

# S E R B I A

## BEYOND TRANSITION

**I**t is hard to believe that it is less than five years since the overthrow of Slobodan Milosevic in the former Yugoslavia. In that short time, the Republic of Serbia has driven full ahead towards a liberal democracy and market economy.

No-one would deny that there is still a long way to go, but the giant strides made by the democratic government and Serbia's re-acceptance into the United Nations and the body of world politics signal massive opportunities for international investors.

The democratic government is battling to undo the legacy of a decade of neglect and international sanctions, which left Serbia with a crumbling economy, low living standards, falling industrial and agricultural output, rampant inflation and widespread corruption. The signs are that the fight is being won, with the establishment of macroeconomic stability and liberalized trade flows, while the process of harmonizing legislation and business standards with the EU has been initiated. But it is a fearsome struggle and Serbia needs the support of international investors to continue on the journey to a full market economy.



**Boris Tadic,**  
President

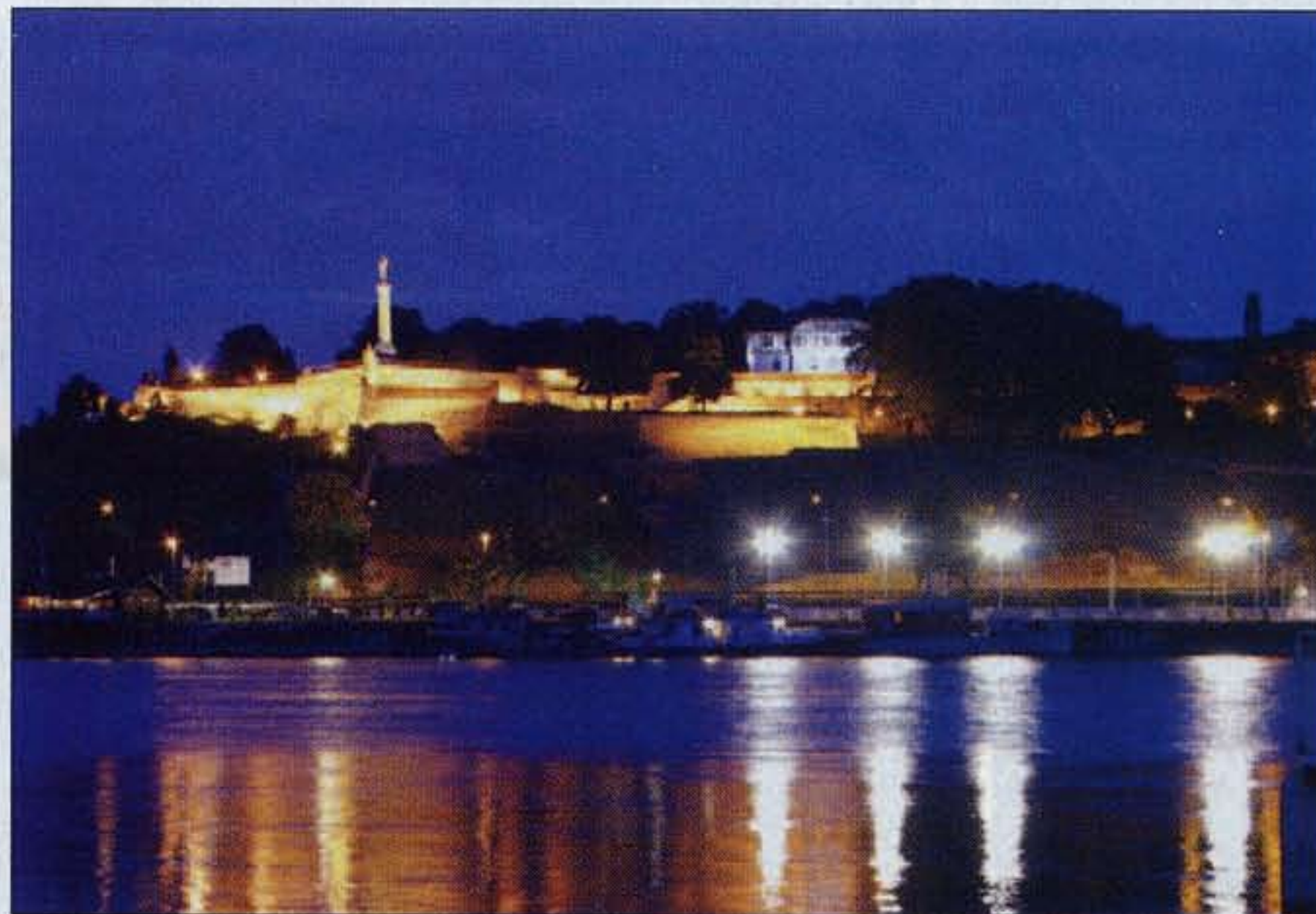
Serbia has already benefited from the economic and financial support of international institutions, debt reduction by the Paris and London Clubs, bilateral donations for reconstruction from individual countries and a preferential trade agreement with the EU. "All of these helped in pulling the country from the verge of total collapse and setting it on the current course of stable growth toward prosperity," says President Boris Tadic, who was elected in June 2004.



**Vojislav Kostunica,**  
Prime Minister

Serbia has good relations with international financial institutions such as the World Bank and IMF and is building a strong democratic base and working towards a new constitution.

"A characteristic of this government and its intentions is to establish the rule of law and a business-friendly legal framework," says Prime Minister Vojislav Kostunica, elected in March 2004. "There is a very strong will among the political actors, the democratic parties and the population in general to



*Serbia's capital, Belgrade.*

establish strong institutions, rule of law, an independent judiciary and to fight corruption."

Macroeconomic stability has now been achieved, with inflation down from 113% in 2000 to around 10% in 2004. Meanwhile, foreign exchange has remained stable over the period and foreign currency reserves increased ten-fold. The administration has also cut red tape and reformed the tax system to encourage business.

The government hopes to reduce the budget deficit to 2.5% from 4% of GDP, but repayment of foreign debts is a major issue – the national debt is around 60% of GDP. IMF research shows that Foreign Direct Investment (FDI) of 3.5% a year is needed to allow Serbia to meet debt obligations during the 2005-2011 period.

Key to attracting FDI is the privatization program in place since 2001. Proceeds will be used for public works and infrastructure development and improvement, to support growth in small and medium-sized enterprises (SMEs), to fund municipal projects and for the Development Fund of Serbia and the Restitution Fund.

Technically the larger part of a loose federation with Montenegro and Kosovo following the Belgrade Agreement which came into effect in February 2003, Serbia and Montenegro are autonomous in all matters except defense and foreign affairs. Montenegro will hold a referendum on full independence in 2006, and Kosovo, in effect a UN protectorate since 1999, may also opt for some form of autonomy.

Serbia is resisting any separation and has ambitions for Serbia and Montenegro to become part of the European Union. It has accepted a European Commission proposal to prepare one Stabilization and Association Agreement for Serbia-Montenegro, but with two different annexes referring to the economic, trade



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# EFT HELPS ENERGY FLOW ACROSS SOUTH-EAST EUROPE

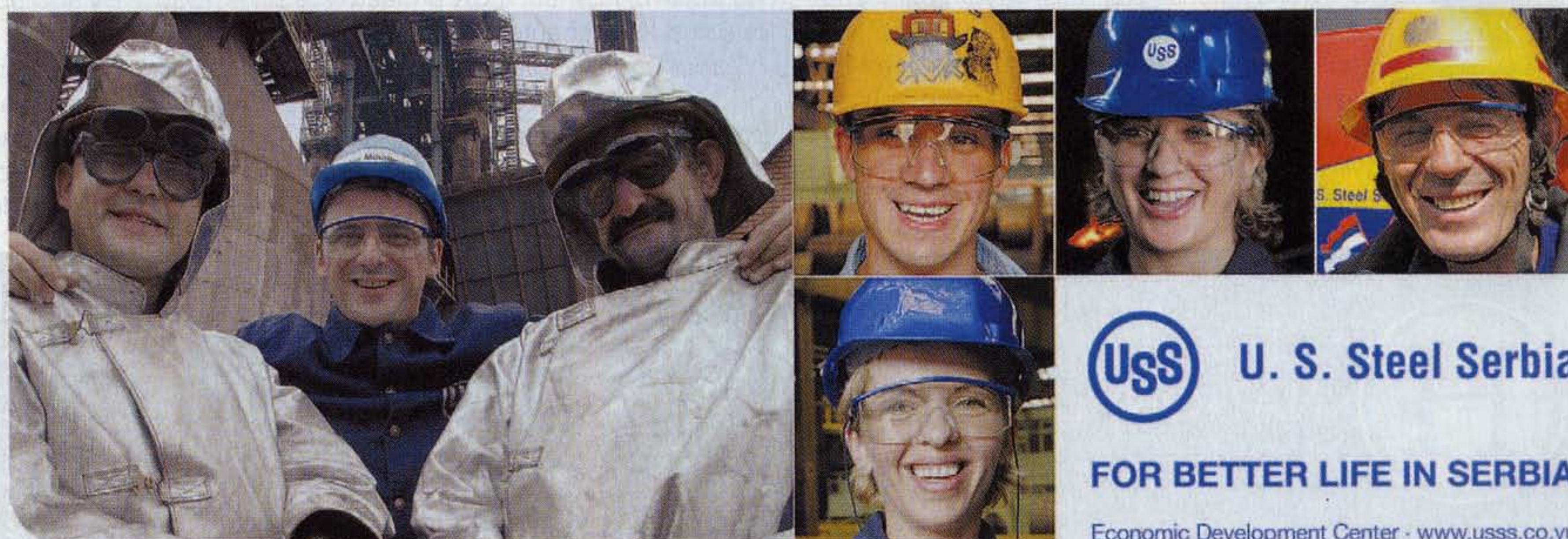
EFT bridges the gap between suppliers and energy consumers in south-east Europe by financing energy trading in a new and developing market. The team's success is based on predicting, financing and managing energy flows, using its analytical and trading expertise together with local knowledge and strong regional partnerships. EFT is expert in delivering energy where economic and infrastructure risks are part of the environment.



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## The new face of Serbian steel





and sector policies of the two member states. This allows the economic part of the negotiations to continue, while continuing to insist on the integration of the two states. "The EU's position is that both Serbia and Montenegro are better off in a state union, because a state union has a better chance of becoming an EU member. We share that position," says President Tadic.

The President has a clear vision of the way forward. "Economic reforms and the creation of a modern, competitive economy, integrated into the world economy, are the best and quickest way to a better life for the citizens of Serbia. Successful economic reforms are also the best means for solving political and social problems in Serbia," he says.

He points out that Serbia is the only country in transition to political reforms and a market economy that has not experienced a dip in GDP growth in the first few years of the process. Instead, the economy has grown at 5% in the first two years, 2.5% in 2003 and a predicted 6% in 2004.

His priority now is to improve the investment environment to bring in foreign and domestic capital. Investment laws have been reformed and incentives such as tax concessions and subsidies for job creation put in place. A new VAT law from 1 January 2005 sets the basic rate at 18% with some essential products at 8%. This is significantly lower than neighboring countries such as Hungary with 25% and Poland and the Czech Republic with 22%. Corporation tax is just 10%, the lowest in Europe.

Serbia has many other positives in its favor, not least its location, enabling it to become a bridge between east and west. It has a highly qualified, cheap labor force, and lies at the heart of the South East Europe Free Trade Zone with established economic relations with the Russian Federation.

Minister of Foreign Affairs, Serbia and Montenegro, Vuk Draskovic, is determined to work alongside other countries of the region. "Regional co-operation has never been so dynamic and important as it is today," he says. Serbia has free trade agreements with all countries in the region except Moldova. The aim is to create a free trade zone across the whole of South East Europe opening up a market of 55 million consumers, and to harmonize regulations with the EU and WTO.

International airlinks

Airlinks to Serbia for international investors and tourists alike have been greatly improved by an agreement by the national carrier JAT Airways allowing direct flights between Serbia and the US. Flights to New York and Toronto will begin in June 2005, complementing the shorter flights to European/Mediterranean destinations.

JAT was founded nearly 80 years ago and at the end of the 80s was one of the top 10 aviation companies in the world, reports its President and CEO, Aleksandar Milutinovic. It suffered greatly during the war and sanctions, but is gradually rebuilding and aims to make the capital Belgrade the hub for long haul flights from the region, including Macedonia, Bulgaria, West Romania and Bosnia, a market of some 40 million people. The airline is expecting six



US Steel Serbia

US Steel's Smederevo plant.

more Boeing aircraft to form the basis of its New Generation fleet. "Boeing also said that they want us to become a regional hub so our plans are all focused on this goal. Technical support, cargo and education are also of primary importance for us," says Milutinovic.

Privatization and Foreign Direct Investment

Since the privatization process began in 2001, around 1,200 companies have been sold, creating a climate of confidence for investors. Major transactions include the sale of three cement factories, to Lafarge (France), Holcim (Switzerland) and Titan (Greece), and two tobacco companies sold to BAT (US) and Philip Morris (US). The focus will now turn to restructuring and privatizing the largest enterprises, and President Tadic intends to establish a National Strategy of Economic Development to support this objective.

By the end of 2004, another 140 companies should be privatized, generating around US\$161 to \$174 million.

"A very important thing to attract foreign investments in the future is political stability and permanent legal reforms that should bring our legal system close to the one existing in the EU," says Director of the Privatization Agency, Miodrag Djordjevic.

US Steel is an excellent example of successful privatization. It started co-operating with state operator Sartid in March 2002, when the company was on the brink of bankruptcy. The purchase was finalized in September 2003 and rescued Sartid and its employees from certain closure. Now US Steel is the country's largest exporter, and is investing \$150 million over the next five years, with plans to increase production by 40% in 2005.



Aleksandar Milutinovic, JAT Airways



Thomas Kelly, US Steel



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*Belgrade aims to act as a regional hub for South East Europe.*

It is also playing a role in promoting Serbia as an investment destination. "We have set up an economic center in Belgrade where we are trying to attract FDI, not purely into the steel sector but into all sectors," says Thomas Kelly, General Director.

He is particularly praising of the Serbian workforce. "Over the past year we have tried to make sure we are running at maximum productivity and every month we break records that were set the month before. That's an incredible testimony to what these people have been able to do," he says.

The first port of call for any foreign investor is Siepa (Serbian Investment and Export Promotion Agency). It aims to attract, facilitate and support the inflow of FDI and promote Serbian exports. One of the key tasks is to overcome the poor image of Serbia internationally and promote the newly-created business-friendly environment and stable macroeconomic situation. Siepa Director Jasna Matic says that Serbia is hoping for a credit rating soon, perhaps a double B as recently achieved by Macedonia.

The government is also using regional fairs as a tool for greater economic integration in South East Europe. The Belgrade Fair was founded in 1937 and was the biggest in the Former Yugoslavia. Today it organizes 30 fairs and hopes to boost its national and regional exhibitions. In 2003, 7,000 companies exhibited in Belgrade, attracting over 1.5 million visitors, and numbers are 20% up in 2004.

## Finance

Reform of the banking system began in 2001 when the National Bank of Serbia closed 25 insolvent banks, including four of the biggest, and allowed foreign banks to enter the market. "As a result we now have a developed banking system that is still expanding," says Mladjan Dinkic, Minister of Finance. A public tender for state-owned Jubanka has raised interest from nine foreign banks, and the sale of Continental Banka and Novosadska Banka will continue the privatization process.

Deposits have also grown significantly as confidence in the banking sector grows. Radovan Jelasic, Governor of the National

Bank of Serbia, reports that the deposit base grew by 16% in the first seven months of 2004. The banking sector is advanced in compliance with European norms with most of the Basel Regulations being implemented, he stresses. "The foreign banks coming to Serbia bring their knowledge, experience and products, which also contributes to faster implementation of European banking," he adds.

The experience of the National Savings Bank demonstrates the radical reform of the sector. Founded in 2002 when the domestic monopoly was ended, it recognizes the need to fight for customers and provide new services – it developed some 60 new products in just six months. "We are trying to increase credit lines and deposits, introduce new banking cards and increase security," says Managing Director, Bojan Stanivukovic. It is now among the top five banks, with 20,000 businesses conducting domestic and international payments, as well as almost one million customers in the retail sector. The Bank is also trying to help build the economy through supporting SMEs, and has invested around \$10.7 million in credits.



**Bojan Stanivukovic,**  
National Savings  
Bank

Wholly privately-owned Centrobanka also targets SMEs, and already has 30 outlets, 6,200 clients, and a current balance of around \$67 million. When General Manager, Petar Stefanovic, came to the bank, it had just six outlets and 1,800 clients. He is proud of this growth and of being awarded the title Best Small Bank in Serbia and Montenegro 2004.



**Petar Stefanovic,**  
Centrobanka

Centrobanka offers a wide range of services and is soon to introduce a risk management program. Stefanovic is keen to stress the Bank's adherence to all regulations set out by the National Bank to ensure the banking sector complies with international criteria in preparation for EU integration.

International support is crucial to the development of Serbia, he believes. "Organisations in this country have the basic need for foreign capital. We don't need help, we need partnerships. Here we have the education and the know-how but foreign partnerships are the key to the success of this country," he says.

Growing confidence in Serbia is also reflected in the increasing market capitalization of the Belgrade Stock Exchange (Belex). This rose to \$4.36 billion in July 2004, 13.5% up on the year before.

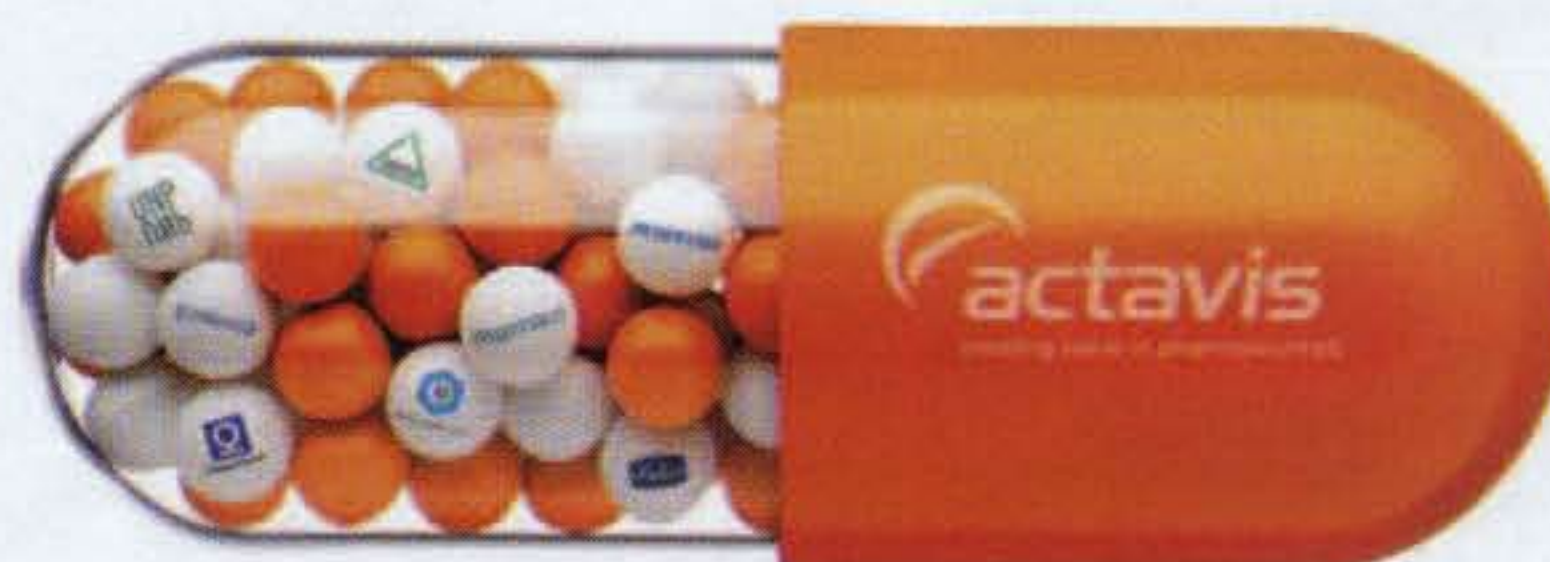
"We are constantly highlighting the importance of legal changes in a way which will ensure a familiar environment for foreign investors," says Gordana Dostanic, Managing Director.

## Health

An obligatory 12.3% of income is paid in health insurance by citizens in work, but among the biggest challenges facing the Ministry of Health are a lack of investment in health infrastructure



**creating value in pharmaceuticals**





and a lack of accountability. "What we did was to define the vision of the future system based on the obligatory insurance, but also the additional and private insurances. We also set out an Action Plan for 2015," says Minister of Health, Prof. Dr. Tomica Milosavljevic. With support from the World Bank and the European Investment Bank, the government is restructuring hospital facilities. A new law for medicinal products was introduced in June 2004, in line with European legislation, and a campaign has been launched to encourage the 50% of the population who smoke to quit.

General Manager of leading pharmaceutical company Zdravlje Actavis, Milan Todorovic, welcomes the new law.

"The legislation means new EU-compliant regulations, which will help develop the market and make it easier for companies to compete," he says.

The pharmaceutical and medical sector is well established in Serbia – such companies were exempt from restrictions and continued to trade throughout the last decade, and the major international players all have a presence. However, the Activis Group is the only one to have invested in the sector by buying Zdravlje, rather than only marketing its own products.

For Zdravlje, this opens up the opportunity not only to benefit from Activis's development work in terms of new products for the local market, but also to export to other markets where Activis is already present. The company is already licensed to produce drugs for Pfizer, among others, and is expanding with the construction of a solid dosage and packaging facility, and also has plans to develop the fast-growing over the counter market.

## Trade and industry

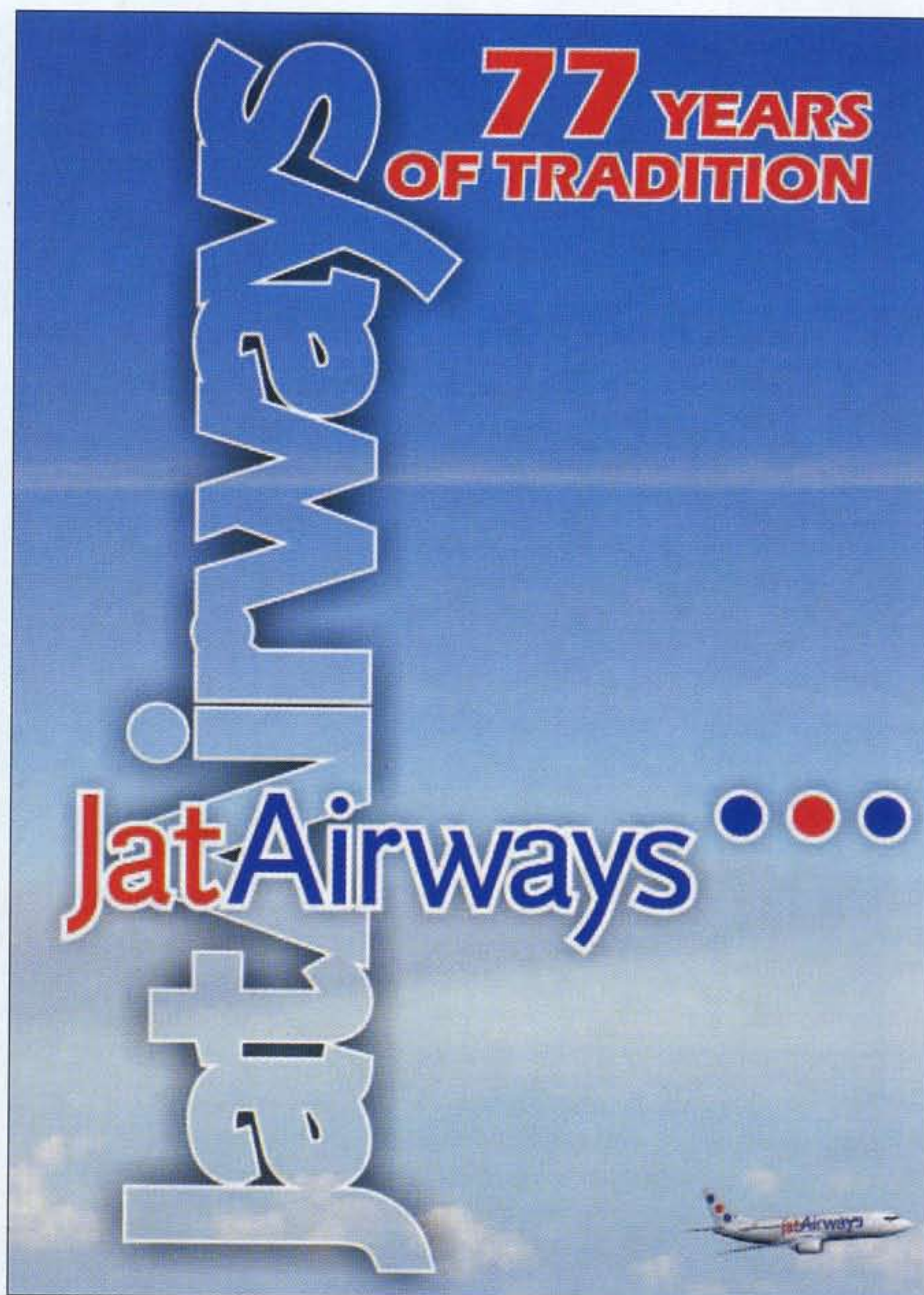
Minister of Trade, Tourism and Services, Prof. Bojan Dimitrijevic, welcomes a wide range of FDI – concessions, franchising, licenses, joint investment, buying existing enterprises or direct investment in their own facilities.

Manufacturer of tire and rubber products Tigar has found joint ventures an ideal way to operate in world markets. It formed an important joint venture with Michelin and the International Finance Corporation which has created a demand which exceeds current supply capacity. It also has a joint venture with British partners and sells 1.5 million TIGAR-branded tires in the UK. With programs of continuous improvement, the firm is growing at 20% a year. Tires account for 70% of business, and Tigar has built a network to support other industries which although not currently performing at optimal level due to lack of demand, will stand the company in good stead when the economy improves.

It has been a difficult time but Tigar has taken a longer-term view in looking after its non-core businesses and its 4,700 employees. "It is a good opportunity for tire and rubber products if we manage to invest and develop ourselves to world standards," says Managing Director, Dragan Nikolic.

Some international trade chains are already successfully operating in Serbia, such as Mercato from Slovenia and Veropoulos from Greece.

Serbian enterprises are co-operating with these international groups to significant mutual benefit. For example, the privately-owned Verano Group, which with 1,500 employees and a turnover of \$93.8 million is one of the leading groups in Serbia, is



concluding a major retail and residential construction project in Belgrade – the Vero Centar – in which Veropoulos will extend its supermarket operations.

"Joint ventures with non-Serbian companies offer the possibility of job creation for our workers, a strengthening of our national treasury, increasing political stability, and a high rate of return for our partners – a 'win-win' opportunity for all," says Radomir Zivanic, General Manager of the Verano Group.

As well as its investment activities, Verano is best known for its exclusive representation of Peugeot Automobiles, and is currently constructing the largest 'Blue Box' in Europe, a new Peugeot concept for auto sales and servicing. However, the Group has also diversified into several other industries, including agriculture, and flour mining and baking. Its construction division is growing nearly 50% a year, and Zivanic sees investments in raw land and real estate development as among the most attractive ventures in Serbia.

### Energy and mines

Energy trading and investment group Energy Financing Team (EFT) is also looking at the region as a whole in developing a South East European electricity market and helping to rebuild and expand the transmission network and generating facilities. It also provides the financing to bridge the gap resulting from power utilities and providers of energy wanting to be paid in advance, and customers wanting to delay payment.

EFT has been operating in the region since 2000, and has been able to accustom people to a trading mechanism. "The first steps were pioneering," says Sales and Trading Director, Svetislav Bulatovic. "For example, it was formerly common to keep prices artificially low... People now differentiate properly between night and peak energy, winter and summer energy. They try to realize the maximum value for their surplus electricity."

EFT has a strong commitment to investing in infrastructure and bringing new employment, as well as a social awareness – it sponsors sports and the arts, in addition to healthcare projects. It welcomes the new energy law which opens the energy market in Serbia to all

operators. It believes stability is becoming stronger in Serbia and if this continues, the group has plans to take advantage of the country's position as a route for energy from Romania or Bulgaria to western countries. It also sees potential for energy production.

Electricity fuels 80% of economic activity within Serbia, and with loans from the European Investment Bank and European Bank for Reconstruction and Development, the government has invested over \$1.34 billion in updating existing facilities in the last four years. This has ensured a reliable supply and opened the way for development of the infrastructure, including the construction of several high voltage facilities.

All development is taking place with a view to creating a regional market that will comply with conditions for EU accession and ultimately be integrated within a European system. The state company EPS/Electric Power Utility has been restructured into core activities. "As a result we should get one efficient energy company that will meet electricity demand," says Radomir M. Naumov, Minister of Mining and Energy. To comply

with the European energy directives, Serbia will create new system, market and distribution operators, as well as an independent Energy Agency.

Meanwhile, the oil and gas industry is likely to be privatized. Interest has already been expressed in the country's two refineries, which need investment of some \$429 million euro. The potential is vast – Serbia currently produces just 10% of its gas and oil requirements. "We are actively promoting the idea of constructing an oil pipeline from the Black Sea to the Mediterranean. Our estimates are that this would cost \$900 million, and the share for Serbia and Montenegro would be \$150 to \$160 million," says Naumov.

In the mining sector, for the first time in 70 years Serbia is to offer concessions for geological research and exploitation of mineral deposits such as copper in the east of the country, while rare boron ore deposits will be exploited in the south. Other opportunities include the modernization of underground coal mining, and two projects for open mine lignite pits.

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