FR Yugoslavia

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Investment Profile 2001

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EBRD ANNUAL MEETING

Contents

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Introduction

Ten years of regional conflicts, international isolation, and economic mismanagement have left a dire legacy in FR Yugoslavia. The economy is in a deep crisis and in urgent need of reform. Output, which has only partly recovered from the economic devastation caused by the Kosovo war, stands at about half of its 1990 level. Unemployment may be as high as one half of the labour force. The country's infrastructure is in disrepair following years of inadequate investment and the damage inflicted by NATO bombing. About 900,000 refugees and internally displaced persons live in FR Yugoslavia under difficult conditions. Serious energy shortages are being somewhat alleviated with humanitarian assistance.

Following the political changes of autumn 2000, the new authorities turned to the international community for help, in the hope of reintegrating quickly into the world economy. The immediate priority was to solve energy and food shortages for the winter, and an adjustment programme was adopted with emergency assistance from the EU and bilateral donors addressing many pressing needs. The next step was to complete the formalities for membership in International Financial Institutions (IFIs) as quickly as possible.

The immediate strategy is to restore financial stability while also protecting the most vulnerable in society. Attention will then shift to moving towards a stable market economy. Foreign assistance in helping FR Yugoslavia through the initial crisis is crucial and has been forthcoming. The government has designed a medium-term economic recovery and transition programme in order to apply for its first loan arrangements with the IMF and the World Bank. Continued foreign assistance will be required to fully return FR Yugoslavia into the European and world economy.

The **Federal Republic of Yugoslavia** (FR Yugoslavia) was constituted in April 1992 as a federation of the republics of Serbia and Montenegro, after the four other republics of the Socialist Federal Republic of Yugoslavia (Slovenia, Croatia, Bosnia-Herzegovina and FYR Macedonia) became independent states. Montenegro accounts for 6 per cent of the total population of FR Yugoslavia of 10.5 million. The populations of Vojvodina and Kosovo, provinces of Serbia, each amount to about 2 million.

FR Yugoslavia's constitution limits federal responsibilities to foreign relations, including foreign trade, defence, monetary/exchange rate policy, and customs. Any powers not vested in the federation are constitutionally allocated to the member republics that have residual jurisdiction. At present, the federal government exercises these powers fully only over the territory of Serbia – excluding Kosovo which has been under UN administration since 10 June 1999. The federal government has very limited powers over Montenegro, whose government has taken over most of the responsibilities for foreign relations, monetary/exchange rate policy and customs.

War and economic sanctions

In May 1992, the UN Security Council imposed economic sanctions (embargoes on trade, travel, and transportation) on FR Yugoslavia for its involvement in the war in Bosnia-Herzegovina and Croatia, and tightened them in April 1993. Following the signing of the Dayton agreement – setting a framework for peace in Bosnia-Herzegovina – the sanctions were suspended by the UN Security Council in November 1995 and lifted in October 1996. However, the US and other countries maintained an "outer wall" of sanctions – affecting membership in some international institutions – until the Yugoslav authorities would cooperate with the war crimes tribunal in The Hague and address concerns about human rights in Kosovo and succession issues of the former Socialist Federal Republic of Yugoslavia.

Owing to the escalation of tensions in Kosovo, in mid-1998 the US and the EU imposed bans on new foreign investment in FR Yugoslavia and on financial transactions by Yugoslav entities, while the EU revoked the trade preferences that it had earlier granted. The confrontation over Kosovo culminated in a NATO bombing campaign from March to June 1999, at which time the EU and the US also imposed a ban on oil sales. The EU sanctions were also observed by 14 other European countries. The sanctions eventually started being lifted in October 2000, following important political changes in FR Yugoslavia.

The political changes of 2000

Federal elections in September, followed by massive street protests, led to the downfall of the Milosevic regime and brought into power an 18-party reformist coalition, Democratic Opposition of Serbia (DOS), led by Vojislav Kostunica, who became the new President of FR Yugoslavia. With the governing block in Montenegro having boycotted the September federal elections, DOS, which won a majority of the votes, formed a coalition government with the Montenegrin Socialists on 4 November.

In Serbia, the Socialist government resigned under popular pressure, early elections were scheduled for 23 December, and an interim government was formed with representatives of the former regime and the reformist forces. Serbia's general election in December produced an overwhelming victory for the reformist 18-party alliance DOS over the Socialist Party of Serbia (SPS), led by the former president, Slobodan Milosevic. The DOS received 64.08 per cent of the popular vote and 176 seats in the 250-member parliament, more than enough to amend the constitution.

On 25 January 2001 the pro-reform government under prime minister Zoran Djindjic was sworn in. The new government consolidated its potentially disparate alliance by assigning powerful deputy ministerial positions to the leaders of four of its member parties and to the leader of the Hungarian minority in Vojvodina, which wants the restoration of the autonomy that the province enjoyed under the 1974 constitution.

In the first months since Mr Kostunica became federal president, the new authorities have stabilised the currency and made the dinar convertible, restored links with IFIs, secured some foreign aid to tide Serbia over its immediate difficulties, and made a start on liberalising foreign trade, freeing prices and bringing transparency to the federal finances. The 2001 federal budget is balanced and in real terms cuts spending by 15 per cent compared with 2000. It includes new taxes and provisions for improved revenue collection. Spending on defence, formerly a large share of the budget, has been reduced.

Economic and political challenges ahead

The new Serbian government faces the daunting task of rebuilding an economy that has shrunk to about half the size it was in 1990. It promises sweeping reforms to improve living standards, and aims to dismantle the state-run economy, introduce a transparent state budget, simplify the tax system, liberalise foreign trade (which is already partly done: part of the legislation was passed by parliament in December 2000, and another part is expected to be passed in late April or early May 2001), and crack down on smuggling and corruption. Serbia's sprawling industrial complexes and indebted banking system will have to be overhauled, and a legal and institutional framework established to make the country attractive to foreign investment. At the same time the government will try to provide a social safety net to soften the impact of market reforms on the poor. FR Yugoslavia is hoping for a Stand-by Agreement with the IMF to help it through its balance-of-payments difficulties and as a stepping stone towards renegotiating its enormous external debt with its foreign creditors. The government would prefer to change its privatisation practice (although there has been virtually no actual privatisation until now) and sell larger stakes in large companies through tender to strategic partners, while sharing the rest between the employees and citizens holding privatisation vouchers. The government has promised to design a medium-term economic recovery and transition programme by the end of April.

There are three specific challenges, concerning internal relations within FR Yugoslavia: the federal vis-à-vis the Serbian government, the constitutional relationship between Serbia and Montenegro, and the status of Kosovo. The federal and the Serbian governments have established mechanisms for joint preparation of new legislation and policy discussions. Nevertheless, it remains to be seen whether the governments will operate effectively as one group. One issue of potential disagreement concerns the extradition of suspected war criminals to the International War Crimes Tribunal in The Hague.

Montenegro has had a high degree of autonomy since 1998. Its coalition government boycotted the September 2000 federal elections. Montenegro has been represented in the past both in the federal parliament and government in Belgrade by pro-Milosevic elements elected by about 30 per cent of its population. A political dialogue is ongoing between Montenegro and Serbia to determine the nature of their constitutional relationship. The government of Montenegro had earlier taken some steps towards independence, but after the October events had agreed to defer the resolution of its status until after the Serbian elections of December and FR Yugoslavia's integration into international institutions. There are divided opinions in Montenegro itself over the issue of the constitutional status. The coalition government collapsed in December 2000. New elections in Montenegro have been called for 22 April 2001 and may be followed by a referendum on Montenegro's constitutional position in relation to Serbia.

Since the withdrawal of Yugoslav troops in the summer of 1999 Kosovo has been controlled by the NATO-led Kosovo Force (KFOR) and, following UN Security Council Resolution 1244, administered by the UN Interim Mission in Kosovo (UNMIK), currently headed by former Danish defence minister Hans Haekkerup who replaced Bernard Kouchner on 15 January 2001. Internationally-supervised municipal elections in Kosovo in October 2000 produced a large majority for the Democratic League of Kosovo (LDK), led by Ibrahim Rugova, a moderate Kosovo Albanian leader. Fighting took place between Albanian guerrillas and Serbian police in early 2001 in three largely Albanian-inhabited districts of southern Serbia contiguous to Kosovo (the Presevo valley). The reaction of the authorities in Belgrade to these events has been constructive and restrained, and was commended by the international community.

International relations

International sanctions began to be lifted immediately after the recognition on 6 October of Vojislav Kostunica as the duly elected successor of Slobodan Milosevic as president of FR Yugoslavia. The EU oil embargo had already partly been lifted for opposition-run authorities and was fully lifted on 9 October. The EU ban on commercial flights, which had been suspended from 14 February 2000 to allow Serbs not connected with the regime to travel, was lifted on 9 October as well. On the same day the EU decided in principle to lift all trade and financial sanctions but to maintain the ban on any dealings with firms other than those that had proved in advance that they had no connections with the old regime and therefore were on the EU "white list". This white list no longer exists. The other 14 European countries which had observed the EU sanctions followed suit. The US lifted the oil and flight ban in October 2000 and the trade and investment and visa bans in January 2001. Japan lifted its sanctions on 22 December.

Following the lifting of the oil embargo and flight ban, the US and the EU have moved quickly to provide aid to Serbia to cover budget commitments and humanitarian needs. The US government pledged US$ 100 million to assist Serbia in meeting its immediate spending needs. The EU in October 2000 formally agreed to provide € 200 million in emergency aid to Serbia for 2000, earlier announced by EU leaders at their Biarritz summit (see *Multilateral and other sources of funding* on page 17).

At its November 2000 summit held in Zagreb (Croatia), the EU made a commitment to Croatia, Bosnia-Herzegovina, FR Yugoslavia, FYR Macedonia and Albania to help them become potential candidates for membership, provided they are good neighbours, respect international obligations, work together towards greater economic cooperation and in fighting corruption and crime.

On 26 October FR Yugoslavia joined the Stability Pact for South-Eastern Europe. On 2 November, after dropping Milosevic's insistence that it had the right to the seat occupied by the former Socialist Federal Republic of Yugoslavia, FR Yugoslavia was admitted as member of the UN. The country joined the Organisation for Security and Cooperation in Europe (OSCE) on 27 November. FR Yugoslavia applied to join the Council of Europe during President Kostunica's visit to Strasbourg on 9 November and subsequently submitted documents for admittance. An application to join the WTO was presented on 23 January 2001.

Important diplomatic steps in November included the country's membership in the Central European Initiative and the Adriatic-Ionian Initiative. Full diplomatic relations were established with Bosnia-Herzegovina and Slovenia, and relations with the US, the UK, Germany and France, broken off in 1999, were renewed in mid-November. Diplomatic relations with Albania were re-established on 17 January 2001 .

On 14 December the EBRD announced that it had admitted FR Yugoslavia as a member state, being the first IFI after the October elections to approve membership of the country, which became effective in January 2001, making FR Yugoslavia the 27th country of operation. The EBRD's step was followed shortly afterwards by re-admittance to the IMF, which announced the new Yugoslav membership on 20 December. World Bank membership will be feasible once the problem of FR Yugoslavia's US$ 1.7 billion debt to the organisation is resolved, which is expected to occur in mid-2001.

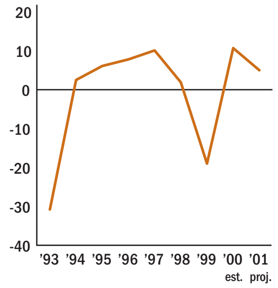
The downfall of the old regime ushered in a new, more hopeful period both for FR Yugoslavia and for the whole south-east-European region. Foreign assistance in helping FR Yugoslavia through the initial crisis is crucial and has been forthcoming. Continued foreign assistance will be required to fully return FR Yugoslavia into the European and world economy.


This map has been prepared exclusively for the convenience of readers. The denominations used and the boundaries shown on this map do not imply any judgement on the legal status of any territory or any endorsement of such boundaries.
4847 IP01 Yugoslavia map
Hungary
Pécs
Szeged
Subotica
Senta
To Arad
Kikinda
Timisoara
Sombor
Sivac
VOJVODINA
Osijek
Vrbas
Croatia
Tisza R.
Danube R.
Zrenjanin
NOVI SAD
Romania
Vršac
To Zagreb
Šid
Ruma
Stara Pazova
BELGRADE
Sava R.
Danube R.
Obrenovac
Požarevac
Loznica
Mladenovac
Brza Palanka
Petrovac
Smed. Palanka
Valjevo
Velika Morava R.
Drina R.
Bosnia and Herzegovina
Ljubovija
Negotin
R. Danube
Bor
Rogatica
Kragujevac
To Sarajevo
Zaječar
Užice
SERBIA
Sarajevo
Kraljevo
Bulgaria
Ražanj
Zapadna Morava R.
To Sarajevo
Aleksinac
Knjaževac
Kruševac
Niš
Pljevlja
Pirot
Južna Morava R.
Žabljak
Novi Pazar
Leskovac
To Sofia
Kosovska Mitrovica
MONTENEGRO
Nikšić
Peć
PRIŠTINA
Priboj
KOSOVO
Vranje
PODGORICA
Tivat
Đakovica
Uroševac
Petrovac
Albania
Prizren
LAKE SCUTARI
ADRIATIC SEA
Bar
Shkodër
FYR Macedonia
To Tirana
Skopje
To Thessaloniki

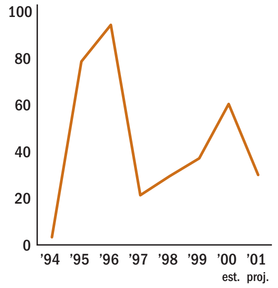
Economic summary

The regional war took an enormous toll on FR Yugoslavia's economy owing to loss of markets, the interruption of long-established production relations, and the implementation of crippling sanctions. The effects of these developments on the economy were aggravated by macroeconomic mismanagement, which in 1991-93, in the wake of the break-up of former Yugoslavia, resulted in hyperinflation and a virtual collapse of the economy. Following the adoption of a stabilisation programme in January 1994, a degree of financial stability with some output growth was achieved in 1994-98. However, the Kosovo crisis erased the modest economic gains of the previous five years and lowered potential output. The economy was put on a war footing, but emergency measures were unable to offset the impact of the imbalances in the external sector. The general economic decline resulted in a sharp increase in the level of poverty. After 10 years of regional conflicts, international isolation and absence of reform, the Yugoslav economy is in poor shape. The federal authorities and the central bank have been focusing on macroeconomic stabilisation, with some success so far. Structural reform, privatisation, liberalisation and institutional strengthening are the key remaining challenges.

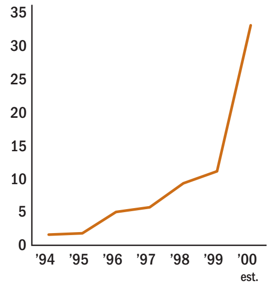
GDP
% change



Consumer prices
Annual average, % change



Exchange rate
Annual average, dinar per US$



Sources: various, March 2001

GDP

Reliable data on current economic activity are not available, but most estimates put GDP in 2000 at around US$ 10 billion, less than half the 1989 level. The fall of output in the official economy contrasts with thriving unrecorded economic activity, which is evident from the level of private consumption in major cities. Independent research on the informal economy estimates it to cover about 35-40 per cent of GDP, but even this may be an underestimate. Real GDP fell by 19 per cent in 1999 and as a result the proportion of the population living in poverty (US$ 60 or less monthly) doubled to two-thirds, according to UN estimates. Some recovery in the economy occurred in 2000, with growth for the year estimated at around 10 per cent, but the lack of investment and the crisis in the public finances are hindering a rapid recovery.

Inflation

Against the background of a demonetised economy and reduced aggregate supply, the inflation impulse stemmed largely from monetary financing of quasi-fiscal deficits. A pick-up in directed credits in the run-up to the September elections led to a rise in the 12-month rate of growth in currency in circulation from 32 per cent at the end of June to 58 per cent at the end of September, thus fuelling inflation. Since the elections, the new government has brought inflation under control. While it ran at about 100 per cent year-on-year after a burst of price liberalisation measures in October 2000, it is expected to fall fairly rapidly, most likely to an annual level of about 30 per cent, under the stewardship of a reformist central bank administration.

Exchange rate

The exchange rate has been unified, enterprises and individuals now have unlimited access to hard currency, and export surrender requirements have been abolished. The central bank has cut off credits to the bankrupt enterprise sector, has introduced partial currency convertibility and is implementing a "dirty" float, later to be replaced with a crawling peg. So far it is holding steady at around 30 Dinar to 1 Deutschemark. In late 2000, Montenegro adopted the Deutschemark as the sole legal currency in the republic.

Current account and trade balance

The economy suffers from severe fiscal and external imbalances, and has low but increasing levels of foreign reserves, covering about one month of imports. Under the Milosevic regime, large and persistent budget deficits were financed in part by monetary emissions by the central bank and the build-up of wage arrears in the public sector. The current account deficit was reduced due to a severe contraction in imports, but the isolation from the international financial community meant that the trade and current account deficits were being financed largely by one-off, usually short-term credits.

Government balance

General government revenue declined sharply in real terms in 1999-2000, by a cumulative 40 per cent. While in 1999 this was the result of the dramatic decline in output, in 2000 it reflected a decision to lower the tax burden so as to stimulate economic activity. The cash deficits of the consolidated general government were kept at low levels (0.2 per cent of GDP in 2000). In the last months of 2000, the sharp acceleration of inflation resulted in a further decline in real revenue and, hence, real expenditure. The fiscal deficit on an accrual basis in 2000 has been higher, at least 3 per cent of GDP. In Montenegro, the estimated consolidated general government deficit will be fully financed by grants from the US and the EU.

The 2001 federal budget is balanced. It includes new taxes and provisions for improved revenue collection. Defence spending, a large slice of the budget, has been cut. With the prospect of substantial short-term economic aid from the west, FR Yugoslavia should have a breathing space in which to put its fiscal affairs in order.

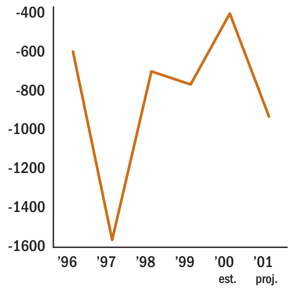
Foreign reserves

The net foreign assets of the National Bank of Yugoslavia (NBY, the central bank) were to be maintained at end-September 2000 levels at least until March 2001. There has been no creation of reserve money by the central bank since September 2000, reflecting not just increased external inflows but also some tentative signs of a return of confidence in the currency. Reserves should receive a further boost once an IMF Stand-by Agreement is in place.

Foreign debt

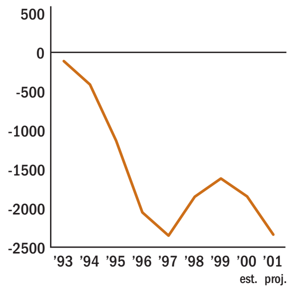
The country's external debt is estimated at about US$ 12.2 billion, more than 100 per cent of official GDP. FR Yugoslavia is in default of virtually all its foreign debts. The level of external debt is rising steadily, mainly through the build-up of interest arrears. Agreements on debt-rescheduling in principle were reached with the Paris Club and the London Club in 1998 on nearly US$ 4.6 billion and US$ 1.9 billion of debt respectively, but their implementation was blocked by the suspension of FR Yugoslavia's membership of the IMF, and by the Kosovo war. The authorities are keen to start fresh negotiations with creditors in 2001, once a Stand-by Agreement is reached with the IMF (which is expected in May), and will ask for substantial debt forgiveness. Negotiations with the Paris Club have already started.

Current account
US$ millions



Source: Office of the Deputy Prime Minister of FR Yugoslavia

Trade balance
US$ millions



Source: Office of the Deputy Prime Minister of FR Yugoslavia

General government balance
% of GDP

Sources: various, March 2001

Selected economic indicators

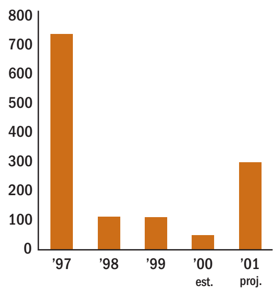
	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 proj.
GDP at constant prices (% change)	-30.8	2.5	6.1	7.8	10.1	1.9	-19.0	10.7	5.0*
Consumer prices (annual average % change)	na	3.3	78.6	94.3	21.3	29.5	37.1	60.4	30.0*
Current account (in US$ millions)*	na	na	na	-595	-1,562	-697	-764	-400	-929
General government balance (% of GDP)	na	na	-4.3	-3.8	-7.6	-5.4	-8.4	-3.7	na
Trade balance (in US$ millions)*	-112	-413	-1,135	-2,054	-2,352	-1,853	-1,619	-1,849	-2,339
Total FDI (in US$ millions, cash receipts, net)	na	na	na	0	740	113	112	50	300
External debt stock (US$ millions)	10,265	10,619	11,058	11,477	11,783	12,152	12,588	12,179	na
Unemployment (% of labour force)	23.1	23.1	24.6	25.7	24.5	25.1	32.6	40.5	na
Exchange rate, annual average, dinar per US$	na	1.6	1.8	5.0	5.7	9.3	11.1	33.0	na
Gross reserves, excluding gold (end-year, US$ millions)	na	200	300	300	300	200	300	524	na

Note: Data for 1993-99 represent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and the OECD. Data for 2000-01 reflect EBRD evaluations, partly based on information from these sources. From 1999 data from Kosovo are largely unavailable. Most estimates from 1999 exclude Kosovo.
** Source: Office of the Deputy Prime Minister of FR Yugoslavia*

Investment climate

The new authorities fully realise that the creation of a favourable investment climate to attract foreign investment into the crisis-ridden economy is vital for the macroeconomic stabilisation of the county. They promise sweeping reforms to dismantle the state-run economy, privatise key enterprises, simplify the tax system, further liberalise foreign trade, and crack down on smuggling and corruption. Serbia's sprawling industrial complexes and indebted banking system will have to be overhauled, and a legal and institutional framework established to make the country attractive to foreign investment.

Total FDI
US$ millions, cash receipts, net



Source: various, March 2001

Socially-owned enterprises dominate the Yugoslav economy, although there is a growing minority of grass-roots privately owned companies. FR Yugoslavia's unique system of social ownership has resulted in a myriad of competing sub-committees, bad management and lack of strategic planning. If a company's capital is socially owned and these socially owned companies are then split into smaller self-management groups, there is effectively no real owner and no one able to take strategic decisions. Ownership has been further obscured by a complex set of "ownership transformation" laws introduced over the last decade, enabling managers to transfer some of the most profitable parts of companies and form their own satellite businesses. Corporate governance issues are therefore a major concern for potential investors. Typically they are addressed in the companies' charters and to a lesser extent in the company law. The federal Enterprise Law applies to privately owned companies as well as to socially- and state-owned companies. The law distinguishes between partnerships, limited liability companies and joint stock companies.

Detailed plans are currently being drawn up by the new Serbian government in many areas of structural reform. Plans to improve the investment climate include the setting up of a new agency for the promotion of foreign investment, a one-stop shop for business registration and licensing, with detailed information for foreign investors, and new foreign investment and concession laws. A new Serbian privatisation law has been prepared in order to facilitate sales to strategic investors. The new legislation is likely to be submitted to parliament in late April or early May. However, the Serbian government may have to convince people that the benefits of privatisation outweigh the cost of abandoning popular concepts of "social ownership".

Privatisation

The privatisation of socially and state-owned companies is regulated at the level of the member republics Serbia and Montenegro. **Serbia** adopted a privatisation law in late-1997 (the Law on Ownership Transformation). The main deficiencies of this law were that each privatisation was initiated voluntarily by the enterprise itself, the procedure provided for free distribution of shares to management and employees in the first stage, and there was no possibility for direct negotiation with a strategic investor. New privatisation legislation, to be submitted to parliament this spring, will soon replace this law. Kick-starting privatisation is an urgent requirement, as the process has ground to a halt in the past three years.

The new Serbian government is currently revising its privatisation strategy with the assistance of the World Bank, the EBRD and the UK's DFID. It is planning to replace the existing law. Privatisation in Serbia was put on hold in February 2001 pending new legislation. The government plans to sell companies by tender to strategic partners, selling at least 70 per cent, and reserving the balance for employees and citizens. The challenge is to convince the politicians and citizens of Serbia that the new law will satisfy economic efficiency, dispose of state assets transparently and preserve workers' rights.

Privatisation revenues in 1998 were about US$ 100 million. Serbia might be able to raise around US$ 350 million in 2001 from the sale of its largest state assets. The firms likely to be easiest to sell would include cement and tobacco companies, Yugoslav Airlines, part of the oil industry and some chemical firms. Privatisation would greatly help to bring in foreign investors, improving prospects for capital investment and restructuring.

The Law on Privatisation of the Economy in the Republic of **Montenegro** provides for compulsory privatisation and the Montenegrin government is implementing a programme of public tenders for important enterprises to attract foreign strategic investors assisted by independent privatisation advisors. Montenegro initially launched its privatisation process in the early 1990s by transferring state-owned capital to a number of state funds. By the end of 1995 these funds had become majority shareholders in about 350 companies. A new privatisation plan in Montenegro was approved in 1998 and led to the establishment of a Privatisation Council. The plan, which is being implemented slowly, targets about 300 enterprises, most of which will be privatised either by a mass voucher scheme or by international tender.

Markets and trade

FR Yugoslavia's foreign trade deficit was just under US$ 2 billion in 2000, with total imports US$ 3.7 billion, and exports US$ 1.7 billion, although there is evidence of considerable under-reporting. In 1998 the deficit was similar but on much higher import and export totals (US$ 4.8 billion and US$ 2.9 billion respectively), indicating a considerable fall in activity. The country's main export partners were Bosnia-Herzegovina, Italy, FYR Macedonia, Germany and Russia. The main import partners were Germany, Italy, Russia, Bosnia-Herzegovina and Greece.

Full normalisation of economic relations with other former Yugoslav states followed the diplomatic recognition of Slovenia and Bosnia-Herzegovina in January 2001. Economic links had already earlier been improved with Croatia and Slovenia. On 16 November 2000 450 Croatian businessmen travelled to Belgrade to meet Yugoslav businessmen, ending a decade-long break in communications. Before the regional war started, trade between Croatia and Serbia (which were then in the same country) amounted to US$ 1 billion, but fell to US$ 50 million in 1999. For the first time in 10 years a Serbian bank (Komercijalna) and a Croatian bank (Privredna) offered banking transactions between the two states. Slovenia and FR Yugoslavia signed agreements to facilitate trade in early 2001. Vojvodina has opened a business representative office in Croatia, and Montenegro and Croatia are undertaking joint action in promoting tourism. Liberalisation of trade and investment between Bosnia-Herzegovina and FR Yugoslavia was announced after a meeting between the Yugoslav foreign minister and his Bosnian counterpart on 15 December 2000.

Budgets, taxes and social fund

The consolidated general government includes the federal government, the republican governments, the social security funds, the local governments and the special extra-budgetary programmes.

The main revenue sources for the federal government are the shared sales tax, excises and customs duties. All other taxes, including personal and corporate income taxes, social security contributions, property tax, and several surcharge taxes are levied at the republican level. The federal budget finances the federal army and the federal administration, and pays for part of the pensions of war veterans. It collects customs duties and shares the sales tax and excises with the republics.

The republican budgets finance the police, the republican administration, social programmes other than those financed by the social security funds, and a large portion of the expenditure on education. They collect the shared sales taxes and excises, personal and corporate income taxes, property tax, and several surcharge taxes.

The social security funds are organised at the republican level, and thus each republic has its own funds. There are three pension funds (according to the type of employment), a health care fund, and an unemployment fund. The funds collect the social security contributions and surcharge taxes.

In addition to the extra-budgetary funds, there are several extra-budgetary programmes that are typically financed by surcharge taxes. Some of the surcharge taxes are earmarked to certain social programmes in the republican budgets.

Montenegro has stopped contributing to the federal budget (customs duties, sales tax and excises that are collected in Montenegro are not transferred to the federal budget) and the federal budget has stopped contributing to the Montenegrin pension funds. Hence, the public finances of Montenegro are effectively separated from those of the rest of FR Yugoslavia.

Major sectors of the economy

In 1999 industry accounted for about 38 per cent of social product (SP, which differs from GDP in excluding government services), and agriculture about 25 per cent. Although the share of services has been growing over the past decade the country lags behind most other east European countries, because of the failure to restructure. Serbia's private sector accounted for slightly less than 40 per cent of SP in 1999, small by the standards of other east European states which are pursuing privatisation programmes.

Energy

Serbia's and Montenegro's energy ministries are responsible for regulation in the power sector, including pricing and policy implementation. There is no regulator and the present Electricity Law does not permit private participation in the sector. The sector comprises the vertically integrated utilities of Serbia (Elektroprivreda Srbije, EPS, 95 per cent of generation) and of Montenegro (Elektroprivreda Crna Gora, EPCG). FR Yugoslavia was the first east European country to join the European electricity grid (UCTE), but these connections were disrupted in 1991.

The power sector is characterised by depressed electricity prices, rising demand and deteriorating reliability due to ageing assets in need of rehabilitation and repair. Electricity demand is increasing as the fall in industrial consumption has been more than compensated for by increased residential heating consumption (61 per cent of demand), driven by low tariffs. Current tariff levels are inadequate to meet even the sector's salary requirements. The government of FR Yugoslavia is committed to gradually raising tariff levels, but affordability concerns are likely to temper the level and timing of increases. A three-step price increase will be introduced during 2001: 60 per cent in April, 40 per cent in June, and 40 per cent in October. An increasing block tariff has been introduced for better demand management.

Although the country was self-sufficient in electricity generation before the war, FR Yugoslavia now imports 23 per cent of its peak requirements. The transmission capabilities of EPS were sharply reduced by the bombing during the Kosovo conflict, and the company had to import significant amounts of electricity last winter. The financing for these imports was provided by the international donor community. Power shortages have been widespread during the winter and Serbia is currently relying on foreign aid in order to implement critical rehabilitation and maintenance.

The combined effect of war damage, limited access to imported equipment and financial constraints have depleted inventory, threatening the stability and capacity of the generation and transmission system. A related issue is the lack of maintenance, which is decreasing reliability. The transmission system in particular suffered extensive war damage, with an estimated 27 per cent of the network in need of repair or replacement.

The EU committed € 30 million for electricity imports for the winter of 2000-01. The German government has provided DM 30 million (US$ 12.86 million) to help solve FR Yugoslavia's power supply shortage under an agreement signed in November. DM 25 million was used to pay for electricity supplies and the remaining DM 5 million to import vital power generating equipment. From 14 November Germany started delivering 2.5 GWh/day to Serbia via Hungary, with the supply later increased to 7.5 GWh/day, and total deliveries amounting to about 100 GWh by the end of 2000.

The EBRD is considering a long-term sovereign-guaranteed loan of up to € 90 million to begin to meet emergency investment needs for EPS. The loan would finance rehabilitation and upgrades to the war-damaged transmission system and selected generation plants. The loan would complement € 80 million in donor grant funds being provided by the EU (the European Agency for Reconstruction) to finance emergency maintenance and repairs.

Oil and gas

Before 1999, FR Yugoslavia produced about 20,000 barrels of oil per day, or one-quarter of its annual requirement, from oilfields in Vojvodina, and imported about 54,000 barrels per day of crude from Russia, the EU, Ukraine, Bulgaria, China, Romania and Iraq as well as 11,000 barrels per day of oil products. The effects of sanctions and oil embargoes was exacerbated by aerial bombardment which caused severe damage to the country's two largest oil refineries (at Pancevo and Novi Sad), fuel storage facilities and regional distribution centres. Montenegro relies on imports from Greece, Italy and Russia. One of the priorities is reconstruction of the oil infrastructure – especially the refineries – as well as the restructuring of the sector in general.

FR Yugoslavia (excluding Kosovo) is expected to consume 2.4 billion cubic metres of gas annually, but domestic production will cover less than 25 per cent of demand. Local production was 624 million cubic metres in 1999, down from 687 cubic metres in 1998. The balance was imported from Russia. During sanctions the state-owned gas and oil company, Nafta Industrija Srbije (NIS), stopped searching for domestic gas reserves, owing to lack of funds.

The share of gas in the country's energy consumption is expected to increase from 15-20 per cent in 1997 to more than 30 per cent in 2020. This will depend on resolution of its payment arrears to Gazprom (Russia) or supplies from alternative sources. In December 2000 NIS signed an agreement with Gazprom to purchase 1.5 billion cubic metres of gas during 2001 with an agreed price of US$ 0.0012 per cubic metre. Serbia's new government has authorised NIS to negotiate with Gazprom. NIS plans to repay part of its gas debt through barter. In early 2001 NIS' debts for past combined gas and crude deliveries stood at almost US$ 300 million.

Currently, gas is imported from Russia via Hungary along the 500-kilometre main gas pipeline network. This was disrupted during the bombing when Hungarian state oil and gas company MOL came under pressure to cease deliveries.

Restructuring in the industry is likely to take place in the near future. This will be potentially focused on creating a number of more specialised entities such as:

- NIS Naftags, (production of oil/gas);
- refineries, potentially as part of one of the distributors (Jugopetrol or Naftagaspromet), and
- a gas network company covering the entire country.

The federal government has no authority regarding the energy sector. The government of the Republic of Serbia is currently investigating possible restructuring approaches. Restructuring is closely tied to the issue of energy consumption through government control over electricity and heating (both major users of gas), which operate under price controls.

NIS is continuing the search for foreign investors to renovate its infrastructure (in particular, the Pancevo and Novi Sad refineries). A possible partnership with Lukoil (Russia) was rumoured in the fourth quarter of 2000, but no action has taken place. Lukoil is one of the most active oil suppliers to FR Yugoslavia.

Transport

Within the Trans-European Network (TEN) of pan-European transport corridors, FR Yugoslavia is situated on corridors VII and X. Corridor VII is the river Danube. Corridor X has a branch running from Salzburg (Austria) via Ljubljana (Slovenia), Zagreb (Croatia), Belgrade, Nis and Skopje (FYR Macedonia) to Thessaloniki (Greece). Corridor X's branch B runs from Budapest via Novi Sad to Belgrade while branch C runs from Nis to Sofia.

FR Yugoslavia enjoys a prime crossroads location at the heart of the Balkans, being the quickest road link between western Europe and the Middle East, but has been unable to capitalise on its geography over the past decade. Serbia has traditionally earned significant revenues from the transit of goods, while countries to the east and south – such as Bulgaria, Romania and Macedonia – rely heavily on routes through Serbia to get their exports to west and central European markets. Rebuilding bombed bridges over the Danube and clearing the debris is a major priority for Bulgaria and Romania, whose producers have been unable to use the cheap transit offered by the waterway for well over a year.

Much of the country's transport infrastructure is in very poor condition. Investment in maintenance and replacement has been minimal over the last 10 to 15 years, while NATO bombing in 1999 caused significant damage to road, river and rail routes. The combined costs due to lack of maintenance and damage from the recent bombing to infrastructure, including industrial facilities, are in the order of US$ 3-4 billion. Upgrading of roads, railways and bridges not yet repaired is an urgent requirement for FR Yugoslavia and for the neighbouring countries. Billions of dollars of investment for repair and modernisation will be required for years to come for the country to become a regional transport hub.

Railways

In 1998 FR Yugoslavia had 4,059 kilometres of railway track, of which one-third was electrified, 3,809 kilometres in Serbia and 250 kilometres in Montenegro. Because of inadequate investment in maintenance and modernisation, as well as serious damage caused by NATO bombing, railway infrastructure performance has deteriorated markedly over the past decade.

The efficiency and effectiveness of FR Yugoslavia's railway in handling transit traffic will be critical to the overall success of rail transport in south-eastern Europe as it provides the shortest path for heavy freight transport both within the region as well as between the region and western Europe and Turkey. A proposed high-speed trans-Serbia railway connecting Subotica, near the Hungarian border, with Dimitrovgrad on the Bulgarian border (504 kilometres), and with FYR Macedonia, would link central and western Europe with Turkey and Greece, but would require at least US$ 3.5 billion of investment.

The railway's long-term sustainability will require early restructuring of the railway company to bring market focus to the freight business and to boost labour productivity in all rail functions. Investments in rolling stock rehabilitation, rather than in general infrastructure, take priority. These investments appear most urgent and would provide the railway with quicker returns through cost savings in fuel, maintenance and reliability improvement. Essential repairs of damaged bridges need to be financed urgently to overcome traffic bottlenecks.

Aviation

FR Yugoslavia is a key route for overflights to and from Greece and the Middle East. As air traffic over the country is projected to increase, the country's air navigation system (ANS), including its air traffic control, will need modernisation to ensure the continuation of safe and efficient service. Priority will be given to the replacement of worn-out traffic control and communications equipment and navigation aids at major airports.

Although the Yugoslav Federal Air Traffic Control Authority, the agency responsible for air navigation, charges for the services it provides to overflight and itinerant aircraft, it historically has not had sufficient access to these revenues to finance equipment replacements.

Telecommunications

During the war the telecom infrastructure was severely affected in some parts of the country. Three satellite earth stations, many microwave towers and technical buildings were destroyed. As a result, access to the network and quality of service are very poor for both fixed and mobile networks. Telecom Srbija, the national fixed line operator in Serbia, estimates the cost of restoring and modernising all the damaged telecom facilities (including Kosovo) at almost US$ 2 billion.

The Serbian government has expressed its interest in establishing a modern telecommunications regulatory framework and, if possible, to bring existing contractual relationships into line with international best practice. A new telecommunications act is likely to be passed by parliament in May, and an Independent Regulatory Agency is to be established shortly afterwards. Licences granted in Serbia in the past five years to fixed and mobile operators have created long term monopolies, apparently with no development or quality of service obligations, creating obstacles to future market liberalisation. Most notably, 49 per cent of Telecom Srbija was sold in 1997 to a consortium of OTE (Greece) and Telecom Italia. Telekom Srbija operates both fixed and mobile networks. The second mobile operator, Mobtel, is controlled by Serbia's largest business empire, BK Group.

A consortium including Siemens and Deutsche Telekom (both Germany) has won a contract tendered by the European Agency for Reconstruction to rebuild the telephone network in Pristina, the capital of Kosovo. The telecommunications company in Montenegro is expected to be offered in a public tender in 2001 together with a newly established mobile company. A telecoms regulatory authority has already been established in Montenegro.

Municipal infrastructure

After years of neglect, mismanagement, low maintenance and civil war, followed by further damage during NATO bombing, investments in the areas of water supply, waste-water treatment, urban transport, solid waste management and district heating are urgently needed.

Montenegro has chosen consortium Aquamundo (Germany) to improve the water supply on its coastal belt. The project is to be financed with DM 40 million in aid from Germany. Aquamundo is a joint venture between Asea Brown Boveri (Sweden/Switzerland), Bilfinger & Berger subsidiary BOT, and MVV Energie (both Germany).

A World Bank project in Kosovo is piloting reform in the water sector in the Gjakove-Rahovec area. The urban water supply improvement component includes urgent infrastructure repairs, management improvement, and an infrastructure improvement fund. The project also includes an integrated water resources management component.

In early February 2001 it was agreed that the EBRD and the local counterparts would begin immediately to develop a multiple city Municipal Infrastructure Reconstruction programme in FR Yugoslavia. In Serbia, the EBRD is considering projects in the cities of Belgrade, Novi Sad and Nis. The EBRD would propose as a programme model similar projects which it is running in FYR Macedonia and Romania. All these programmes were supported with substantial grant financing from bilateral and multilateral donors.

Agribusiness

The agricultural sector plays a very important role in the economy. About one-fifth of the population lives off agricultural income and output from this sector accounts for approximately one-quarter of GDP. Eighty per cent of arable land is in private ownership but much land remains uncultivated because of outdated machinery, shortages of key inputs and low profitability.

Agriculture had an unusually bad year in 2000, owing to the former government's policy of keeping food prices low, and to dry weather conditions. The drop by more than half in overall grain, oilseed and maize production would have an effect on stock feed, were it not that the general agricultural crisis is also causing a fall in livestock numbers as farmers slaughter herds they cannot afford to feed. The wheat crop is estimated at 1.6 million tonnes, the lowest for 10 years. The previous government ran down wheat stocks during mid-2000.

The new authorities have appealed for aid in kind to build up stocks in order to prop up market prices and prevent farmers from going bust. The new government welcomed liberalisation of access to EU markets from 1 December 2000 for 95 per cent of Yugoslav products, but the federal agriculture minister expects there will be little to export before 2002. FR Yugoslavia exported US$ 251.4 million in farm produce between January and October 2000, only 59.3 per cent of the annual target. Farmers are also facing problems with fuel and fertiliser supply, as well as with an urgent need to replace old machinery. One of the reasons for the deteriorating agricultural performance is the country's outdated farm machinery. The tractors now in use are on average 20 years old.

Food processing

The Yugoslav agribusiness industry has a strong tradition, particularly in the north of the country with many companies reported to have successfully exported products on the international market. However, since the beginning of the 1990s there has been a lack of bank or other financing for either short or long-term maturities. This has meant that the corporates in the sector have had to finance capital expenditure programmes through internally generated cash flows. Most corporate entities have yet to finalise their privatisation programmes and have unclear ownership structures which significantly complicates their potential privatisation.

Under the previous government there has been a significant loss of export markets due to sanctions, the imposition of state control on some prices and a nation-wide upheaval of distribution networks. More recently there has been a move to liberalise prices and companies are re-establishing traditional trading relationships. However, access to credit remains extremely limited due to the lack of effective banks.

Cement

Cement is a vital product in a country destroyed by war and in urgent need of rebuilding housing and infrastructure. Development of the building materials sector is an economic priority and there is already more activity in cement production than in many other sectors. FR Yugoslavia offers opportunities from potential privatisations of state-owned cement companies.

The previous government tendered the cement maker Fabrika Cementa Beocin and awarded the tender to Lafarge (France). However, the deal was never concluded and the new government must decide whether and how to proceed. Two other cement plants, including Popovac, are expected to be among the first large enterprises to be privatised under the new privatisation law. Large building material internationals including ALAS International AG (a joint venture of Alpine Bau and Asamer & Hufnagel, Austria), Lafarge, Heidelberger (Germany), Italcement (Italy), and Titan (Greece) may decide to participate in the (re)tenders for Beocin and Popovac. Lafarge's acquisition of 77.4 per cent of Blue Circle Industries (UK) is likely to intensify competition in the Balkans between Blue Circle's Greek subsidiary Heracles and its main competitor, Titan. Heracles is market leader in the Greek cement sector, while Titan, the second largest, has two factories in FYR Macedonia and Bulgaria and is likely to expand activity to FR Yugoslavia.

Holderbank Financiere Glaris Ltd (Switzerland) in July 2000 signed a 10-year lease on the Sharr cement plant in Djeneral Jankovic, the largest cement plant in **Kosovo**, representing the first FDI to go into Kosovo since the war. Under the agreement, cement producer Holderbank will not acquire the plant's assets, but lease the site and take operations management control. Holderbank will invest DM 34 million (US$ 16.5 million) in new equipment for the plant to increase production to full capacity and will finance training programmes and environmental protection measures.

Financial sector

The central bank and banking laws, including the Bank Rehabilitation and Deposit Insurance Laws, are relatively new and provide all the tools needed for monetary policy and bank supervision and resolution, but have yet to be fully implemented.

Banking sector

About 80 per cent of the banking sector in FR Yugoslavia is owned by enterprises under social ownership (the “old” banks), with private ownership accounting for the remaining 20 per cent of capital (the “new” banks). The largest (“old”) bank, Beogradska Banka, accounts for 37 per cent of total capital in the sector. Thirty banks accounting for 70 per cent of banking system assets are insolvent. Moreover, the banks’ reported capital is unreliable and probably overstated, owing in part to the common practice of reporting accrued interest of non-performing loans as income.

Confidence in the banking sector is very low, a legacy of the freezing of foreign currency deposits and several pyramid scheme scandals in 1992-93. In the Serbian banking sector, an estimated 50 per cent of the loan portfolio is non-performing (80 per cent in the biggest four banks). Many banks (particularly state-owned banks) will also have the problem of frozen foreign currency deposits and liabilities to deal with. Also, many state-owned banks are likely to have been stripped of cash under the Milosevic regime. It is therefore possible to contemplate the closure of existing large banks without dramatic social consequences.

While the larger state or socially owned (“old”) banks are virtually bankrupt, the “new” banks which are solvent tend to be very small. These small private banks have limited capacity to provide loans either to large companies or to SMEs in any significant number or volume relative to the needs of the economy.

The banking sector in FR Yugoslavia has suffered from the years of isolation and their damaging effect on the economy. Of the “old” banks, some may be subject to a rehabilitation programme, but most may be closed down. The government has not yet articulated a strategy for this process although advisors to the National Bank of FR Yugoslavia (NBY, the central bank) are preparing an initial audit and categorisation of individual banks according to their financial condition. A detailed plan will be in place in mid-May.

Foreign banks

Some foreign banks have already been granted a licence and several others have shown some interest in entering the market. Several foreign banks have visited FR Yugoslavia to assess the banking sector and talk to some of the smaller banks. Société Générale (France) has formed the joint venture Société Générale Yugoslav Bank. Raiffeisen Zentral Bank (Austria) has a licence for greenfield operations.

Non-bank financial institutions

Insurance

The insurance sector is predominantly based on motor, third party, fire and theft, with little life insurance business at present. Currently the market is largely controlled by two state-owned companies.

Pensions

It is anticipated that the introduction of a three-pillar pension system will take a great deal of time to implement, and as such opportunities in this area will be probable only in the medium to long term.

SME financing and micro-lending

The development of SME financing programmes is crucial for the private SME sector. The most effective and sustainable manner in which to provide an environment where SMEs have access to medium-term financing is through the establishment of a strong and stable private banking sector. However, currently the banking sector is dysfunctional and unable to attract new deposits, nor can it provide adequate capital as a basis for any meaningful financing to the SME sector. The entry of foreign banks will take some time to emerge.

The EBRD will approach bilateral donors for contributions to a new FR Yugoslavia SME facility to provide technical cooperation, both directly for SMEs and for local banks with SME clients. The facility would aim to support the institutional development of local banks whose operations and business plans are oriented towards SME lending, and which would provide a “delivery mechanism” for medium-term SME loans. At the same time, resources would also be mobilised to support SMEs directly in their preparation of suitable investment and loan proposals to the local banks, thereby encouraging the sort of relationship between banks and their clients that is typical of normal market economies. The EBRD would also consider, if necessary, direct financing of SMEs, provided such exposure was shared with a local bank.

There is already a strong micro-finance culture in the country. Most of the banks, both "old" and "new", acknowledge a strong need and demand for micro-lending. As such there is an existing platform to develop this activity further.

The Microfinance Bank of the Federal Republic of Yugoslavia (MFB), one of the first EBRD initiatives to be realised, is a newly established bank providing financial services to micro and small enterprises. It opened on 9 April 2001 and started operations the day after. MFB is initially operating in Belgrade, Novi Sad and Nis, with nationwide expansion to follow as soon as possible. The founding shareholders, alongside the EBRD (33.3 per cent), are Commerzbank AG (Germany, 16.7 per cent), Internationale Micro Investitionen AG (IMI, Germany, 16.7 per cent), Nederlandse Financierings Maatschappij Ontwikkelingslanden N.V. (FMO, Netherlands, 16.7 per cent) and Kreditanstalt für Wiederaufbau (KfW, Germany, 16.7 per cent). The International Finance Corporation (IFC) has worked closely with the participating institutions on developing the project and has indicated an interest in joining the shareholders' group once FR Yugoslavia has become a World Bank Group/IFC member country.

In **Kosovo**, in January 2000 the same shareholders opened the Micro Enterprise Bank (MEB) Kosovo in Pristina, which started lending in April 2000. By the start of 2001 it had made 806 loans for US$ 4,824,937 (€ 5,185,842). MEB's paid-in share capital is DM 4,500,500, well above the minimum equity requirement of the UNMIK Banking and Payment Authority in Kosovo. The EBRD is a shareholder in MEB Kosovo through its equity participation in MEB Bosnia and Herzegovina. MEB Kosovo has branches in Prizren, Peje, Gjakove, and Gjilan. Two other branches will soon open in Mitrovice and Ferizaj.

AREF (Albania Reconstruction Equity Fund) Kosovo Branch is a venture capital fund established to provide equity financing to support SME development. (See *Multilateral and other sources of funding: EBRD* below.)

The **South-East Europe Enterprise Development** (SEED) is an IFC initiative designed to support the development of SMEs in south-eastern Europe (Albania, Bosnia-Herzegovina, FYR Macedonia and Kosovo). By December 2000 funding commitments totalled US$ 20 million, with a further US$ 13 million to be secured over the five-year life of the programme. The IFC is providing funding and also the management team to implement the SEED. Main aims include outreach to regional investment funds for potential pipeline development, investment preparation and post-financing services, creation of business centres to support Internet-based learning among SMEs and their support institutions, development of advocacy groups for SMEs, local training and technical assistance towards developing a local consultancy capacity for SMEs, and development of enterprise zones, and leverage of undisbursed international funds towards SME development. The SEED has already been active in Kosovo to support the implementation of a joint World Bank/EU funded credit line, and undertook analysis of two local SME databases as part of credit line preparations. A pipeline of 17 potential projects was identified. The SEED plans to establish long-term relationships with high potential companies from the pipeline, and to offer a training programme to the rest. It is also developing a strategy for catalysing other equity/debt funds available in Kosovo.

Multilateral and other sources of funding

After the "October revolution", the EU and the US moved quickly to provide aid to Serbia to cover budget commitments and humanitarian needs. The EU supplied an Emergency Assistance Package worth € 200 million and the US government provided US$ 100 million worth of aid. Several governments started offering bilateral emergency assistance at an early stage as well. Of the IFIs, the IMF granted an Emergency Post-Conflict loan of US$ 151 million, of which the government used US$ 130 million to eliminate its arrears to the IMF. The EBRD is in the process of implementing its first projects in FR Yugoslavia, while the EIB will begin operations at a later stage. The World Bank will start operations in Serbia once negotiations on clearing arrears of US$ 1.7 billion are finalised, expected by mid-2001. Both bilateral and multilateral development programmes have been underway in Montenegro and Kosovo since the end of the Kosovo war. A first donor conference to coordinate assistance to Serbia will be held in the near future.

EU assistance

Although FR Yugoslavia had not, under the Milosevic regime, respected the conditions (respect for democracy, human and minority rights, etc.) which would enable it to benefit from large-scale EU assistance, it had received considerable assistance through the EU's programmes of humanitarian aid and support for democratisation and independent media. In addition, FR Yugoslavia was eligible for support under the EU-OBNOVA reconstruction programme. This support was, in practice, only given to Montenegro and Kosovo, but since 1999 has also been used for the "Energy for Democracy" and "Schools for a Democratic Serbia" programmes within Serbia (see *EU support to Serbia* below).

ECHO

The EU's Humanitarian Aid Office (ECHO) has since 1992 been providing humanitarian assistance – which is not subject to political conditionality – to three main target groups: refugees from the conflicts in Bosnia-Herzegovina and Croatia, internally displaced persons from Kosovo and the most vulnerable groups such as social cases and the elderly, and medical institutions. Assistance includes shelter, food, medicines, water supply and sanitation. Since the beginning of 1999, ECHO has donated € 378 million in emergency humanitarian assistance to the region affected by the Kosovo crisis. ECHO financed operations in Kosovo itself, Albania, Montenegro and FYR Macedonia to provide assistance to refugees.

The **Stability Pact for South-Eastern Europe**, launched after the Kosovo war in July 1999, supports countries in south-eastern Europe in their efforts to foster peace, democracy, and respect for human rights and economic prosperity, in order to achieve stability in the whole region. The economic integration of the region, within itself and into the European and world economy, is a central objective under the Pact. Under the Pact's "Quick Start" package of urgent projects, the countries in the region can benefit from upgrading of crucial road and railway transport links and electricity transmission facilities.
Quick Start projects include emergency road rehabilitation in Kosovo and transport rehabilitation in Montenegro. Two regional projects included in the Stability Pact's Quick-Start package involve Serbia: the resumption of navigation of the Danube, after removal for a total cost of € 24 million of the three bridges destroyed in Novi Sad in spring 1999, and a Transport Infrastructure Regional Study to identify transport investment priorities in south-eastern Europe for some € 2.3 million.

EU support to Serbia before and after October 2000

In line with support for democratisation and human rights throughout the region, the EU has given support to NGOs and civil society actors in Serbia since 1994, in order to help them raise awareness about democracy, human and minority rights issues and to stimulate true civic values. Projects include promoting dialogue between the different ethnic communities in Kosovo, conflict resolution, training programmes for NGOs, awareness raising on the role of human rights in building a civil society, promotion of citizens, participation in local democracy projects, voter education, etc.

The EU launched an "Energy for Democracy" programme in the winter of 1999-2000 aimed at supplying heating fuel to Serbian towns in order to alleviate harsh winter conditions. After pilot projects in Nis and Pirot, the programme was extended to Kragujevac, Kraljevo, Novi Sad, Sombor and Subotica. Assistance to the energy sector forms one of the main pillars of the € 200 million EU Emergency Assistance Package.

This was outlined as a top priority in close consultation with the new federal authorities in Belgrade.

Before October 2000, the EU supported opposition-controlled municipalities in Serbia by providing cash to improve schools ("Schools for a Democratic Serbia") which are in strong need of basic maintenance and repairs. After the democratic change, the EU immediately extended this programme Serbia-wide, to all Serbian municipalities, as part of the € 200 million Emergency Assistance Package for FR Yugoslavia.

To take account of the 24 September 2000 municipal elections, the European Commission developed the programme "Towns for Democracy", similar to "Schools for a Democractic Serbia", for which all Serbian municipalities are now eligible, to provide basic municipal improvements and services.

EU support to Montenegro

In response to the difficult situation faced by Montenegro, the EU provided budgetary assistance to the Montenegrin government in order to cover social welfare payments to the most vulnerable households, to help fund electricity imports and to cover additional expenses linked to the displaced persons hosted in Montenegro during the Kosovo crisis in 1999.

As part of the Stability Pact's "Quick Start" projects defined at a Regional Donors Conference for South-Eastern Europe in early 2000, the European Commission is providing the funds for the reconstruction of a bridge over the Moraca river in downtown Podgorica and the rebuilding of the road to Podgorica airport and the airport junction.

The EU is providing technical assistance designed to institute economic reform in key areas, including tax policy, public administration and revenue collection. The EU stepped up its technical assistance programme to Montenegro in 2000, with advisors in the prime minister's office, the ministry of finance (revenue collection and reform of the tax system), the ministry of justice (public administration reform) and the statistics department.

EU support to Kosovo

The EU – both its member states and the European Commission – is playing a prominent role in the reconstruction of Kosovo. Some 36,000 soldiers from EU nations are serving as members of KFOR, some 80 per cent of the total force. Some 800 civilian police from EU member states are serving in Kosovo. Over 100 NGOs from the EU member states are working in Pristina and elsewhere. In 2000 the EU supported Kosovo with funds of approximately € 400 million.

Of the € 378 million that ECHO has donated since the beginning of 1999 in emergency humanitarian assistance to the region affected by the Kosovo crisis, € 112 million were spent on projects within Kosovo itself. After the refugee crisis was over and the vast majority of refugees and internally displaced people had returned or been repatriated, ECHO provided assistance to the most vulnerable within Kosovo and its focus was replaced on preparations for the winter period, implementing an emergency firewood and shelter material distribution plan for the whole province. ECHO is reducing its programmes in Kosovo substantially in 2001.

EC/World Bank Kosovo reconstruction and recovery programme

High level officials from more than 100 donor countries and international organisations met in July 1999 for a first donor conference on Kosovo. During the next donor conference in Brussels in November 1999 senior officials from 47 donor countries and 34 international organisations discussed Kosovo's medium-term reconstruction programme, prepared jointly by European Commission and World Bank experts in support of UNMIK. The donors pledged US$ 1 billion to kick-start the first phase of the programme, which covered recovery needs until December 2000. An additional conference on Kosovo was held in Pristina in February 2001.

In February 2000, the European Agency for Reconstruction took over the work of the European Commission's Task Force for the Reconstruction of Kosovo, which had been set up in July 1999 to launch the first phase of a major EU-funded programme of reconstruction in Kosovo pending the establishment of the Agency. The main focus of the Agency is on reconstruction and institution building. The implementation of projects is carried out in close cooperation with UNMIK (in particular its EU-led pillar in charge of economic reconstruction), other international agencies and donors active in the various sectors and with KFOR. Most of the funds available for reconstruction projects in 2000 through the Agency were spent on housing and energy and the remainder on road rehabilitation, water supply, health and economic development.

As part of UNMIK, the EU is in charge of rebuilding war damage and creating the framework for development of a market economy in Kosovo, requiring stable institutions, transparent rules and solid infrastructures. The EU pillar is responsible for:

- The Central Fiscal Authority: management and development of Kosovo's budget and public finances (customs service, tax authority).
- Public Utilities: repair and modernisation of electricity, water, heating and waste management.
- Trade and Industry: creating a legislative framework for the private sector, encouraging investment in industry, supporting the development of enterprises.
- Reconstruction: development of a reconstruction programme, coordination of international donors to maximise impact.
- Banking and Payments: coordinating the development of an effective, well-regulated financial sector, including banking and insurance.

IFI assistance

International Monetary Fund (IMF)

In 1992, the IMF acknowledged that the Socialist Federal Republic of Yugoslavia had ceased to exist and allocated the respective assets and liabilities of fund membership to the five successor states, Bosnia-Herzegovina, Croatia, FYR Macedonia, Slovenia and FR Yugoslavia. The electoral defeat of Slobodan Milosevic in October 2000 paved the way for FR Yugoslavia to rejoin the fund, but the country had to find a way to repay its arrears. FR Yugoslavia owed US$ 128 million to the IMF. The new government cleared its arrears with the IMF and re-gained membership in December 2000. It was immediately granted an Emergency Post-Conflict loan of US$ 151 million. The government has used US$ 130 million to repay the bridge loans it received from Switzerland and Norway to eliminate its arrears to the IMF.

The short-term stabilisation programme, which ran through the end of March 2001, paved the way for a comprehensive programme formulated in early 2001. The deputy prime minister of the federal republic and the governor of the central bank presented a Statement of Economic Policies to the IMF in December. The stabilisation programme called for tight fiscal and monetary policies and the introduction of a managed float with current account convertibility. FR Yugoslavia is hoping for a Stand-by Agreement with the IMF to help it through its balance-of-payments difficulties and as a stepping stone towards renegotiation of its enormous foreign debt. Banking reform will be one of the main issues on the agenda of meetings between Yugoslav officials and representatives of the IMF.

World Bank

The World Bank on 11 October 2000 spelled out a two-step approach to help revive FR Yugoslavia's economy. As a first step, it initiated preparations for membership by assessing the economic situation and exploring with the government options for the settlement of the US$ 1.7 billion arrears the country owes the World Bank. The bank is providing analytical and advisory support in partnership with the EU, the IMF and other international actors, and in connection with the Stability Pact for South-Eastern Europe. In the second phase, once FR Yugoslavia has rejoined the bank and the arrears have been settled, the World Bank would be able to provide new financing. Negotiations on clearing the arrears of US$ 1.7 billion with the World Bank are ongoing and expected to be completed in mid-2001. Membership is likely to be resumed before the arrears are cleared, in late April or May.

The World Bank has launched a US$ 30 million trust fund for FR Yugoslavia "with the urgent task of preparing a wide-ranging crisis programme for economic reconstruction and transformation into a market economy". This programme, in cooperation with the IMF and the EBRD, will be the basis for the donor conference scheduled in May/June.

The World Bank has been implementing projects in Kosovo since November 1999 when the first World Bank financed operation, in cooperation with the Kosovo Foundation for Open Society (KFOS), was the Kosovo Community Development Fund. Other projects included a Learning and Innovation Loan for an Education and Health Project. On 5 October 2000 the World Bank approved a credit which supports a pilot project to provide financing to SMEs in Kosovo. Another project in Kosovo is piloting reform in the water sector in the Gjakove-Rahovec area. The urban water supply improvement component includes urgent infrastructure repairs, management improvement, and an infrastructure improvement fund. The project also includes an integrated water resources management component.

European Investment Bank (EIB)

The EIB is well-placed to finance infrastructure projects in FR Yugoslavia by virtue of its long and successful experience of lending in the country from 1977 to 1990. Subject to the necessary green light from the EU, the EIB will as soon as possible commence operations in FR Yugoslavia, once problems with arrears will be solved. EIB operations will focus on the transport and energy sectors.

European Bank for Reconstruction and Development (EBRD)

On 14 December 2000 the EBRD announced that it had admitted FR Yugoslavia as a member state, being the first IFI after the October elections to approve membership of the country. The membership became effective in January 2001, making FR Yugoslavia the EBRD's twenty-seventh country of operations. The EBRD, as the first IFI able to commit long-term investment funds, has decided to work on a relatively small number of high impact projects which have a strong likelihood of being approved and signed in 2001, while recognising that the range and pace of operations will depend on the implementation of reforms by the government.

The EBRD has outlined five areas in which it is focusing its initial support. It will:

- identify and support local creditworthy banks, with an emphasis on strengthening their institutional capabilities and providing funding to micro, small and medium-sized enterprises (see *Major sectors of the economy: Financial sector* above);
- fund export-oriented medium-sized and large companies undergoing privatisation;
- make infrastructure investments in the public sector, with an early emphasis on power, airport navigation and refurbishment, and railway rehabilitation;
- make loans to local municipalities for water supply, district heating and environmental services, while encouraging the setting up of a regulatory framework; and
- mobilise bilateral technical assistance funding to support enterprise and financial sector reforms, which are a prerequisite for increased foreign investments and efficient local financial intermediation.

These priorities do not intend to exclude possible transactions in property and tourism, telecommunications or other sectors where opportunities will exist, provided privatisation and legal reforms progress as planned. The amount of EBRD commitments in 2001 could vary from € 100 million to € 150 million. The EBRD's immediate objective will be to define specific projects with clear grant co-financing components for submission to bilateral and multilateral donors in time to be incorporated into their annual budgets for 2001 and well ahead of the planned donor conference to be held in May/June 2001.

One of the first EBRD initiatives to be realised is the Microfinance Bank of the Federal Republic of Yugoslavia (MFB). See *Major sectors of the economy: Financial sector* above.

EBRD assistance in Kosovo

The EBRD office in Pristina is fully operational. The staff consists of a local professional recently hired and a part-time office manager. The Head of Office for Albania and Kosovo is supervising the operation. EBRD investments in Kosovo are, however, directly dependent on the establishment of the legal framework for private sector development and effective management of non-private enterprises. The most important concern remains the issue of ownership (clear procedures and laws on property rights). The EBRD will closely monitor the relevant legal framework in Kosovo and its implications for the Bank's operations.

The EBRD has financed technical assistance for the design and evolution of a telecommunication policy in Kosovo, and has offered to organise a discussion with local authorities, consultants and interested companies.

The EBRD is closely monitoring the ongoing process of privatisation/commercialisation of state-owned companies. Under this framework the EBRD has developed contacts with the DTI (Department for Trade and Industry, UK) and other organisations and departments involved in the process and is closely following the tenders published and organised by the DTI.

The EBRD is involved in initiatives to provide financing for micro and small and medium-sized enterprises in Kosovo, including the Micro-Enterprise Bank (MEB) Kosovo. See *Major sectors of the economy: Financial sector* above.

AREF (Albania Reconstruction Equity Fund) Kosovo Branch is a venture capital fund established to assist business development in the local private sector in Kosovo. Its contributors include the EBRD, the Italian government and the Banca Popolare di Bari (Italy). The fund's budget consists of € 4 million available for investment and a € 850,000 technical assistance fund. The fund provides equity financing to support SME development. So far, two Kosovo-based projects have been approved by the EBRD board, firstly to provide a plastic bottle producer with the necessary finance to vertically integrate its production facilities (€ 500,000), and secondly to support the import and processing of a building materials company (€ 500,000).

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Main sources of bilateral assistance

United States

Following the October 2000 events, the US government provided US$ 100 million worth of emergency funding to **Serbia** to cover budget commitments and humanitarian needs. In **Montenegro**, USAID supports macroeconomic reforms and the development of the private sector in cooperation with the Montenegrin government. Projects include Macro Economic Reform, Industrial and Enterprise Development, Micro Enterprise Lending, Dairy Industry Development, Strengthening the Role of Private Enterprise, and Private Sector Economic Research.

In **Kosovo**, USAID has an Economic Reform Programme (ERP) and a Community Infrastructure and Services Programme (CISP). Through the ERP, USAID provides technical assistance to UNMIK's Kosovo reconstruction programme by assisting UNMIK in institutionalising stable macroeconomic policies and the formulation and full implementation of a market-friendly economic policy framework. USAID's Business and Enterprise Development programme focuses on revitalising agriculture and agribusiness and providing micro loans to individuals and small groups. The CISP, with a budget of US$ 40 million, is designed to revive and reactivate Kosovar communities through rehabilitation of infrastructure. Engineering firm Parsons (US) is implementing USAID's infrastructure repair programme in the Ferizaj region and the International Organisation for Migration is conducting USAID's infrastructure repair programme in the Mitrovice region in northern Kosovo.

Germany

The German Technical Cooperation Agency (Gesellschaft für Technische Zusammenarbeit, GTZ) began operations with **Montenegro** when the measures to be financed by the German contribution to the Stability Pact for South-Eastern Europe were determined. GTZ measures address support for the privatisation process, reform of fiscal law, promotion of the tourism sector, promotion of SMEs, reorganisation of commercial vocational education, and maintaining and modernising physical infrastructure.

Early GTZ-supported measures in **Kosovo**, financed primarily from bilateral emergency and refugee aid funds, focused principally on providing food security and supplying urgently needed equipment, especially to ensure at least a minimum standard for schooling and medical care for children. A German Office for Reconstruction and Development (GORED) has been established in Pristina under an agreement between the German federal ministry for economic cooperation and development, GTZ, Kreditanstalt für Wiederaufbau (KfW), and the investment and development company DEG (Deutsche Investitions- und Entwicklungsgesellschaft).

Besides special projects for the support of the university of Pristina and for capacity-building within the health system, GTZ projects are focusing on measures to develop and rehabilitate water supplies, road repair and maintenance, and solid waste disposal and to rehabilitate housing, as well as on measures to promote economic activity and employment, with components for promoting commercial and technical vocational training, SMEs, and agricultural production and marketing.

Japan

Following the political changes in October, the government of Japan decided to provide emergency aid of up to US$ 10 million of Official Development Aid (ODA) to FR Yugoslavia, including US$ 5.7 million in aid for refugees to be contributed through the office of the UNHCR. In addition, on 1 December the Japanese government decided to lift its freeze on providing FR Yugoslavia with bilateral aid. Another US$ 4.3 million of the US$ 10 million package was extended to purchase fertiliser for wheat.

United Kingdom

In **Serbia**, the Department for Foreign International Development (DFID) provided a £ 10 million emergency aid package to help fill any gaps before the full EC package was delivered. Since the election of President Kostunica, DFID has established an Aid Coordination Unit within the Serbian ministry of foreign economic relations and provided consultancy and advice on macro-economic reform, public administration, privatisation, banking and telecommunications. DFID also provided £ 3.4 million to pay arrears to family income support.

In **Montenegro**, DFID has approved a project to help develop legislation for utilities privatisation and is investigating projects to introduce VAT, a national audit office, banking reforms, IT systems for the share trading and registry systems, and support to the ministry of justice.

DFID's humanitarian and rehabilitation programme in **Kosovo** was delivered both directly and through UN and other agencies. Since the strategy shifted from immediate humanitarian aid, DFID has committed £ 5 million a year to a programme of focused technical assistance to support the long-term development activities of the international community. It supports Radio Television Kosovo, Pristina University Hospital, a programme of social protection (in liaison with the World Bank), development of payroll systems in the public sector and further assistance to public administration reform, public finance planning, customs service, road rehabilitation and housing.

Switzerland

Immediately after the political changes, Switzerland set up an emergency assistance package of about CHF 8 million, used for payments to the poorest pensioners and recipients of public relief and for the financing of fuel and drugs. In addition, Switzerland provided CHF 5 million for spare parts for urgent repairs to the electricity transmission and generation infrastructure. Switzerland intends to contribute to the reconstruction of basic infrastructure, again most probably in the electricity generation sector. The plan is to provide financial assistance of approximately CHF 15 million for rehabilitation of a power generation facility. Switzerland also intends to provide additional medium-term assistance in the private sector.

Switzerland supports FR Yugoslavia's cooperation with the IFIs. It has granted a loan for the financing of FR Yugoslavia's capital shares with the EBRD and has accepted the country as a member of its constituency at the bank. Switzerland also provided two bridge-loans to facilitate FR Yugoslavia's membership of the IMF.

Besides pure assistance, Switzerland intends also – within its general economic policy towards the region – to strengthen its economic relations with FR Yugoslavia. Since 1 April 2001 Belgrade has again been able to benefit from autonomous tariff preferences for developing countries (GPS). As soon as possible, Switzerland intends to conclude an agreement on trade and economic cooperation.

Canada

Canada has provided some US$ 40 million for FR Yugoslavia, US$ 37.5 million of which has gone to Serbia. In October the Canadian government supplied an initial package of US$ 10 million for humanitarian assistance and support for democratic development, which is being provided by the Canadian International Development Agency (CIDA). Canada is also involved in several international humanitarian aid programmes, such as a teacher training programme. Canada has made a US$ 1 million contribution to Serbia through the EBRD to strengthen SMEs and support the development of micro-lending institutions. It has contributed US$ 15 million to SEETEC, a project designed to help the region acquire the expertise, skills and tools to better meet/maximise electricity needs and implement viable reforms.

In **Montenegro**, Canada was represented in the OSCE election observation mission in June 2000 and is sending observers to the April 2001 elections. It has provided support for the OSCE's human rights office, a judicial reform project, the Local Initiative Programme, a US$ 1.5 million micro-credit programme targeting the rural population, and has contributed US$ 500,000 to the EBRD Trust Fund for projects in Montenegro. Canada has also provided US$ 2.5 million in humanitarian assistance to Montenegro.

Italy

The total amount of Italian bilateral funding committed for FR Yugoslavia is ITL 250 billion, of which ITL 58.5 billion were earmarked for the most urgent needs of winter 2000-01 and to help consolidate the democratisation process. The remaining sum of ITL 191.5 billion, for further interventions, became available from early in 2001. Furthermore, the Italian government is planning to commit ITL 31 billion for Kosovo and ITL 10 billion for Montenegro, on top of ITL 6 billion already disbursed. Total Italian bilateral commitments for Serbia, Montenegro and Kosovo therefore amount to ITL 297 billion.

Greece

During his visit to Belgrade in November 2000, the Greek finance minister Yannos Papantoniou approved a US$ 15 million emergency aid package, froze US$ 50 million of debt owed to Greek utilities, and offered help with fuel and pharmaceuticals over the winter.

Sweden

The Swedish International Development Agency (SIDA) is allocating considerable resources for humanitarian aid to the region following the Kosovo war. A large part of Swedish assistance to Kosovo focuses on rebuilding infrastructure and house reconstruction through integrated area programmes, with production of electricity and district heating having the highest priority. SIDA is financing the rehabilitation of the Kosovo B power plant, and the district heating distribution network in Pristina. SIDA has contributed SEK 35 million to destitute Serbs for the winter of 2000-01, aimed first and foremost at refugees from the Kosovo war. In Serbia, the projects are being implemented by the Swedish NGO PMU-Interlife and the Swedish Red Cross. In Montenegro the projects are being implemented by aid organisation Hoppets Stjarna (Star of Hope).

Netherlands

The Netherlands Programme for Cooperation with countries in central and eastern Europe (PSO) is operational in Montenegro, but not yet in Serbia. The ministry of international economic development is contributing, via co-funding from FMO, to the EBRD's Micro Enterprise Bank Kosovo which started lending in April 2000, and to a similar bank set up for FR Yugoslavia.

Notes