilled employees are still in discrepancy, since there is not enough labour supply yet to cover the increasing needs. In addition, by looking at the unemployment figures and seeing a large percentage of people with a low level of education, it is evident that retraining is also necessary. It is also an ultimate priority to attract Serbian people with the right competencies to come back to Serbia – those who have been working abroad and have obtained key skills and business understanding from global companies. Foreign companies are happy to appoint them to top positions instead of bringing in expatriates.

There is still a need for the social partners to get closer, and establish a closer dialogue and cooperation amongst international companies and the government, colleges, universities and labour unions, in order to ensure that the educational programs are properly designed for the new labour market. The FIC is interested in taking part in these dialogues.

FIC RECOMMENDATIONS

- Establish regular contact between FIC and the Government, ministries of Education and Youth, as well as with the universities, so the good educational plan and programs could be adapted and aligned with the Labour market needs – Deans together with the student representatives;
- Provide a forum for Human Resource professionals seeking to enhance their professional and personal development. Programs, networks, and support services, that empowers foreign companies to make meaningful contributions to the complex and dynamic world of Human Capital;
- Joint proactive engagement of the FIC and Ministry of Diaspora in order to attract highly skilled and educated workforce currently abroad, to return to Serbia;
- Establish a licensing system for HR professionals. This system should be developed by independent expert organizations and supported by competent ministries.

LEGAL FRAMEWORK

The legislative activity in Serbia has significantly slowed down during the last year. Parliamentary elections were held in January 2007, but the Government has not been appointed by May 2007. This Government survived for less than 10 months, and parliamentary elections have been held again in spring of 2008. At the time of writing this White Book the new Government has just been appointed, and no laws, apart from those regulating the election of the new Government, have been adopted by the Parliament since the beginning of the year.

The political situation resulted in a number of laws being held up in the legislative pipeline of the Serbian Parliament, which was focused on pressing political issues rather than on reform activities. Certain important laws have been adopted at the end of 2007 pertaining to the President of Serbia, the Serbian Army and Defence, and the Serbian Constitutional Court.

The signing of the Stabilization and Accession Agreement with the European Union in April 2008 opened the doors for Serbia to start systemic reforms and harmonize its legislation and implementation thereof with the EU standards. The amount of political will which shall be put behind this process remains to be seen and evaluated. Serbia is therefore at an important junction, between a fast-track EU accession process and a slower but still certain path in the same direction.

At the same time, legal framework still suffers from implementation deficiencies. Most deficiencies in implementation are originating from unclear wording of the laws themselves. In addition, by-laws are not enacted within the deadlines provided in the laws and in some cases they are not enacted at all. By-laws are enacted by the Government, and they often reflect the political opinions of the current Government, rather than the spirit in which the law has been originally drafted. In some cases this leads to contradictory and unpredictable situations.

The courts and administrative bodies lack the technical and personal capacity to perform their activities in a proper and timely manner. This leads to inconsistent implementation and very lengthy procedures, which frequently surpass the deadlines provided by the law.

SERBIAN BUSINESS REGISTERS AGENCY

CURRENT SITUATION

The Business Registers Agency was established according to the Law on Business Registers Agency with the aim to implement regulations of the Law on Companies Registration and the new Companies Law as well as the Law on Financial Leasing and the Law on Pledges on Movable Property and Rights to be entered into the Register.

All these laws have been adopted in order to initiate the reform which would enable foreign investors to quickly start their business operations in the Republic of Serbia. It was clear from the very beginning that this was only a part of the reform, since starting of business operations is connected with many other judicial and administrative institutions on which the starting of a commercial entity depends.

The core activity of the Agency is to register data in respective registers, to form them as centralized, electronic and public databases, and to act as a supervisory body. In order to decrease the grey economy and corruption, all data registered at the Agency are available online on the website of the Agency free of charge.

The Business Registers Agency is an example of a successful reform, with the following registers:

Companies register

Since its commencement on January 1, 2005, the Agency succeeded to re-register from the court register all active and inactive existing companies, (73,000 active and 160,000 inactive) and not to cause any delay in incorporating new companies, and deleting and registering changes regarding existing companies. All kinds of registration, incorporation, changes and issuing of excerpts and certificates from the Register have always been executed within the legal deadline of 10 days in the beginning and then 5 days, while today almost all registrations are carried out in 1-3 days. Currently, there are over 100,000 active companies. The fact that 12,350 companies were incorporated only during 2007, knowing that in 3,100 of these companies the founder or cofounder was a foreign legal entity or individual is interesting for foreign investors.

Register of entrepreneurs

Since the beginning, on January 1, 2006, the Agency managed to re-register 165,000 active entrepreneurs from registers of 164 municipal administrative bodies which have been keeping those registers until that day. When this register started, legal deadline for incorporation was only 5 days. Today, the registration of entrepreneurs is carried out in most cases within a day, and 4 days at most. Foreign investors are interested in entrepreneurs only in terms of cooperation, but not for investment as well, which is explained below.

Sub-register of financial reports

The Agency conducts the segment of registered data regarding financial reports in a very simple way, within the database of companies. The Agency has data on the business condition of all companies and for those entrepreneurs as prescribed by the Law on Accounting and Audit for years 2005 and 2006. In May 2008, data for 2007 were also published.

Register of Financial Leasing

From the very beginning on January 1, 2005, financial leasing has been a very successful register of all leasing agreements entered not only since the beginning of the register's operations, but also a year before its start. Apart from providing legal certainty, it has excellent statistical data on countries where the goods bought through leasing came from, as well as on the structure of leasing, showing from year to year that more and more machines for production are imported from abroad, while the number of luxury and expendable goods decreases. Currently, there are 61,658 registered financial leasing agreements.

Register of Pledge on Movable Property and Rights to be Entered into the Register

This register is operational since August 2005. It has completely adopted the novelty provided by electronic registers regarding the pledge – now taking effect not through the delivery of property, but with registration into the public register. A high level of safety has been provided to the creditors this way, mostly to banks and other financial institutions. As well as in other registers, all data are available, including creditor, debtor, owner of property, amount

of debt, duration of pledge as well as sequence of pledge creditors. Both legal and contractual pledges are registered. Currently, there are 23,297 pledge agreements.

POSITIVE DEVELOPMENTS

According to assessment of international organizations the Agency for Business Registers remained the only part of administrative system for starting business operations subject to reform with a successful outcome. The Agency is also trying to prompt reform in other government institutions.

During 2007 a new, much better and user friendly website was launched, part of which is available in English. By the end of 2007, the Agency has enabled starting of two new sub-registers within the Companies Register – Register of Incentive Assets (which registers all one-time investments into business start up, domestic or foreign, in the form of donations or incentive loans) and the Register of Foreign Investment in which not only investments of foreign legal entities and individuals are to be registered, but all other investments – into the real estate sector, direct investments, etc

The Agency is also working on creating a one-stop shop system in which as many activities as possible needed for starting business operations could be initiated before the Agency. This includes activities such as: submission of requests for obtaining licenses and approvals – when necessary, obtaining of the tax identification number, application for social insurance and even opening of bank accounts.

The Agency also participates, as much as it can, in the drafting of amendments to legislation referring to it directly or indirectly. The Agency keeps track of all irregularities which it encounters through its activities and tries to correct them.

REMAINING ISSUES

The main remaining problem is essentially in the lack of good will of the rigid administrative system to get rid of the unnecessary paperwork, forms in which the same data are always entered, numerous signatures and endless stamps. A particularly big problem is the refusal of all administrative bodies to eliminate its complicated, unreliable and always different numbers and to accept only one identification number of a company, which in our opinion should be the ID number generated by the Statistics Administration which has the least, almost accidental error percentage. The Agency for Business Registers accepted this number as its own registration number and thus eliminates at least one company number from the system.

Moreover, the Tax Administration is not ready to renounce the personal allocation of the tax identification number for companies, but there is a hope that tax authorities shall allow this number to appear in the entrepreneurs' Decision on Incorporation. Having in mind the large number of existing entrepreneurs, this is a significant step forward. Allegedly, the agreement regarding this has been reached in December 2007, but without a clear indication when it will be implemented.

A further problem is that banks, actually the National Bank of Serbia, interpret the Money Laundry Act too rigidly. This demand, like nowhere else in the world and without any legal grounds, makes it very difficult for foreign investors to open a company bank account and of recently to open a temporary bank account for payment of foundation capital, because the bank requires evidence on the chain of founders of the founding company, until a natural person at the end of the chain is reached.

Finally, we consider that the biggest problem is that in Serbia, an entrepreneur as a form of business organization still exists, as a relic from socialist economy and socially owned property – but not as a legal entity, but as a natural person individually performing its activity, which is registered and having some specific characteristics for legal entities. This confuses foreign investors because all property of this entity is actually personal property of an entrepreneur, whether it is used for performing business operations or not. An estimated 80,000 of those entrepreneurs would fulfil criteria to become micro or small companies and 10,000 of them could immediately be considered as medium-sized companies. It is obvious how much this would change the economic image and business environment of Serbia and what it would mean for foreign investment, knowing that no foreign investor would be willing to invest in someone's personal property and no donor or creditor would finance such an undetermined entity.

FIC RECOMMENDATIONS

- All new business registers and records should be assigned to the Agency, which has full capacities and know-how for this;
- The Agency should participate in legislative activities regarding complete abolishment of the Law on entrepreneurs;
- Participation of the Agency in the regulation of the status of an entrepreneur, as well as in the introduction of micro companies, which are currently not foreseen by the law;
- Providing incentives for greater connection of the Agency with other administrative organizations aiming to create a one-stop shop system. The example of the Former Yugoslav Republic of Macedonia could be instructive, since their reform was performed only with one law according to which respective articles were changed in 20 different laws and thus a one-stop shop system was established.

COMPANY LAW

CURRENT SITUATION

The Company Law in effect today has been enacted in 2004. Adjustments with the old law were completed in 2005, except for the few provisions dealing with socially owned companies that are entering the privatization process. The Law has not been amended since.

The Company Law applies to the company's registration and governance in general and that special laws are in effect for banking, insurance, financial leasing and listing on the stock exchange. In that sense, the Company Law applies only as a supplement or where those laws specifically refer to it.

The current Company Law is in need of being adjusted with other legislation and market developments in the country. Namely, the conflict of laws between the Company Law and the Securities Law (discussed in more detail in the Section on security market trends), threatens to slow down the companies and market development in Serbia. The conflicts and the needed amendments to the Company Law will be listed in the recommendation section.

General Overview

The Company Law defines four forms in which a company may be established. Those are:

- Partnership;
- Limited partnership;
- Limited Liability Company, or
- Joint Stock Company.

No minimal requirement is set by the Law in terms of the share capital for partnership and limited partnership. Partners/founders in those companies bear full personal liability for the obligations of the company. Limited Partnerships hardly exist in practice, while Partnerships are a bit more frequent. The law prescribes that at least two persons are required to be the founders of such a company. According to the Company Law, legal entities can also be founders and owners of such a company.

Due to its characteristics, based on the ease of functioning, and on the fact that a relatively small founding amount is required (500 EUR), the Limited Liability Company is by far the most common form established in Serbia. The Law prescribes the minimum of one, and the maximum of fifty persons who may be shareholders. For more than fifty shareholders the company would have to be transformed from a Limited Liability Company into a Joint Stock Company.

As far as liability is concerned, the Limited Liability Company is liable to its creditors only with its assets, and not with the property of its owners. The only exception is in the case when owners damage the company for unlawful or deceptive purposes ("lifting the veil").

Joint Stock Companies can be founded as closed (share capital must be at least 10,000 EUR) or those open to the public (where significantly higher share capital is required, 25,000 EUR).

Closed Joint Stock Companies are defined as companies whose shares are published only to its founders or to a limited number of persons in accordance with the law. Opened Joint Stock Companies are defined as those for whose inscription and payment of the shares by a public invitation is mandatory either at the moment of its incorporation or at any time after that. Both domestic and foreign persons can be founders of a Joint Stock Company. The advantages of the current Company Law are:

- It is drafted in accordance with the EC Directives on the Company Law;

- The procedure for incorporation and its registration is simplified;

- Numerous provisions of the Company Law are of a non-binding nature, allowing the companies to regulate their internal relations freely, without many strict limitations;

- The amount of foundation capital for the Limited Liability Company (the most common form of company in Serbia) is very low.

Foreign entities are permitted to open representative offices in Serbia. Representative offices are registered with the Business Registration Agency. They are not legal enti-

ties and can not be engaged in commercial activities within Serbia, but they can be used for marketing purposes and for providing assistance to the company they represent in closing the deals inside Serbia. On the other hand, branches can also be established by the foreign entities, and they are permitted to do business in Serbia.

REMAINING ISSUES

- As mentioned earlier, Joint Stock companies have a mandatory listing requirement. However, the Stock Exchange Rules, which prescribe in detail the listing process, have very strict criteria for being admitted to the A and B listing. Therefore the company's shares are traded on the "off stock exchange market" because most companies in Serbia do not satisfy the necessary criteria for being admitted to the A or B listing. Thus, Closed Joint Stock Companies which are becoming Open Joint Stock Companies find themselves in difficulty when observing the Law. This conflict of laws/regulations puts companies into the non regulated "off stock exchange market", which in turn undermines the laws and market objective of the public being informed of the listing. This problem also gives opportunities for manipulation;

- When registering the changes in the share capital the joint stock companies find themselves being sent back and forth between the Central Registry and the Business Registration Agency.

FIC RECOMMENDATIONS

- We recommend that the Law on Market of Securities and Other Financial Instruments be harmonized with the Company Law and that the by-laws of SEC and the Stock Exchange Rules also address this issue;
- We recommend harmonization of Central Registry Rules with Business Registration Agency rules to clearly define the registration procedure;
- The Company Law provisions pertaining to changes of company status, as well as those pertaining to mergers and acquisitions, should be amended for more clarity and detail, as the current provisions are vague and too brief causing numerous problems in practice.

SECURITIES MARKET TRENDS

DRAFT AMENDMENTS TO THE LAW ON MARKET OF SECURITIES AND OTHER FINANCIAL INSTRUMENTS

CURRENT SITUATION

The Law on Market of Securities and Other Financial Instruments (Official Gazette 47/2006) which was enforced on June 10, 2006 became applicable on December 11, 2006. The Law regulates Initial public offering process leaving many legal obstacles for implementation of IPO, the major being:

- Absence of rules which would allow joint sale of existing and newly issued shares;

- No possibility for book building (in conjunction with the Company Law);

- Implementation of the IPO requires changes in Securities and Company Law, and in addition, in the by-laws of the Securities Commission and in the Rules of the Belgrade Stock Exchange (BSE).

None of Serbian companies have yet made an Initial public offering of shares at the BSE. It was announced that Tigar Pirot will make initial public offering, however this IPO was never made.

In its Information on concept of privatization of large public enterprises, enterprises which perform common interest activities and enterprises with state capital for period from 2008 to 2010, the Ministry of Economy and Regional Development of the Republic of Serbia has suggested IPO as method for the privatization of telecom provider "Telekom Srbija", power utility JP "Elektroprivreda Srbije", Airport "Nikola Tesla" and pharmaceutical company "Galenika".

In order to solve some of the issues in relation to IPOs, relevant authorities, namely the Ministry of Finance in, as we presume, cooperation with the Ministry of Economy and Regional Development, the Securities Commission and the Belgrade Stock Exchange, drafted and published on its web site the draft amendments to the Law on Market of Securities and Other Financial Instruments.

POSITIVE DEVELOPMENTS

The draft amendments to the Law provide possibility for investors to subscribe and pay for both the newly issued and the existing securities at the same time, by means of public offering of securities. This means that subject of the offering may be both newly issued and existing securities, as well as only newly issued or only existing securities.

Further on, the draft amendments provide for new definition of public offering in accordance with EU directives while definitions of primary and secondary public offering are deleted. Namely, the amended law defies the public offering of securities as "a public invitation directed to an unspecified number of persons to subscribe and pay for the newly issued securities and/or to subscribe and pay for the existing securities". The public company in the sense of the draft amendments to the Law is "a legal entity that has performed public offering of securities to an unspecified number of persons when issuing securities, or for which securities a public offering has been made, by means of public invitation and in accordance with the prospectus that has been approved by the Commission for Securities".

Pursuant to the draft amendments, the issuer is obliged to prepare the prospectus for the issuance of shares in such a way that the prospectus encompasses both the existing and newly issued securities. This is not the case only when both existing and newly issued securities are covered by the public offering, but also in a situation where only newly issued securities are offered this way (provided that the existing securities are of the same kind and class as securities that are offered by means of prospectus). This will provide better information of investors.

The draft amendments introduce the preliminary notification as replacement for the preliminary prospectus existing under the currently applicable Law. In case of offering on the basis of preliminary notification the public offering may

be conducted without the prior approval of the Securities Commission. The preliminary notification, as well as any amendments to it, has to be only notified to the Securities Commission, i.e. the Commission has to have insight into subject document(s), but it does not approve them.

The preliminary notification to some extent provides possibility for "book building". Namely, the preliminary notification has to contain all data that will be published in the prospectus, but it may contain data concerning the price giving the price range (minimum/maximum price) or fixed amount, and it may also, if possible, contain data on interest rate and underwriter. This should enable the issuer to, prior to the actual subscription and payment for the securities, conduct a kind of market research and "an investigation" among interested investors in order to establish the optimum/adequate price for its securities based on, at the first place, demand, and to, in such a way, enable entirely successful and satisfactory sale of its securities.

In addition, the draft amendments:

- Harmonize the status of Securities Commission and its supervision measures with EU directives and IOSCO standards on independence of regulatory body;

- Delete obligation to obtain the consent of the National Bank of Serbia for trade in securities of a foreign legal entity; and

- Allows "netting" between seller and purchaser of the shares.

REMAINING ISSUES

- Preliminary notification rules are not clear enough. Namely, the draft provides that the preliminary notification has to state clearly that information contained in it is not complete, that it may be amended, and that securities may not be sold, as well as that no confirmation on subscription may be made based on the preliminary notification, while at the same time it stipulates that offering of securities may be done on the basis of it. Probably the intention was to allow marketing of securities on the basis of preliminary notification, whereby the subsequent subscription and payment for securities is to be performed in accordance with the prospectus (which is to be approved by the Commission for Securities);

- The final sale i.e. actual subscription and payment for securities still should be made based on the fixed price contained in the prospectus approved by the Commission for Securities. At the same time pricing rules in relation to the new issuances of shares set by the Company Law remain applicable, so that there is collision of two laws in this respect, or the pricing range to be included in the preliminary notification could be established only within the boundaries set by the Company Law;

- Lack of by-laws needed for the implementation of IPO.

FIC RECOMMENDATIONS

- The draft amendments should be more precise in relation to the preliminary notification;
- Book building should be allowed to the greater extent;
- Once the amendments to the Law are enacted in the Parliament, additional explanations and clarifications of instruments introduced by the said amendments will and have to be contained in by-laws that are yet to be enacted by both the Commission for Securities and the Belgrade Stock Exchange;
- Pricing rules for share issuance should not be defined by the Company Law, or exemptions in case of IPOs should be introduced.

THE LAW ON TAKEOVER OF JOINT STOCK COMPANIES

CURRENT SITUATION

Law on Takeover of Joint Stock Companies entered into force on June 10, 2006. The Law regulates the takeover bid more thoroughly than it was previously regulated. However, number of issues with respect to the takeover procedure still remains.

POSITIVE DEVELOPMENTS

The Law protects minority shareholders of a target company, prescribes equal conditions for all participants in takeover bid and provides setting out of the price in accordance with market principles.

Amendments to the Rulebook on Content and Form of Takeover Bid adopted by Securities Commission (SEC) came into force on April 2, 2008 (Official Gazette of the Republic of Serbia, No. 30/2008). According to the amended Rulebook the bidder is no more obliged to enclose the approval from Competition Protection Commission (CPC) with its request for approval to publish the takeover bid; it may enclose a proof of submission of the request to CPC instead. This provision is also applicable to competing takeover bid.

REMAINING ISSUES

- The application of TOB rules as stipulated in the Takeover Law is limited by a number of exceptions;

- The terms prescribed by Law are too restrictive. Namely, the bidder has to submit a request to the Securities Commission for approval of a takeover bid one day after the announcement of the intention to perform a takeover bid;

- In the cases that competing takeover bid lead to concentration a proof of submission of the request to CPC is sufficient. However preparing of the documents needed for submission of the request to CPC is often time consuming so the bidder is not able to submit the request before due date for applying for SEC`s approval to publish its bid.

FIC RECOMMENDATIONS

- The number of exceptions stipulated in the Takeover Law should be narrowed down;
- To allow 5 working days for the submission of TOB documents to the SEC after the announcement of the intention for takeover;
- Competing takeover bid should not be linked to the CPC approval for conducting the concentration.

TAKEOVER OF MINORITY SHARES

CURRENT SITUATION

The procedure for acquiring possession over shares of the joint stock companies privatized through tender is regulated:

- By the Law on securities' (value bills) and other financial instruments' market, which legislates the possibility of dealing in shares exclusively at an organized market (Belgrade stock exchange);

- By the Law on stock companies takeover (hereafter: the Law on Takeover), which regulates the obligations of the acquirer when he acquires 25% and more of the shares with voting right within a specific open stock company;

- By the Law on the right to free shares and financial compensation realized by the citizens in the privatization pro cess (hereafter: the Law on the right to free shares) .

Mandatory takeover bid

In case when the major shareholder of the open joint stock company would be interested to purchase minority shares, he would be able to do so, at an organized market (Belgrade stock exchange), from the shareholders willing to sell them, when he would automatically be obliged, in accordance with provisions of the Law on Takeover, to proclaim a takeover bid.

Namely, Article 6, of the Law on Takeover, legislates that:

"*A person who acquired shares of a target company with which, jointly with the shares he already has, he exceeds 25% of the total number of votes provided by the shares with the voting right of the target company, it is necessary, at the same time, to inform about the acquisition the organizational model of the organized market at which the shares of a target company are being traded, the Committee and the target company and to proclaim a takeover bid, on conditions and in the manner specified by this Law.*"

In case the takeover bid results in the ownership of less than 75% of the total number of voting shares of the target company, any further acquisition by the same party triggers its obligation to make a takeover bid.

If, however, a person acquires, pursuant to a takeover bid, more than 75% of voting shares, it is obliged to make a new takeover bid only after it acquires at least additional 5% of voting shares of the target or at least 3% of voting shares within the period of 18 consecutive months.

Squeeze out

The major shareholder intending to perform full take over, i.e. Squeeze out of the minority shareholders, is entitled to do so under conditions set in the Law on Takeover (Article 34), as well as in the Companies' Law (Article 447):

Shareholder who through takeover acquires at least 95% of the shares of a targeted company through a public offer, is entitled to "squeeze out" minority shareholders (non-accepting shareholders), within 120 days following the expiry of the deadline for acceptance of the bid, by granting them the same conditions as in the bid.

Conversely, the shareholders who did not accept the takeover bid may force the majority shareholder to purchase their shares. Such request may be made within 180 days following the acquisition of 95% of shares by the majority shareholder. (Article 35 of the Law on Takeover, and Article 448 of the Company Law).

Limitation

In cases where during privatization of the company some of company's shares are registered to Privatization register (privatization through tender), and in absence of decision of Privatization Agency to sell the shares from Privatization Register portfolio, takeover bid would refer to usually insignificant number of shares (mainly owned by company's employees).

Furthermore, transformation of an open joint stock company, which has the shares in Privatization register, into a limited liability company is not allowed before all shares are acquired/sold in accordance to procedure defined by the Law on the right to free shares.

POSITIVE DEVELOPMENTS

The lack of main conditions for performing full takeover bid ("squeeze out"), and, in connection to this, change of company form from open joint stock to limited liability company, in cases when any percentage of company's shares is inscribed in Privatization register (Shares' Found), was partially removed at the very end of 2007, when *the Law on the right to free shares and financial compensation realized by the citizens in the privatization process* was adopted.

Till this year, the Privatization register (Shares' Found) could not handle the shares from its portfolio prior to adoption of regulation on distribution of shares left after privatization to citizens who have never before participated in the procedure of shares distribution in privatization.

The Law on the right to free shares, effective since January, 2008, governs the exercise of citizens' rights to financial compensation on the account of the sale of shares or stakes recorded in the Privatization Register kept in accordance with the Law on Privatization, and to the transfer without compensation of shares in enterprises and business companies specified by this Law.

Further, the Law (Article 12) defines that the shares of open joint stock companies shall be sold:

- on the organized market;
- by accepting takeover bids;
- by tender (auction).

Also, by way of exception, shares may be sold by invitation for submitting bids as well.

The Law authorizes the Privatization Agency to decide on the manner of selling shares and conditions that price per share, at which the Share Fund shall sell shares, may not be lower than the price per share paid by the buyer of capital in the privatization procedure.

The Law is obliging the Shares' Found (to which all shares inscribed in Privatization Register were conveyed) to sell all of its shares by December 31, 2008, or not later than within 6 months from the date of the transfer of shares, or stakes into the Privatization Register, when shares or stakes were transferred to the Privatization Register after June 30, 2008.

Ban on transforming open joint stock companies into closed joint stock companies and limited liability companies is explicitly defined by Article 14 of the Law on the right to free shares, and remains until the procedure of selling all shares of such company in accordance with this Law is concluded.

REMAINING ISSUES

As a condition for squeeze out is acquiring 95% through takeover bid, it may be impossible in case Privatization Agency decide to sell the shares inscribed in Privatization register otherwise than accepting the take over bid published by the major shareholder.

In respect to takeover procedure, there are still insufficient tools to prevent various speculations that may occur on the securities exchange market.

FIC RECOMMENDATIONS

- Having in mind that *the Law on the right to free shares and financial compensation realized by the citizens in the privatization process* has been recently adopted, it remains to be exercised by authorized subjects, institutions;
- However, it is recommended that sales of shares through accepting the takeover bid lunched by the major shareholder at the price not lower than the price reached during the privatization process, by the due date set by the Privatization Agency (but not less then 6 months), should be defined as a method of sales of open joint stock companies' shares.

DRAFT LAW ON SECURITIZATION

CURRENT SITUATION

On January 15, 2008 the National Bank of Serbia on its website has published the draft of the Law on Securitization.

According to NBS's website the draft is product of careful consideration of all comments and suggestions on the first draft of the Law on Securitization. The purpose of this law is to foster conditions for further development of the financial market of the Republic of Serbia, ensuring at the same time sustainable financial stability.

POSITIVE DEVELOPMENTS

The draft regulates the procedure of securitization of receivables, setting up and operations of securitization funds management companies and supervision of securitization.

The draft defines Securitization as a financing and risk management technique whereby the originator transfers a pool of current or future receivables to securitization funds management company, which serve as the basis for issuing asset-backed securities, and/or transfers the credit risk associated with such receivables based on issued guarantees or concluded financial derivative contracts. Further on it distinguishes between two types of securitization: (a) "true sale securitization" where the originator transfers a pool of current or future receivables to securitization funds management company, based on which the company issues asset backed securities for sale to investors and (b) "synthetic securitization" where the originator does not transfer receivables but the credit risk associated with a pool of current or future receivables, based on issued guarantees or concluded financial derivative contracts. The synthetic securitization is supposed to be further regulated by the Securities Commission.

The scope of persons who may act as originators is limited to banks, financial leasing companies and insurance companies which may be headquartered in Serbia or abroad.

Transfer of receivables being the subject of securitization from the originator to the management company shall be performed based on the agreement which shall be concluded in writing, while signatures of parties thereto shall be certified by the court. The agreement may be effected in foreign currency, if the receivables being the subject of securitization are expressed in foreign currency and are to be collected in foreign currency in accordance with the law. Transfer of receivables to the management company shall be accompanied by a simultaneous transfer of subordinate rights and means of collateral such as mortgage, pledge over movables, interest rights, right to enforce contract penalty, priority collection right, rights under warranty agreement and guarantees except otherwise prescribed by the agreement. It is also prescribed that the agreement must be delivered to the Securities Commission within 3 days while the debtor must be notified of the assignment within 15 days.

Transfer of receivables being the subject of securitization shall be exempt from the payment of value added tax.

Securitization fund shall be assets composed of receivables being the subject of securitization, subordinate rights and means of collateral transferred to the management company along with such receivables, financial assets generated by collection of such receivables and temporary investment of the fund's assets, as well as other receivables and assets generated in the securitization process. The fund shall be managed by a management company and its assets shall be separated from the assets of such company and the assets of other funds managed by this or another management company.

Management company shall be founded as a limited liability company and may be founded by domestic and foreign natural and legal persons. It may perform exclusively activities related to the securitization of receivables. The pecuniary portion of basic capital of a management company may not be lower than EUR 100,000 in the dinar equivalent value. Securities Commission shall issue operational licenses for management companies.

The Commission shall conduct supervision of the securitization process and operations of management companies, issue secondary legislation within its scope of authority for the purpose of implementation of this law, maintain a register of issued management company operating licenses and perform other operations coming under its remit in accordance with this law.

REMAINING ISSUES

- Penalty provisions and transitional and closing provisions are still missing;
- The draft of the Law on Securitization until this moment has not been sent to Parliamentary procedure;
- Right after adoption of the Law on Securitization Securities Commission should pass necessary regulations for implementation of the Law.

FIC RECOMMENDATIONS

- FIC welcomes drafting of the Law on Securitization and suggests that the Law should be sent to Parliamentary procedure as soon as possible;
- After adaptation of the Law, Commission should pass necessary regulations for implementation of the Law.

COMPETITION LAW

CURRENT SITUATION

The current version of the Competition Law (Law) is in effect since September 2005. The Law came as a response to the EU integration process efforts. It features rules on market behaviour (according to Article 81 and 82 of the EC Treaty) and also the rules on merger control (from the EC Merger Regulation). Both in structure and substance, it adopts the outline and wording of such laws in the "new" EU member states.

The Law applies to all undertakings (and all affiliated entities which belong to the same corporate group) whose actions can affect competition in Serbia. This practically means that all undertakings registered or engaged in sales in Serbia, are affected and should consider the Competition Law.

The Law features the following substantive provisions:

- Restrictive agreements (copying Article 81 of the EC Treaty);
- Abuse of a dominant position (copying Article 82 of the EC Treaty); and
- Merger control.

The Law also regulates the establishment, appointment and competences of the authority which will enforce the law – Commission for the Protection of Competition (*Competition Commission or just Commission*). The Commission of five is appointed by the Parliament from ten candidates proposed from five sides (the Government, Serbian Chamber of Commerce, BAR Association and two academic guilds). They are appointed for a five-year mandate which can be extended only once.

The final sections in the law deal with penalties of which there are many. Fines can reach 10% of the group's annual turnover. The same range will apply to managers (on the basis of their personal taxable income base). In addition, companies can face prohibition to perform certain activities while managers can be disqualified from performing such functions over a period of three years. Finally, agreements infringing the Law can be deemed null and void and the pertinent goods confiscated.

Restrictive Agreements

In a nutshell, restrictive agreements provisions relate to all agreements (either oral or in writing, formal or tacit) which may prevent, restrict or distort competition in the market. Typically these agreements are divided into vertical (e.g. distribution agreement) and horizontal (e.g. joint production agreement). Any agreement aimed at modifying the free market (i.e., regarding minimal prices, market partitioning, margins, exclusivity, selective distribution etc) is caught by the law and as such deemed restrictive. This means that in order for it to be effectuated, an exemption must be sought, and not all agreements will qualify for exemption (a cartel agreement or resale price maintenance clause will always be null and void).

There are two types of exemptions: (1) block exemptions, by which certain types of agreements are exempted from prohibition automatically; and (2) individual exemption, by which certain agreements which do not meet the requirements laid down in the block exemption rules, can still be exempted, by virtue of an exemption application with the Competition Commission. Both ways, the exemption is motivated by and assessed in the context of, weighing between benefits and detriments to consumers and competition.

Abuse of Dominant Position

As mentioned above, the rules on abuse of dominance are copied from Article 82 of the EC Treaty. The rule is rather straightforward – where an undertaking reaches significant market power (determined by a number of parameters, such as market share, market structure, concentration levels etc), it must act in such a way that its competitors and trading partners are not harmed, foreclosed or in other way placed in a significant competitive disadvantage.

Since the rules on abuse of a dominant position are somewhat unclear (for instance, Article 82 even today raises many controversies with respect to its application, scope, analysis methods), it is neither possible nor prudent elaborating on all aspects of its application. The summary of concerns can be explained as follows: company (or group of companies) which has significant market power (a standard that has to be established in every individual case), must abstain from certain practices (predatory pricing, refusal to supply, fidelity rebates, marketing schemes, tying and bundling, etc).

Merger Control

Merger control does not pertain to market behaviour, but rather to market structure. Basically, just like competition can be harmed by a cartel of independent undertakings agreeing on the minimum prices, it can also be harmed by such undertakings merging into one. Merger control rules are designed to prevent undertakings from becoming dominant and detrimental to competition by virtue of merging (economic concentrations).

Technically, there are three types in which two or more previously independent undertakings can merge: acquisition of control (A acquires B), merger (A and B consolidate) and full-function joint venture (A and B create C but retain their independence).

In order for the merger to take place, the parties to it must obtain merger clearance from the relevant merger control authorities if they meet certain threshold levels in terms of turnover, market share or asset value. In Serbia, they must notify the merger to the Competition Commission if their combined revenues exceed 10 million Euros in Serbia or 50 million Euros worldwide (provided that at least one of them is registered in Serbia).

The review period can take up to four months (or one month in fast track proceedings) and the clearance can cost up to 25,000 Euros (fast track) or up to 50,000 Euros (enquiry proceedings, reserved for complicated issues).

Although the Competition Law is the central competition/antitrust legislation, certain issues are regulated alternatively or concurrently by other laws.

There are no laws or regulations pertaining to state aid control with regard to competition/antitrust issues in Serbia. However, the Law on State Aid is expected to be enacted in the course of 2008.

POSITIVE DEVELOPMENTS

In the first year of its term the Competition Commission demonstrated a commitment to harmonizing its procedures and substantive assessment with the EU rules and case law. Also, in January 2008 the Commission moved its offices downtown, thus demonstrating (symbolically) its independence from the Government (whose offices it had been using before the move).

It ought to be noted that the Serbian Government proposed amendments to the Competition Law in early 2008. However, due to disbanding of the Parliament and the election announcement the law is not expected to reach the agenda of the parliament before autumn 2008.

REMAINING ISSUES

While it is inspired by and generally coherent with EU competition law, its application raises certain concerns: lack of secondary regulations, low turnover thresholds and inconsistencies in its practice require significant improvements.

In the second half of 2007 and early 2008 the Commission has become less efficient in dealing with merger control filings and in a number of instances become the last authority in multi-jurisdictional filings to issue a clearance, even in no-issue exterritorial transactions. Additionally, significant shortcomings in the practice have been noticed, the most noticeable of which being the lack of consistency in applying the law. Some of those inconsistencies can be noticed even in Commission's own Annual Report for 2007.

FIC RECOMMENDATIONS

- Immediate enactment of Block Exemption Regulations is a prerogative for ensuring compliance with EU regulations – certain industries (automotive in particular) have been affected by the lacking of automatic exemptions for their distribution agreements;
- The mandatory merger notification thresholds should be higher – FIC recommends increasing the local turnover threshold and combined presence for the worldwide threshold to be applicable;
- The Commission should apply European guidelines in assessing competition issues to avoid inconsistencies in its application;
- The Commission should apply European standards with regard to review periods – one month review period ought to be sufficient for review of no-issues transaction and summary clearances;
- The Commission should make its practice consistent towards all undertakings, in order to remedy the current situation which leaves high legal uncertainty for undertakings.
- The regulation on tariffs before the authority have to be decreased to a reasonable level appropriate for comparable jurisdictions (Croatia, Slovenia, Bosnia and Herzegovina, Montenegro etc).

INTELLECTUAL PROPERTY

CURRENT SITUATION

After the dissolution of the State Union of Serbia and Montenegro in May 2006, all regulations in the area of intellectual property were transferred to Serbia. This change has not affected the legal protection of intellectual property. The competent institution for intellectual property issues is the Intellectual Property Agency, registered in Belgrade.

The following intellectual property rights are regulated and protected: patents, designs (former samples and models), and trademarks, indications of geographical origin, topographies of integrated circuits, copyright and related rights. All these rights are protected by special laws, adopted in 2004, except the Law on Indications of Geographical Origin, which was adopted in 2006. The Law on Herbal Sorts and the Law on Protection of Undiscovered Data is currently in the legal pipeline.

POSITIVE DEVELOPMENTS

Since the implementation of the regulations on IP protection has started to produce effect, the natural and legal persons (foreign and domestic) enjoy three types of legal protection in Republic of Serbia that are consistent with EU law: civil-legal protection in front of commercial courts or courts having general jurisdiction; administrative-legal protection through inspection bodies, customs and others; and, criminal-legal protection in front of criminal jurisdictional bodies.

The quality of jurisdictional protection has been improved by creating special departments in the district courts that are competent and have specialized knowledge/experience in intellectual property cases.

With respect to intellectual property rights, the foreign investors are infinitely better positioned today than a few years ago.

REMAINING ISSUES

The adoption of the remaining two legal texts, on herbal sorts and protection of undiscovered data, is needed as soon as possible to complete the full set of laws in the IP area.

FIC RECOMMENDATIONS

- The more efficient and prompt implementation of the regulations on IP protection should be conducted through the reorganization of existing inspection department, and establishing of new ones as needed;
- Continue to communicate clear messages and alter the public opinion so that people understand that IP piracy and forgery are not only unacceptable but not permissible. Reinforce this message and position through active prosecution and punishment of violators.

LAW ON FOREIGN EXCHANGE OPERATIONS

CURRENT SITUATION

Law on Foreign Exchange Operations ("RS Official Gazette", No. 62/2006 dated 19/07/2006) came into force as of 26/07/2006 and has not been amended or supplemented since.

Law on Foreign Exchange Operations regulates following sections:

- current transactions
- capital transactions
- payments
- foreign exchange market and RSD exchange rate
- measures of protection
- exchange control
- Exchange Inspectorate

Through Capital Transactions, as section which liberates capital and exchange transactions, among the other issues, the following issues are regulated: international credit operations; residents, except for residents – private individuals, may purchase or sell, and/or pay or collect claims and payables arising from residents' foreign trade activities; banks and residents – legal entities may purchase claims from residents arising from credits granted to non-residents as well as assume debt of residents towards non-residents with regard to international credit operations; private individuals may purchase top-rated foreign shares and long-term debt securities; using RSD loans by non-residents.

Law on Foreign Exchange Operations has established Exchange Inspectorate within the Ministry of the Republic of Serbia.

POSITIVE DEVELOPMENTS

- Principally, residents – companies for management of investment funds and voluntary pension funds may freely effect payments for the purpose of investing abroad. The same applies to non-residents when making payments for the purpose of investing in companies for management of investment funds and voluntary pension funds in the Republic of Serbia. Likewise, non-residents may freely purchase shares and long-term debt securities in the Republic of Serbia.

- Possibility of purchase and sale, and/or payment and collection of claims and payables arising from residents' foreign trade activities, as well as the fact that banks and residents – legal entities may purchase claims from residents arising from credits granted to non-residents as well as assume debt of residents towards non-residents with regard to international credit operations will make additional financing of legal entities, both in the country and abroad, faster and cheaper.

REMAINING ISSUES

- The Law on Foreign Exchange Operations, in principle, purchase of debt securities. However, the by-laws regulating relevant payment transactions are rather insufficient and not complete and, though a year has passed since the implementation of the by-laws, the banks are still not making any foreign payments on this ground. The reason is unclear definition of the role of the bank as the payment operator in foreign transactions and the role of an agent in the securities trade, as well as the responsibility for mandatory reporting on these activities to the National Bank of Serbia;

- The Law on Foreign Exchange Operations regulates, in principle that non-residents may purchase claims based on foreign trade and credit transactions from residents only on the condition and the way set by the Government. The Government has not yet adopted relevant by-laws.

FIC RECOMMENDATIONS

- New by-laws should be passed to precisely define the role of agents in the securities trade and their business relations with the bank that performs foreign payment operations i.e. who should give payment orders (client or agent in trade transaction) and who should provide reports to the NBS – bank or agent;
- Relevant by-laws should be passed which will regulate conditions under which non-residents may purchase claims based on foreign trade and credit transactions from residents.

TAX

A. CORPORATE INCOME TAX

GOVERNING LAW

Taxation of corporations in Serbia is governed by the Law on Corporate Income Tax (Official Gazette of the Republic of Serbia, No. 25/2001…84/2004; the "CIT Law"). The CIT Law is supplemented by a number of by-laws governing the implementation of the provisions of the CIT Law.

The changes to the CIT Law have been on the Government's agenda since 2006, to address the shortcomings of the current text of the CIT Law. The last draft proposal was submitted to the Serbian Parliament for adoption in January, 2008 (the "Draft Proposal"). At the time of this report, the adoption of the Draft Proposal was still pending.

POSITIVE DEVELOPMENTS

- The Draft Proposal addresses the majority of the existing problems of the taxation of corporate taxpayers;

- The most important changes to be introduced by the Draft Proposal include, among other, the reduction of the tax-loss carry-forwards and capital-loss carry-forwards from 10 to 5 years, and the reduction of the withholding tax rate from 20% to 15%;

- Other changes include the abolishment of limitations on marketing and advertising expenses, removal of technical inconsistencies related to deductibility of long-term provisions, and improvement of the system of taxation of capital gains made by non-resident taxpayers in Serbia.

REMAINING ISSUES

- Provisions governing taxation of permanent establishments are scarce and vague, and do not provide sufficient guidance as to what constitutes a permanent establishment, nor as to the methodology for establishing the profit subject to taxation;

- Provisions governing transfer-pricing are too vague and are rarely implemented in the practice. The lack of legislative guidance and any reliable practice in this area has caused significant uncertainties as to the way taxpayers should handle their related-party transactions;

- Neither the CIT Law, nor other relevant legislation provides a clear definition of the underdeveloped regions to which tax incentives for investment in these areas apply;

- The CIT Law does not contain a single provision to govern the taxation of investment funds. The result is the distortion of the tax neutrality of investment funds, as well as the neutrality of different forms of investment funds, in particular the closed-ended and open-ended funds;

- The absence of tax credit for tax paid by resident taxpayers abroad on types of income other than dividend leads to the double taxation of these types of income, as well as to distortion of neutrality of different types of income generated by Serbian corporate taxpayers abroad;

- The CIT Law provisions which regulate application of tax credit for investment in fixed assets (Article 48 and 48a) do not make distinction between new assets and assets already in use in the Republic. The Law presently allows the use of tax credit for the acquisition of new assets, as well as for the acquisition of assets already in use in the Republic. The Draft Proposal (Article 44) introduces a change in this regard, and no longer allows the use of tax credit for assets that are already in use in the Republic. Such solution is not fair as it provides different treatment for used assets, which are imported (hence, tax credit can be used) and used assets that are acquired on the Serbian market (tax credit is not allowed).

FIC RECOMMENDATIONS

- While the Draft Proposal addresses the majority of shortcomings of the present text of the CIT Law, some of its provisions introduce additional confusion in certain areas (such as, primarily, the taxation of permanent establishments). Certain issues have not been dealt with at all (the tax status of investment funds, the problem of tax credit for income generated by resident taxpayers abroad, transfer-pricing, etc), and some of the changes introduced are clearly bad (such as, for example, the prohibition of the transfer of tax credits for investment in fixed assets in the case of mergers and divisions);
- The Draft Proposal should be amended to allow the same treatment to be given to the acquisitions of new and/or used assets in the Republic and to the import of new and/or used assets, if such assets are used for business purposes (excluding the assets for which tax credit is not applied, by law). We see no reason why a taxpayer that imports used assets should be entitled to tax credit, while the taxpayer who acquires used assets in Serbia should be discouraged. Present CIT Law provides a fair solution which is granted for taxpayers and should not be changed;
- Serbian tax authorities should consider the possibility to introduce the tax-transparency of partnerships, so as that the profits generated by this type of company are taxed at the level of partners, instead at the level of the partnership;
- Many of the existing problems in taxation of companies are related to the practical implementation of the provisions of the CIT Law. These problems should be dealt with in the by-laws of the Ministry of Finance and the Tax Authority, rather than by amendments to the CIT Law, which will introduce more flexibility in this area;
- The draft amendments to the CIT Law should be further worked on to address all the outstanding issues on the basis of input from the business community, and its representative associations such as the FIC, and other similar organizations;
- Many of the existing problems are a result of the fact that the present text of the CIT Law was issued in 2001 (relying for the most part on the solutions of the previous law from 1994), drafted at the time when the business activity, in particular the presence of foreign business in Serbia was practically non-existent. For this reason, the existing solutions of the CIT Law are not fit to accommodate numerous changes which have been introduced in Serbian laws and business practice since 2001. Instead of providing partial and often inconsistent solutions through frequent amendments to an essentially outdated law, the Government should introduce a new and complete legislative text to provide a modern, clear and consistent system of taxation of companies in Serbia.

B. PERSONAL INCOME TAX

GOVERNING LAW

Taxation of individuals is governed by the Personal Income Tax Law (the "PIT Law") from 2001, last amended in 2006. In January 2008, the Serbian Government has issued its official draft proposal of the amendments to the PIT Law (the "Draft Proposal"). At the time of this report the Draft Law was still pending adoption in the Serbian Parliament.

POSITIVE DEVELOPMENTS

- The Draft Proposal from January 2008 addresses some of the problems present in the current text of the PIT Law;

- The focus of the proposed changes is taxation of capital gains made in relation to the trade in securities. Changes introduced by the Draft Proposal in this area include the reduction of the rate of capital gains tax from 20% to 10%, tax exemption for capital gains made in the sale of securities which the taxpayer held in his/her portfolio for more than 3 years, and improvements in the procedure for the offsetting of capital gains with capital losses;

- Other proposed changes include the abolishment of the tax exemption for additional expenses of non-resident taxpayers, inclusion of interest income in the annual taxation of income, and provision of certain benefits for taxation of income from agriculture.

REMAINING ISSUES

- Higher thresholds for payment of annual income tax for foreign nationals lead to discrimination of Serbian taxpayers without any plausible justification;

- Taxation of foreign nationals on their Serbian-sourced income continues to be a matter of considerable controversy in the practice;

- The tax treatment of compensation of business expenses to natural persons (both employees, and persons engaged under service contracts) has not been dealt with adequately in the PIT Law. These expenses are routinely taxed as if they represent a personal expense of persons to whom they were compensated. In that sense, the PIT Law should make a clear distinction between compensation of business expenses, which do not represent income of natural persons, and cannot be subject to taxation, and compensation of personal expenses, which should be taxed;

- Specific problem are compensations of expenses for business travel abroad, which are not regulated neither in terms of procedure in which such expenses need to be documented by Serbian companies, nor in terms of thresholds which are "exempt" from the obligation to pay tax. In the absence of relevant by-laws to regulate this matter, Serbian tax authorities continue to apply the Decree on the Compensation of Expenses and Severance Pays to Employees in State Bodies. Not only that this practice has no ground in the applicable laws, but is also completely inappropriate, as the Decree imposes limitations on travel expenses which may be appropriate when it comes to civil servants, but are absolutely out of place in the business environment.

FIC RECOMMENDATIONS

- Notwithstanding certain improvements to be introduced by the Draft Proposal, the PIT Law still suffers from many substantial inconsistencies, as well as from numerous technical deficiencies, which should be resolved in a systematic and consistent way;

- The application of the cedular system of taxation of personal income remains the central problem of the Serbian system of taxation of individuals. This system was abandoned as unclear and unjust by many advanced tax jurisdictions, and Serbian government should replace it with the synthetic system as well;

- Serbian tax authorities do not seem to have adapted themselves to the new tax environment in which they are supposed to apply often outdated provisions of the PIT Law, and the Ministry of Finance should provide its personnel more trainings;

- Taxation of foreign individuals should be dealt with systematically, so as to remove confusion generated through inconsistent practice of the Tax Authority and the Ministry of Finance.

C. VALUE ADDED TAX

GOVERNING LAW

The Value Added Tax is governed by the Law on Value Added Tax from 2004 (the "VAT Law"). In 2007, VAT Law was amended by the Law on Changes and Amendments to the VAT Law which introduced significant changes in the existing VAT System.

POSITIVE DEVELOPMENTS

The amendments to the VAT Law introduced in 2007 have refined and clarified many of the legislative provisions which have been proven to be controversial in the practice.

REMAINING ISSUES

- Due to the abolishment of VAT refund, and the absence of the possibility for the VAT registration of foreign taxpayers in Serbia, foreign companies now do not have any means to recover the VAT paid in Serbia. The 18% VAT paid to their Serbian suppliers is now a pure cost for any company with direct operations in Serbia. Not only does this solution distort the neutrality of VAT, but it also discriminates foreign companies against Serbian taxpayers. On the other hand, this exposes Serbian companies to the risk of being denied the right to refund in foreign countries on the grounds on lack of reciprocity;

- Rules relevant for the implementation of the VAT Law are scattered over numerous by-laws, instead of being summarized in one act;

- While Serbian Tax Authority has adapted itself very quickly to the VAT system and become quite proficient in the application of VAT Law, due to lack of clear legislative guidance many of the provisions of the VAT Law are still subject of considerable controversy in practice.

FIC RECOMMENDATIONS

- Tax Authority should issue comprehensive guidelines for the application of provisions of VAT Law to address various issues which have repeatedly been source of problems in the practice;

- Provisions of the VAT Law dealing with the position of foreign entities within Serbian VAT system should be revisited and amended so as to create a coherent system of taxation of transactions involving foreign suppliers.

D. THE LAW ON TAX PROCEDURE AND TAX ADMINISTRATION

CURRENT SITUATION

The Law on Tax Procedure and Tax Administration (Official Gazette of the Republic of Serbia, No. 80/02…61/07; the "TPTA") regulates the general issues related to the organization of the Tax Authority and the administrative procedure before the Tax Authority. The general administrative and procedural rules of the TPTA apply to all forms of tax applicable in Serbia, unless specific tax law contains special provisions to govern a specific issue, and, in that sense, the relationship between TPTA and tax laws is that of the *lex generals* to *lex speciali*. The TPTA was last amended in June 2007.

REMAINING ISSUES

The latest amendments to the TPTA did not introduce any significant changes in the substantive rules of this law. The

general problems inherent in the TPTA Law are still present, and the Serbian tax authorities should consider a thorough revision of the TPTA to address the general inefficiency of the tax procedure.

FIC RECOMMENDATIONS

- Tightening of the deadlines for the issuance of decisions of the Tax Authority;
- Introduction of meaningful procedural defences of the taxpayers against unlawful decisions of the tax inspectors;
- Clarification of the relationship of the penal provisions of the TPTA and those prescribed by the individual tax laws;
- Clarification of the status of foreign entities within Serbian tax system (including in particular the tax registration of foreign entities in Serbia, the status, responsibilities and liabilities of the tax representatives appointed by the foreign taxpayers, etc);
- Relevant Serbian authorities should consider introduction of the "binding rulings" in the Serbian tax system, as this would introduce a greater level of certainty for Serbian taxpayers, especially in the areas which have proven to be controversial in the practice, and provide additional source of guidelines as to the practical implementation of Serbian tax laws.

E. OTHER TAXES

CUSTOMS DUTIES

CURRENT SITUATION

Law on Customs ("Official Gazette of the RS", no. 73/2003, 61/2005, 85/2005, 62/2006) and Law on Customs Tariffs ("Official Gazette of the RS" No. 62/05 61/07) represent the legal framework for the regulation of the customs system and customs protection.

Customs legislation in Serbia is adjusted to the general principles and rules of the EU Customs Code. The adoption of the Law on Customs in July 2003, that came into force on January 1, 2004, had the effects of harmonization with the EU regulations and WTO rules. The existing law accepted the institutes of the EU Customs Code.

In the draft stage is the new Law on Customs which entails further harmonization with the EU regulations, and which needs to be adjusted to the new solutions envisaged by the new EU Customs Code.

Customs Tariffs

The adoption of the Law on Amendments of the Law on Customs Tariffs ("Official Gazette of the RS", No. 61/2007) fulfils the priority task within the framework of the harmonization with the EU regulations. The Law on Amendments of the Law on Customs Tariffs grants powers to the Government of the Republic of Serbia to adjust, via Decree, and at the latest in November of the current year for the following year, the nomenclature of the customs tariffs with the EU Combined Nomenclature that will be applied for the classification of products within the customs tariffs.

Adjustment of the nomenclature is being carried out in compliance with the obligations transpiring from international agreements.

Provision on adjustment of the nomenclature of the customs tariffs with the EU Combined nomenclature is also contained in the Stabilization and Association Agreement with the EU and in the CEFTA Agreement, with the objective of proper application of the undertaken obligations by the signatories.

By the Decree on Harmonization of the Customs Tariffs Nomenclature for 2008 ("Official Gazette of RS", No.112/2007), that has been applied as of January 1, 2008, the national customs tariffs were harmonized with the EU Combined Nomenclature for 2008, that has been applied as of January 1, 2008. Thus, the national customs tariffs were simultaneously harmonized with the Harmonized Commodity Description and Coding System-HS 2007, which the World Customs Organization adopted in 2004, with applicability since January 1, 2007.

POSITIVE DEVELOPMENTS

The improvements are related to improvement of customs procedure by granting the possibility of electronic submission of the documents, modernization and reconstruction of border crossings and improved coordination of all border services. Specifically, the following has been achieved:

- Submission of documents by e-mail introduced. Out of the total number of submitted declarations, 67% was submitted by e-mail in 2007, and 78% in the first five months of 2008;

- Three out of four biggest border crossings were reconstructed (Gradina, Horgoš and Batrovci);

- Traffic lights are installed at custom offices thus enabling the parties in customs procedures to monitor in which phase of procedure every document is at any given moment, as well as how much time has passed from the beginning of the procedure.

In accordance with the National Strategy for Integrated Border Management adopted in 2006 with the aim of establishing best possible coordination with all services at border crossing points, it is envisaged that only 4 services shall remain at the border crossings: border police, customs administration service, veterinary and phytosanitary inspection.

- In July 2006, CAS has taken over the responsibility for preliminary control of radioactivity from the Ministry of Science and Environment Protection;

- In April 2008, CAS has taken over the responsibility for preliminary control of waste, poisonous substances and substances that deplete the ozone layer from the Ministry of Science and Environment Protection;

- Meetings of the representatives of border services at border crossings are held on regular basis and exchange of data with relevant ministries is established.

REMAINING ISSUES

Problems in the customs system are by and large related to the customs procedures and to much less extent to the solutions given in the existent regulations. Problems related to customs procedures are:

- Customs procedure is still slow;
- Hefty paperwork requirements for export/import;
- Lengthy procedure linked with customs and inspections services;
- Discordant work of customs and inspections bodies;
- Insufficient technical facilities at border crossings;
- Insufficient administrative capacity.

FIC RECOMMENDATIONS

- Further harmonization with EU regulations and WTO rules;
- Law on Customs should stipulate requirements for the status of the authorized operator;
- Provide the administrative capacity for the implementation of the regulations;
- Accelerate the introduction of Integrated Border Management with the aim of more effective control of the work of all services and their cooperation with other state bodies and international entities;
- Accelerate the implementation of the single E-window;
- Carry out selective goods inspections based on the risk assessment.

EXCISE DUTIES

Excise duties are governed by the Law on Excise Duties from 2001. The Excise Law was last amended in 2007, as a consequence of the signing of the CEFTA Agreement and the abolishing of fiscal discrimination in the area of tobacco products.

Excise duty is a consumption tax payable on certain categories of goods, produced or imported on the territory of Serbia, and is payable when the excise goods are shipped by the producer to the recipient of goods.

Excise duties are payable on oil derivatives, tobacco products, alcohol beverages, and coffee. Starting from the adoption of the amendments to the Excise Law, excise duties are no longer payable on the imported non-alcoholic beverages.

The amount of excise duties is determined as a fixed amount per unit of goods, except for coffee and partly cigarettes, for which excise duty is prescribed as a percentage of the customs, namely the production value.

PRODUCT	EXCISE DUTY
Oil derivatives	RSD 10.00 – 32 per litre, depending on the type of oil derivative
Tobacco	Starting from January 1, 2008 the amounts of excise duties are identical for both imported and Serbian-produced cigarettes, and shall increase every year until 2012, following the schedule prescribed by the Excise Law. In 2008, the amount of excise duties is RSD 7.70 per pack (nominally) + 33% of the retail price.
Alcoholic beverages	RSD 9.00 to 136.55 per litre
Imported non-alcoholic beverages	RSD 3.50 to 5.42 per litre
Coffee	30% of the customs value

Excise duties are payable by-weekly, by the end of the month for the first two weeks, and by the 15th of the following month for the last two weeks. Excise tax return with the reconciliation of excise liabilities is filed quarterly and annually.

PROPERTY TAXES

Property taxes are governed by the Law on Property Tax from 2001, last amended by the Law on Changes and Amendments to the Property Tax Law from 2007.

Property taxes in Serbia include real estate tax, property transfer tax, gift tax and inheritance tax.

Property Transfer Tax

Property Transfer Tax is payable on the transfer of assets for consideration. Assets subject to taxation are immoveable property, intellectual property rights, shares and other securities, used cars, boats and aircrafts, and the right to use city construction land (including the long-term lease of the city-construction land).

The tax base is the contract price, or where the Tax Authority determines that the contract price is lower than the market price, the market value of the asset which is being transferred.

The tax rate is different depending on the type of asset: 0.3% for transfer of shares and other securities, and to 2.5% in all other cases.

Person liable to pay tax is the seller of assets, except for the transfer of the right to use of the city construction land, in which case the person liable to pay tax is the person to which the right of use is being transferred.

Real Estate Tax

Property tax is payable on the ownership of immoveable property such as land, buildings, and flats. Tax base is the market value of the real estate as of December 31 of the year proceeding the year for which the tax is assessed. The market value is determined by the Tax Authority on the basis of criteria prescribed by the law.

The tax rate is established by the municipality where the immoveable property is located. For corporate taxpayers, the applicable tax rate cannot exceed 0.40%, while for taxpayers – natural persons maximal tax rates are progressive and may range from 0.40% up to 3.4% for immoveable property which market value exceeds RSD 30,000,000.

ENVIRONMENTAL PROTECTION LEGISLATIVE FRAMEWORK

CURRENT SITUATION

In 2007, six conventions were ratified:

- Kyoto Protocol to the United Nations Framework Convention on Climate Change;
- UN Convention on Environmental Impact Assessment in a Transboundary Context;
- UN Convention to Combat Desertification in Countries Experiencing Serious Draught and/or Desertification, Particularly in Africa;
- Framework Convention on the Protection and Sustainable Development of the Carpathians;
- Convention on the Conservation of European Wildlife and Natural Habitats;
- Convention on Conservation of Migratory Species of Wild Animals.

POSITIVE DEVELOPMENTS

A large number of laws to be adopted by the Government and Parliament are prepared.

A preliminary list is made of all plants for the operation of which an integrated permission is needed (IPPC Directive).

REMAINING ISSUES

- Certain laws enacted in 2004 are not fully operational in practice, due to delay in passing of the by-laws;
- Rulebooks adopted in 2005 – 2006 are still not fully implemented in practice;
- Economic and financial mechanisms and tax incentives for investments in environmental protection (clean production, pollution decrease, energy efficiency, waste reduction, eco-innovations, etc) have not been sufficiently developed yet;
- There is a lack of data on environmental status due to inefficient monitoring and reporting system;
- Information systems for environment protection and cadastre of pollutants, which are stipulated by the law, have not been developed;
- Inventory of gases with the greenhouse effect and first National Communication with the UN Framework Convention on Climate Changes has not been prepared;
- National strategy for clean development mechanisms has not been adopted.

FIC RECOMMENDATIONS

We recommend that the following legislation and regulation are adopted:

- Law on Waste Management, Law on Packaging and Packaging Waste, Law on Chemicals Management, Law on Air Protection, Law on Waters;
- By-laws on Waste Management – 2 decrees and over 20 rulebooks;
- By-laws on Packaging and Packaging Waste – 8 rulebooks;
- Plan for decreasing the amount of packaging waste.

Also, we encourage the adoption of:

- National programme for environmental protection;

- National strategy for clean production in Serbia.

Furthermore we recommend:

- To consolidate regulatory framework through adoption of by-laws on environmental protection information system, including the contents and monitoring procedures, reporting system and pollutants registries;
- To accelerate building of infrastructure for environmental protection – testing, analysis, broadening of network of authorized organizations, certification, specialized services for waste management, depositing hazardous waste, remediation of contaminated soil, etc;
- To clearly define, in close cooperation with the main stakeholders, the objectives of pollution decreasing and make quantitative targets as well as mid-term and long-term time limits for attaining these objectives;
- To create basis for building a national system for marking with ecologic sign of all products, processes and services (procedures, directives, rules, education, and enhancing ecological awareness);
- To reinforce the capacities of local governments for the purpose of preparing local action plans in the field of ecology;
- To support foundation of new and development of the existing enterprises engaged in production and/or services in environmental protection sector, in particularly those engaged in recycling of secondary raw materials;
- To elaborate special regulatory and economic instruments as incentives for enterprises to apply regulations for environmental protection;
- To accelerate activities related to functioning of Environment Protection Fund.

REMUNERATION FOR ENVIRONMENTAL PROTECTION AND ENHANCEMENT

CURRENT SITUATION

The Article 85 of the Environmental Law (Official Gazette of the RS, nr. 135/04, herein after: The Law), establishes the obligation of payment of the remuneration for the environmental pollution (at the Republic level), along with criteria for its establishing, the obligatory payers, distribution of the assets accumulated from the fee (60% presents the income of the Republic's budget, and 40% is the income of the local municipality's budget), as well as the remuneration purpose: "for the environmental protection and enhancement" according to the programs and plans made in accordance to this law and other special by-laws.

The article 87 of the Law, defines a discretion right of the local municipality to issue the fee for "environmental protection and enhancement", "within the scope of their rights and duties", "in accordance with its needs and specifications", amount of the fee to be paid, the payment methods and the exceptions for certain categories of the tax obligatory parties. The same article establishes the obligation of using the

assets collected in this way with the purpose of the environmental protection and enhancement.

REMAINING ISSUES

At the beginning of 2007, draft of the Law's amendments was published, which, among other issues, suggested specifying the criteria and establishment of the highest amount of the a.m. tax (whose definition is in the jurisdiction of the local municipalities) by the Government itself, within one month from the day of this law's amendments coming into force.

During the same year, the draft of the Law on amendments and appendices of the environmental Law has been amended in way it brought more amendments of the Law, and related to the article 87 of the Law as follows:

- It states that the local municipality cannot prescribe the remunerations issued based on the articles 84 and 85 of this law (i.e. the remuneration defining the usage of the natural resources and protection and enhancement of the environment, at the level of the Republic);

- It omits the provision establishing that the Government will issue the maximum amount of the remuneration within one month of this Law coming into force, hence prescribing the obligations of the local municipalities to align the existing legislation on establishing the remuneration for the environmental protection and enhancement within two months from the day of this Law coming into force (The Law on amendments and appendices of the Environmental Law).

The prescription of the obligation to pay the remuneration for "the environmental protection and enhancement" by the local municipality in relation to the article 87, brings to:

- Unequal position of the tax obligatory parties, only due to a fact that they convey their activities in the territories of the different municipalities;

- Double taxation of the remuneration for "environmental protection and enhancement" by the same legal subjects, i.e. double payment of this remuneration to the local municipality unit and in relation to the allocation of the assets accumulated at the level of the Republic, based on article 85 of the Law;

- Investment of the additional resources of certain obligatory parties for the purposes for which they are paying the remuneration based on both articles, without real influence on the definition of the amount of the remuneration.

FIC RECOMMENDATIONS

It is necessary to amend the provisions of the article 87 and other provisions of the Law which are of importance for establishing the remuneration for the environmental protection and enhancement.

We propose the amendment to the Law and issuance of the related by-laws which would:

- Provide the conditions for equal application of the remuneration for the environmental protection and enhancement to all pollutants in the Republic;

- Clearly define the criteria for establishing the remuneration of the local municipality and disable double taxation of the remuneration, based on the same criterion by the same providers;

- The method "Pollutant Pays" – when the pollutant causes or may cause the burdening of the environment by conveying its activities, thus it is responsible for the total costs of the measures for preventing and decreasing of the pollution, but not if in direct way, the pollutant invests into the listed measures, i.e. bears the costs of those;
- Issue the highest amount of the remuneration which can be defined by the a.m. by the local municipality;
- Establish a clear deadline for issuing proper by-laws and implementation of the solutions defined in accordance with the recognized international standards in this area, but also in accordance with the principles of the sustainable development of the local society and industry.

TOXIC MATERIALS

CURRENT SITUATION

Production and trade of toxic materials and supervision of production and trade of toxic materials is performed in accordance with provisions of Law on Production and Trade of Toxic Materials ("Official Gazette of FRY", No. 15/95, 28/96 and 37/2002 and "Official Gazette of RS", No. 101/2005), Law on Transportation of Toxic Materials ("Official Gazette SFRY" No. 27/90 and 45/90 and "Official Gazette of FRY" No. 29/94, 28/96,21/99, 44/99 and 68/02) and corresponding by-laws.

Based on provisions of Law of Production and Trade of Toxic Materials in force, toxins are classified in groups according to level of noxiousness i.e. peril and a list of toxins is officially published " List of toxins classified in groups"("Official Gazette FRY", No. 12/2000 and "Official Gazette SCG", No. 1/2003 – Constitutional Charter).

Based on the provisions of the same Law, only those legal entities who meet prescriptive conditions and which are approved by authoritative Ministry to functions service, i.e. which are proved to meet the prescriptive conditions for supply and usage of toxins can practise the production and trade of toxins.

Import of toxic materials is performed according to a special procedure which requires a previous approval by Ministry of Environmental Protection that toxic materials are allowed to be transported across frontiers, which is, again, received based on compliance of Ministry of Interior of Republic of Serbia. The approval is issued by virtue of the importer's request for clearly specified producer, supplier and quantity, border crossing and it has limited period of 3 months. The following is enclosed with the request: a pro-forma invoice with all the above mentioned elements, safety data sheet, decision on fulfilment of the prescriptive conditions for trade of toxins. If there is any change (quantity, supplier etc), the procedure for obtaining the above mentioned approval has to start from the beginning.

According to the existing List of toxins, calcium-carbide is rated in II group of toxins, ordinal number 412, cas.No. 75-20-7, redlight C, F, Caution Board Notice R-15,34 and reference mark S-8,45, assignment IH.

REMAINING ISSUES

Classification of calcium-carbide as a toxin is not compatible with European Union regulation. In EU countries and neighbouring countries (i.e. Croatia and others) calcium carbide is not classified as toxin. Calcium carbide is a raw material for production of industrial gas acetylene and it is exclusively supplied from abroad.

Because calcium carbide is classified as a toxin according to effectual regulations of Republic of Serbia, the complicated and lasting procedure of importing it also significantly complicates, defers, and cumbers the procedure of acetylene production and business in general. The procedure itself does not leave any possibility for flexibility in case there is a

breakdown in production of foreign supplier or if there are significant changes in market terms.

Time limits concerning import approvals have been even prolonged lately, and instead of previous ten days it is now minimum 30 days.

According to existing regulation, a package of calcium carbide must be properly marked, with a designation that it is a toxin, which generates additional problems on getting around the states where it is not considered a toxin.

FIC RECOMMENDATIONS

- The list of toxins should be changed, i.e. classification of calcium carbide should be adjusted to EU regulations and it should be deleted from the list of toxins.

SECTOR SPECIFIC

CHEMICAL INDUSTRY (ADCPI)

CURRENT SITUATION

The Ministry of Environmental Protection has prepared the Draft Law on Chemicals and the Draft Law on Biocides, as well as the proposal for the changes to the Rulebook on Conditions for Health Safety of General Goods for Commercial Use (Part V, "Products for Personal Hygiene and Care, Body and Face Cosmetics"). The adoption of these regulations has the goal of harmonizing the field of environmental protection and the management of chemicals with European standards.

Proper management of chemicals covers the production and use of chemicals in the manner that leads towards the reduction of consequences that are harmful for the health of humans and the environment. The field of the management of chemicals covers the control of production and trade of chemicals, sale, imports and exports of chemicals and chemical products, classification of chemicals and chemical products, their packaging and marking.

At the moment, the field of the management of chemicals in Serbia is not regulated adequately, bearing in mind the lack of proper legal regulations in this field, as well as that the regulations currently in force have been adopted in the 1980s and 1990s, and have not been harmonized with the new EU standards.

POSITIVE DEVELOPMENTS

The Draft Law on Chemicals provides for the establishment of the Agency for Chemicals, with competencies to adopt by-laws for the implementation of the Law on Chemicals and the Law on Biocides. The Agency would be charged with, among other things, the keeping of the Integral Inventory of Chemicals, as well as the control of the implementation of the principle of good laboratory practices. The goal is systematic monitoring and safe management of chemicals and chemical products produced and/or traded in Serbia. In this manner, Serbian industry is preparing for the implementation of EU standards on the local market, and thus for the future entry into the EU market.

In June 2007, the EU adopted a new regulation on Registration, Evaluation, and Authorization of Chemicals (REACH). The Serbian draft laws in this field have been partially harmonized with REACH, and provide that the new EU system is gradually introduced into the local system, bearing in mind the financial and professional capacities of the local economy.

In addition, the draft laws provide for the introduction of EU rules related to the procedures of classification, marking, and packaging of chemicals (GHS) developed at the level of United Nations in order to improve safety in the management of chemicals. GHS system has been created because it has been established that the existence of different systems of classification and marking of chemicals complicates and makes the trade in chemicals difficult. The reason for the delay in the adoption of local regulations in this field has been the wait for new EU rules in order to implement the provisions on the new GHS system into the local laws.

The Ministry of Environmental Protection, under the patronage of UNITAR, is currently working on the SAICM project (Strategic Approach to International Chemicals Management). The goal of this project is to aid the developing countries in taking an active part and being ready for the implementation of GHS. The first phase of this project is finished, and the Ministry has invited the industry to join this project in its second phase.

It is of great significance for the chemical industry that the criteria for classification of products and the classification procedure, as well as the standards covering packaging and marking of chemicals and chemical products, are harmonized with the EU regulations and standards.

In addition, the health safety requirements for general goods, and the provisions covering the declarations on the products for personal care and hygiene, as well as face and body cosmetics, which comprise a significant segment of the proposed changes and amendments, would provide the manufacturers with clearer guidelines in this field, bearing in mind that the regulations currently in force leave a lot of playroom left to the interpretation of the state bodies.

REMAINING ISSUES

The lack of legal regulations in the management of chemicals, and the inadequate inter-sector cooperation of the competent departments in the field of sanitary control of chemical and other products, make for considerable difficulties in the operation of chemical industry.

In addition, unclear provisions regulating the declarations on detergents, household chemical products and cosmetic products leave a lot of space for different interpretations by competent bodies, which is an insecure environment for doing business and operating in the industry.

The general expectation is that the adoption of the said laws would provide the legal framework in the field of management and trade of chemicals and chemical products, which would be largely harmonized with European standards. However, we are of the opinion that the adoption of the said laws is just the first step, and that the real challenges are still ahead, in the preparation of the institutional framework that would proceed in accordance with them, primarily meaning the Agency for Chemicals, as well as in the adoption of the by-laws required for the implementation of these laws.

FIC RECOMMENDATIONS

- To adopt the said laws and to establish the Agency for Chemicals as soon as possible, in order to proceed with the creation of the by-laws for the implementation of these laws;
- To improve the inter-sector cooperation of competent departments;
- To harmonize the criteria for classification of chemicals with the ones in force in the EU;
- To simultaneously adopt the Law on Chemicals and the Law on Biocides, in order to avoid the legal vacuum after the abolishment of the Law on the Production and Trade of Poisons ("Official Gazette of FRY" No. 15/95, 28/96, 37/2002) which is currently governing this field;
- To timely engage the business sector and the industry about the new regulations and the manners in which it can best be implemented, bearing in mind the costs of adaptation to the new system, as well as the obligations that the industry is going to have in the procedure itself;
- To provide the industry with adequate deadlines for the implementation of the new system, bearing in mind the properties of the industry branch, especially in respect of the procedure and time required for the changes to the packaging, labels, and declarations on the products.

TOBACCO INDUSTRY

CURRENT SITUATION

The tobacco industry in Serbia is one of the strongest sectors of the Serbian economy, with three major international players present with their production capacities. Following the adoption of Action plan for CEFTA implementation, and later CEFTA ratification in Serbian Parliament, three major laws regulating tobacco industry (Law on excise, Tobacco Law, and Law on customs tariff) have been changed. Changes in effect have removed protection of domestic tobacco industry and allowed importers from CEFTA equal conditions. In addition, changes to the Law on excise have provided adequate predictability of the excise system, one of the most important elements for tobacco industry.

REMAINING ISSUES

- An excessive increase of proportional excise element in 2010 as provided by the Law on excise;
- Latest initiative to introduce more restrictive regulation of public place smoking;
- Excise discrimination in Croatia and trade blockages;
- Lack of institutional capacity of relevant Government authorities.

FIC RECOMMENDATIONS

- The envisaged increase of proportional excise in 2010 from 33% to 40% can be regarded as very steep and could lead to significant market distortion so such measure should be changed. The best solution would be to mantain or decrease the proportional excise which would be compensated by an increase in the specific part of the excise (RSD/pack). This would simultaneously allow for the market and the industry to gradually adjust to the higher excise and Serbia to move closer to the EU standards in this area;

- Regulation on public place smoking needs to find an adequate balance between the need of smokers and non smokers, and to provide a solution which can be enforceable. Owners of hospitality outlets bellow 100 sqm should be given the right to decide if the outlet should be smoking or non-smoking area with clear indication on the outlet. Smoking in hospitality outlets above 100 sqm should be allowed if the physical separation of smoking and non smoking sections is provided and/or appropriate ventilation is installed in smoking sections. It is of utmost importance that any solution must provide sufficient transitional period prior to its full implementation and should be phased in – from simple segregation – to physical separation with proper ventilation at least as of 2011. Main reasons: i) predictability as one of the most important conditions for FDI, and ii) good practice of phasing in tobacco related legislation (excise increase, TNCO levels etc);

- Croatia has still to remove its excise discrimination of imported products and also a number of barriers in trade. In this effort, the help of Serbian Government would be welcome through bilateral negotiations with their Croatian counterparts, since increasing export potential of Serbian tobacco industry will have positive effects on current account deficit and further development and growth of Serbian economy;

- Lack of institutional capacity of relevant Government authorities has significant influence of tobacco business. First, there is the issue with implementation of Advertising Law. Its arbitrary interpretation by Trade inspectors leads to lack of transparency of this regulation and deteriorates its effectiveness. The regulator must set forth clear rules and effectively provide level playing field to all market participants. Second, the procedure of testing imported raw materials and cigarettes by the sanitary inspections often takes months, disrupting normal business cycles. It is necessary to set clear testing procedures along with time frames for each testing and to increase the capacity of sanitary inspection and independent laboratories.

MINERAL EXPLORATION AND MINING

CURRENT SITUATION

Changes of the mining law in 2006 have introduced a more operational legal environment but it did not fully eliminate the unnecessary legal risks involved in doing mineral exploration and mining business in Serbia.

The intention to regulate commercial geological exploration with a separate law on geological exploration still seems to exist and unless it is replaced with a vision of one law for mining and exploration, it will continue to produce unnecessary overlapping of jurisdictions between ministries and government agencies.

FIC RECOMMENDATIONS

- A mineral license/mining permit holder should be allowed to transfer freely all or a part of its rights to one or more other parties;
- The mining law should 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;
- 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;
- A mining license 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;
- Consider adopting sliding scale of royalties. Royalties should not be based as a percentage of gross revenue (as they are now) or even worse, as a charge per unit of volume or weight;
- Consider implementing internationally recognized standards for regulatory and public reporting of exploration results, mineral resources and ore reserves, such as JORC Code (Joint Ore Reserve Committee Code).

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