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Serbia 2006 Progress Report

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COMMISSION STAFF WORKING DOCUMENT

Serbia 2006 Progress Report

1. INTRODUCTION

1.1. Preface

Since March 2002, the Commission has reported regularly to the Council and the Parliament on progress made by the countries of the Western Balkans region.

This report largely follows the same structure as in previous years. The report:

- briefly describes the relations between Serbia and the Union;
- analyses the political situation in Serbia in terms of democracy, the rule of law, human rights, protection of minorities, and regional issues;
- analyses the economic situation in Serbia;
- reviews Serbia's capacity to implement European standards, that is, to gradually approximate its legislation and policies with those of the "*acquis*", in line with a Stabilisation and Association Agreement and the European Partnership priorities.

The period covered by this report is 1 October 2005 to 30 September 2006. This Report only covers Serbia. Issues related to the former State Union of Serbia and Montenegro are mentioned, where relevant. Kosovo, as defined by the UN Security Council Resolution 1244, is dealt with in a separate Progress Report. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are under preparation or await parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. In addition, many sources have been used, including contributions from the government of Serbia, the Member States, European Parliament reports¹ and information from various international and non-governmental organisations.

The Commission draws conclusions regarding Serbia in its separate communication on enlargement², based on the technical analysis contained in this report.

1.2. Relations between the EU and Serbia

The **Stabilisation and Association Agreement (SAA) negotiations** with Serbia and Montenegro were officially opened on 10 October 2005. Initially, substantial progress was

¹ The *rapporteur* for Serbia is Mr Kacin, MEP.

² Enlargement Strategy and Main Challenges 2006 – 2007.

made in these negotiations. However, this country did not meet its commitments on co-operation with the International Criminal Tribunal for former Yugoslavia (ICTY) and so the Commission decided to call off the SAA negotiations on 3 May 2006. The Commission stressed its readiness to resume negotiations as soon as full cooperation with the ICTY is achieved. The Council supported the Commission's decision. The Council has adopted amended negotiating directives for an SAA with Serbia, since Serbia has become the successor state of the State Union of Serbia and Montenegro³. At present, the SAA negotiations are still on hold. Serbia has nevertheless continued to benefit from Autonomous Trade Measures (ATMs) granted by the EU.

The Commission has continued to closely monitor the progress made by Serbia and Montenegro, notably in the context of the **Enhanced Permanent Dialogue**. Several sectoral groups have been set up to deepen technical discussions. After the end of the State Union, the Enhanced Permanent Dialogue has continued separately both with Serbia as well as with Montenegro. A **political dialogue** meeting at ministerial level between the EU and Serbia and Montenegro was held in February 2006. Two political dialogue meetings with Serbia also took place in July and October 2006.

In July 2006, the Commission proposed negotiating directives to the Council for visa facilitation and readmission agreements with Serbia.

A revised **European Partnership** was adopted in January 2006. Following the end of the State Union, some priorities have no longer become applicable or need to be interpreted in the light of the new situation. Most priorities that were addressed specifically to the two Republics remain valid. Serbia has been able to make progress in addressing a number of the short-term priorities and also some medium-term priorities, as a result of its good Action Plan for the implementation of the European Partnership.

Serbia has continued to receive substantial pre-accession **financial assistance** from the EU. In 2006, Serbia is getting €167 million. Serbia also benefits from regional and cross-border co-operation programmes.

2. POLITICAL CRITERIA

This section examines progress made by Serbia towards meeting the Copenhagen political criteria which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors regional cooperation, good neighbourly relations, and the respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia.

2.1. Democracy and the rule of law

Constitution

Following Montenegro's proclamation of independence on 3 June 2006, the Serbian Parliament adopted a decision confirming the status of Serbia as a successor state of the State

³ In its conclusions of 12 June 2006, the Council took note that Serbia was the continuing state of the State Union of Serbia and Montenegro in accordance with the Constitutional Charter.

Union of Serbia and Montenegro. The succession process has taken place in accordance with the State Union Constitutional Charter.

Serbia recognised Montenegro on 15 June 2006. Diplomatic relations were swiftly established. The resolution of issues between the two republics has been proceeding smoothly. The remaining issues concern citizenship rights and social security in particular.

Serbia has inherited the international legal personality of the State Union, its membership in international organisations as well as the participation in international treaties ratified by the State Union.

The end of the State Union made it more urgent the need for replacing the Serbian Constitution dating from the Milošević era. The parliamentary committee for constitutional matters was reactivated. It largely harmonized the two proposals put forth respectively by the Serbian Government and by the Serbian President. It included comments from the Radical Party. The new Constitution was adopted by the Serbian Parliament on 30 September and approved by referendum in late October. The adoption of a new Constitution is a welcome development. In particular, it contains detailed provisions concerning human rights and protection of minorities. It gives a constitutional basis to the Ombudsman. It provides for democratic civilian control over the military. Moreover, the new Constitution foresees a lighter procedure that may make it easier to adopt amendments in the future.

However, the final stage of the drafting process before parliamentary adoption took place without adequate public consultation. Moreover, the new Constitution presents some areas of concern, notably the lack of objective mechanisms free of political influence to appoint, promote and dismiss judges and prosecutors; the political parties' control over parliamentary mandates; the scope of territorial decentralisation; and the ambiguous relationship between domestic law and international law.

The future status of Kosovo will be determined by the political process established under the UNSCR 1244.

Overall, there has been progress in setting the constitutional framework after the end of the State Union. This constitutional framework needs to be soundly developed and implemented to strengthen democracy and rule of law, and to ensure its future compatibility with EU membership. *Parliament*

The Serbian Parliament has continued with intensive legislative activity. It has adopted 87 laws and a number of other legal documents. It has amended its Rules of Procedure to take over the competencies of the State Union Parliament, especially control of the military and international parliamentary cooperation. Parliament has become more transparent and open to the general public. Under the law on Free Access to Public Information, Parliament has started publishing a comprehensive information bulletin. The practice of publishing regular three-monthly reports has been maintained and the Speaker has continued to brief the media and the international partners regularly.

In November 2005, a new parliamentary Committee for Local Government was set up. The Committee for European Integration has continued its good work to implement the European Partnership. The Committee promoted the establishment of the parliamentary office for harmonisation with European standards. The activities of this Office are still at an early stage.

However, the operation of Parliament has continued to show weaknesses. Parliament still lacks specialised staff. Moreover, Parliament has executed party decisions depriving Members of Parliament of their mandates. The Democratic Party has continued to abstain from parliamentary works for reasons related to MPs' mandates, except on occasions involving issues of national interest (primarily Kosovo). In some cases, Parliament has not taken into account international standards when adopting new laws. It has often set too short periods of *vacatio legis* for new pieces of legislation. It has not respected constitutional and legal deadlines especially concerning the appointment of the Ombudsman. It also did not take action to prevent and sanction hate speech during parliamentary debates.

The election legislation has not yet been revised. There are a number of outstanding issues concerning election monitoring, updating of voters' registers and financing of election campaigns.

Overall, there has been intensive legislative work and more transparency, but there is scope for further improvement especially on the basis of the recently amended parliamentary procedures.

Government

There has been some improvement in the transparency of how the Government works. The Government published an information bulletin in line with the Law on Free Access to Public Information. Almost all Ministries have done the same. The Government has continued with the regular practice of reporting to the Parliament (*i.e.* to the European Integration Committee) on the activities within the European integration process, as stipulated in the 2004 Resolution on European Integration. The European Integration Office has continued its good work, mostly of a technical and coordination nature, to promote the implementation of the European Partnership. It has also supported the Serbian SAA negotiating team effectively.

The Serbian Government adopted decrees regulating general issues relating to those State Union institutions that have ceased to operate (Parliament, President, Court, Supreme Defence Council, Council of Ministers as well as the Council of Ministers services, including the Office for European Integration). The competences of the State Union Ministries for international and internal economic relations were taken over by the Serbian Ministries where relevant. The State Union Ministry for Human and Minority Rights was replaced by an Office under the Serbian Prime Minister and its competencies in the area of justice and home affairs were transferred to the Serbian Ministries of Justice and of Interior. Still, there are some outstanding issues such as the adoption of the amendments to the Law on Ministries aimed at institutionalising within the Serbian legal order the former State Union's portfolios of Foreign Affairs and Defence; the appointment of the relevant Ministers; the regulation of the takeover of the former State Union's legislation.

However, the lack of coordination within the Government has persisted. In May 2006 the Deputy Prime Minister and Chief Serbian Negotiator for SAA resigned in protest against the Government failure to comply with the ICTY that had led to the Commission's decision to call off SAA negotiations. A new Deputy Prime Minister was appointed in June. As the conditions for the resumption of the SAA negotiations were not in place by end of September, she resigned together with the ministers of her party.

Overall, there has been progress, but there is scope for strengthening policy co-ordination.

Public administration

The Public Administration reform – a key priority of the European Partnership - has continued. The new law on Civil Servants entered into force in July 2006. With the respective by-laws, it aims at ensuring merit-based recruitment and promotion. The law on salaries of civil servants was adopted in July 2006 to restructure the payment system.

During the SAA negotiations, Serbia has demonstrated a good level of administrative capacity. The relevant institutional setup – including the representatives of ministries, agencies and non-governmental organisations – has proven to be well established and effective.

A human resources management service was set up in December 2005 and is operative although its staffing is not yet complete. The Ministry of Public Administration has started transferring human resources management tasks to this service. This service is implementing a training programme for civil servants based on the training strategy adopted in 2005. Training on public management has been provided to a large number of staff. This has had a positive impact on Serbian administration.

The parliament has not yet appointed an Ombudsman as required by the relevant law. The Provincial Ombudsman in Vojvodina, established in 2003, reported that around 2,500 individual complaints were received in its second year of work (2005), which is twice as many as during the first year of its operation.

A new law on local government financing allows for greater fiscal decentralisation and enables poorer municipalities to receive a larger share of budgetary resources.

However, pending the full implementation of the public administration reform, remuneration and working conditions quite often remain unattractive. This makes it difficult to recruit and retain qualified staff. The issue of the civil servants of the former State Union remains to be fully addressed. General administrative procedures law has not yet been revised.

The line ministries still have widely varying capacities and resources to deal with European integration issues.

Concerning free access to information of public interest, the commissioner for public information has been very active. However, lack of enforcement remains a problem. In several cases, the authorities have not complied with the commissioner's requests.

New regulations on municipal property and management have not yet been adopted. Recently implemented laws on local government and on local elections proved to be deficient in a number of respects. This has affected the operation of municipal administrations, including sensitive multi-ethnic regions such as Sandžak and Southern Serbia.

Overall, there has been further progress in setting the legal framework for the civil service which is now in line with general European standards. Serbia has a good administrative capacity in a number of areas. This capacity needs to be further developed throughout the administration, including at local level.

Civil military relations

Serbia has taken over the State Union competences concerning the defence sector. The adoption of the revised law on ministries institutionalising the defence portfolio within the Serbian legal order and the parliamentary appointment of the Minister of Defence are still

pending. As foreseen in the then Serbian Constitution, the command of the armed forces was formally taken over by the Serbian President. The role of the President has been confirmed and expanded in the new Constitution.

After the end of the State Union, Serbia and Montenegro have been solving personnel-related issues as well as the issue of military assets.

The new Serbian Constitution sets the principle of democratic civilian control over the military. The recent amendments of the parliamentary rules of procedure give the parliamentary defence committee such responsibility. The reform of the military has continued but with difficulties and resistance from some elements within the Army, notably its security services. The Military Intelligence Agency and the Security Agency were reformed and placed under the direct supervision of the Minister of Defence. A report that was submitted to the State Union Council of Ministers in February 2006 confirmed the links between some army officers (mostly retired) and ICTY indictees. This has led to arrests and court cases against several former officers. The centre for the co-operation with the ICTY was established within the ministry of defence to improve co-operation with the ICTY.

The Government decided to transform military institutions that generate profit into companies. It decided to sell the surplus of immovable military property to finance the reform of the defence system. The Fund for Military Reform was dissolved and proceeds of privatisation are integrated into the state budget. Organizational changes within the Serbian army have continued, with the gradual replacement of conscripts with contract officers and the overall downsizing of the army.

The Ministry of Defence has established an Office for Liaison with the Parliament. The Ministry has started a practice of briefings for international partners.

However, pending the implementation of the new provisions, civilian oversight of the military - a key priority of the European Partnership - has remained insufficient, in particular parliamentary oversight. The State Union parliamentary committee has been ineffective. The work of Serbia's parliamentary Committees for Defence and Security was affected by the lack of adequate provisions in the Rules of Procedures. The Serbian Military Doctrine has not yet been approved.

Overall, civilian oversight has remained insufficient but the new Constitution and the revised parliamentary rules of procedures set out the bases for reinforcing such a control.

Judicial system

In May 2006 the Judicial Reform Strategy was adopted by the government and submitted to Parliament. Its aims are full independence of the judiciary, transparency, accountability and efficiency. The Government has adopted an Action Plan for the strategy implementation.

Amendments to the Criminal Code entered into force in 2006. A broad revision of the Criminal Procedure Code was adopted in May 2006, and is to come into force in June 2007. It introduces the prosecutorial-police model of investigation and modifies the present role of the investigating judge. The Law on education of judicial professionals has been adopted. This law strengthens the role of the Judicial Training Centre. Positive trends as regards speeding up of proceedings can be seen in commercial courts.

However, the reform of the judiciary – a key priority of the European Partnership – is still at an early stage. The independence of the judiciary is affected by political influence. The Strategy does not fully ensure permanent tenure of judges as it keeps a controversial probation term. It does not provide for an effective self-governing structure of the judiciary. In December 2005, the Parliament rejected 20 out of the 100 judges nominated by the High Judicial Council. The Judiciary committee of the Serbian Parliament has not been functioning properly, due to the lack of quorum. As a result some 40 judges that have fulfilled the legal conditions for retirement could not be relieved of their duties. This problem applies also to the State Prosecutor and Belgrade district Prosecutor.

The level of efficiency in the administration of justice is not satisfactory. The situation is particularly difficult as concerns civil cases. The lack of adequate financial resources coupled with the limited capacity of the judiciary contributes to inefficiency. In some criminal cases, misconduct in proceedings, even before the highest judicial instances, resulted in the prescription of legal action for serious criminal offences and the subsequent release of the offenders. In some high profile cases decisions were taken contrary to the established practice. The credibility of the judiciary is affected by corruption cases involving some of its highest instances.

Moreover, the Serbian judiciary has to cope with the backlog of the State Union Court. Over 4,300 unresolved cases are to be transferred to the Supreme Court of Serbia. The cases concerning compliance of by-laws with laws were transferred to the Serbian Constitutional Court.

The Government has proposed to further postpone the establishment of administrative and appellate courts to September 2007. Such a postponement will affect already inefficient proceedings, in particular before the highest judicial instances.

As regards the prosecutors, they were often exposed to political influence. The judicial reform strategy does not provide sufficient guarantees for an autonomous prosecution.

Since the new model of investigation under the revised Criminal Procedure Code gives the police and prosecution the leading role in the investigation and collecting the evidence, it is a matter of concern the fact that these new rules have been adopted in a situation where there are not sufficient constitutional guarantees as regards the autonomy of prosecutors. The new code does not fully comply with the Convention on legal assistance to which Serbia is a party.

The Specialised War Crimes Prosecution has not been given adequate support.

No efforts have been recorded to further develop the legal framework for witness protection in such a way as to ensure that the safety of vulnerable witnesses is appropriately balanced with the accused right of defence.

Overall, the judiciary remains in a difficult situation, although there has been some progress since the 2005 report. The judicial reform needs to be stepped up to ensure independence, efficiency and professionalism.

Anti-corruption policy

Serbia has continued to participate in the Council of Europe's GRECO initiative (Group of States against Corruption).

In October 2005, Serbia and Montenegro ratified the UN convention against corruption. In 2005 Serbia and Montenegro signed the Council of Europe civil law convention against corruption. The Serbian criminal Code which entered into force in 2006 has brought the wording of criminal offences closer to the Council of Europe's ratified criminal law convention against corruption.

The national strategy for fighting against corruption was adopted in December 2005. Some measures have been taken to fight corruption, in particular in the judiciary. At present, some judges including high level judicial officials are standing trial for corruption and abuse of office.

However, as acknowledged by the national strategy, corruption is perceived as widespread in Serbia. Relatively few cases are brought to justice. The Action Plan for the implementation of the strategy has not yet been adopted. The Law on the anticorruption body is still outstanding. A clear institutional setup and the role of existing bodies such as the anti-corruption council remain to be defined.

The implementation of the laws on conflict of interests and on the financing of political parties continues to face difficulties, notably concerning the inefficient mechanisms for sanctions. Around 40% of public officials failed to report on their assets and income, and a high number of political parties failed to submit their financial reports to the parliamentary committee for finances, within the set deadlines. Moreover, the issue of board membership in public companies for the members of Parliament has not been resolved.

Overall, there has been some progress since the 2005 report, but there is scope for improvement. Though most of needed legislative measures on anti-corruption are in place, the anti-corruption strategy needs to be implemented without further delay and for its efficient implementation a centralised specialised independent anti-corruption body has to be set up.

2.2. Human rights and the protection of minorities

Observance of international human rights law

Serbia and Montenegro was party to all major international human rights instruments. Participation in these conventions has been taken over by Serbia. Serbia has inherited the membership in the Council of Europe.

Serbia took over the office of a state agent before the European Court of Human Rights. Around 1,000 cases against the former Serbia and Montenegro are pending before the European Court of Human Rights. The first sentence against Serbia was pronounced in September 2006.

The European Charter on Regional and Minority Languages was ratified in December 2005 by Serbia and Montenegro.

The new Serbian Constitution provides for constitutional appeal. It also provides for direct applicability of ratified international treaties, including human rights conventions, while stating that these treaties must be compatible with the Serbian Constitution.

Serbia has as yet not ratified the revised European Social Charter and the European Conventions on Local Self-Government and on Trans-Frontier Co-operation. Serbia remains subject to the monitoring procedures of the Council of Europe. Since February 2006, the

frequency of the Committee of Ministers monitoring has been reduced from quarterly to bi-annually. This decision took into account the fact that the majority of outstanding tasks are of a longer-term nature.

Civil and political rights

In the area of the **prevention of torture and ill-treatment**, efforts to implement the European Convention for the Prevention of Torture have continued notably through training. The optional protocol was ratified by Serbia and Montenegro in December 2005. The definition of torture in Serbian legislation has been brought closer to international standards with the entry into force of the new Serbian Criminal Code.

The Committee for the prevention of torture (CTP) published a comprehensive report in May 2006 of its visit to Serbia and Montenegro in September 2004, noting in general good cooperation by the authorities and unhindered access to the facilities, except state security facilities. The Serbian Ministry of Interior established a commission that is charged with the implementation of the CPT recommendations.

However, the CTP May 2006 report also notes a number of shortcomings concerning ill-treatment by the police, pre-trial detention and prison conditions. Moreover, there continues to be reports of cases of ill-treatment by the police. Serbian has not yet fully complied with UNCAT recommendations on individual cases of torture.

The Office of Inspector General in the Serbian Ministry of Interior also continues to claim political obstruction and lack of ministerial support, including a lack of replies to the Office's inquiries and of information as to the enforcement of disciplinary measures. The role of the Office has been affected by the by-laws implementing the 2005 Police Law.

As regards **fight against impunity**, eight persons (including former police officers) were indicted in June 2006 in relation to mass graves identified in Serbia.

As regards **access to justice**, the new Criminal Procedure Code, coming into force in June 2007, prescribes mandatory defence in most serious cases. There are no specific provisions on mandatory defence in cases of pre-trial detention. The legislation on legal aid has not been adopted. At present, there are no clear mechanisms to secure coherent planning and management of legal aid or ensure its quality.

Efforts have been taken to improve the conditions in the **prison system**. There has been progress in the implementation of the legislation on execution of penal sentences and on juvenile offenders. The improvement and reconstruction of prison facilities is ongoing. A new facility for organised crime and war crime cases is under construction. The conditions for medical care have been improved. However, further efforts are needed to improve the security in prisons, in particular concerning the education of employees and rules of conduct and disciplinary procedures.

As regards **freedom of religion**, there have been some developments with the adoption of a new Law on Churches and Religious Organisations. However, this law does not meet some international standards concerning the registration of religious organisations, the powers provided by the law to state and religious authorities and the legal status of canonical acts and decisions.

Concerning **freedom of expression (including media)** the transformation of Radio Television Serbia and Radio Television Novi Sad into public services was completed in the second quarter of 2006. The process of frequency allocation was completed in April 2006.

However, there has been insufficient transparency and effective independence in the decision-making process concerning frequency allocation. The Broadcasting Council did not comply with the rulings of the Serbian Supreme Court. Without proper consultation, in July 2006 Parliament passed some amendments to the Broadcasting Law that increased the discretionary powers of the Broadcasting Council and are incompatible with the fundamental rights protected by the European Convention on Human Rights. The Serbian President opposed these amendments and sent them back to the Parliament. The latter adopted the amendments through a repeated vote in September. Concerns over the lack of representation of minority representatives in programme boards have been raised. There has also been no progress in the resolution of cases involving murders of journalists. Concerning **freedom of association**, the new law on associations has not yet been adopted. It was prepared with wide public consultation, involving the civil sector and relevant international organisations. **Civil society organisations** are well developed and active. The authorities have made efforts to take the opinions of the civil sector on board, notably in the area of poverty reduction. Non Governmental Organisations (NGOs) are allowed to attend sessions in Parliament. The Serbian Office for European Integration has signed a special memorandum of cooperation with NGOs.

However, the administration continues to show insufficient understanding of the appropriate role of NGOs in a democratic society. NGO activities that imply criticism of the government, and in particular those that draw attention to sensitive, often unpopular issues such as war crimes, are publicly denigrated. The legal situation of civil society organisations remains precarious due to the continued lack of adequate legislation. This has a consequent effect on financial sustainability.

Economic and social rights

As regards **women's rights**, the implementation of the 2005 Labour Law has started. This law marked a significant improvement, by introducing definitions of the concepts of direct and indirect discrimination and by further developing the principle of equal pay for equal work and work of equal value. It also covers the right to court protection from sexual harassment at work. Similarly, the Family Law improved protection from domestic violence. However, the representation of women in public life and their access to job opportunities remain poor. There is a parliamentary Committee for Gender Equality and a Government Council for Gender Equality. However, their activities have only recently started to produce some results in terms of legislation. The alleviation of the burden of proof has not been introduced in civil procedures regarding discrimination. The Labour Law protects pregnant women and parents on child leave against dismissal, but it does not guarantee return to their former jobs or equivalent posts.

As regards **children's rights**, the 2005 Family law is in line with international standards. Serbia also ratified ILO Convention 182 concerning the prohibition of child labour. The inter-ministerial Council for the rights of the child initiated a wide education campaign, which to date included has 50,000 employees in Serbian schools. However, due to ethnic origin, refugee status or poverty, children often continue to suffer from limited access to healthcare, education and proper housing.

As regards **socially vulnerable and disabled persons**, a national strategy on ageing has been prepared by the ministry of work, employment and social welfare in cooperation with civil society. This strategy aims to combat discrimination, improve employment, education, social and health protection of elderly people. A new law on prevention of discrimination of disabled persons was adopted in April 2006 with comprehensive provisions to prevent discrimination in employment, education and healthcare. A good strategy on mental health is in place. However, Serbian policy on disability still fails to meet European standards. There are almost 5,000 children and adults with the intellectual disabilities who live in large residential institutions in extremely poor conditions. Community-based alternative programmes are not yet adequately supported.

As regards **labour rights and trade unions**, the 2005 Labour Law contains provisions on working conditions and information of workers in particular, which take into account the European standards in this area. Labour legislation was revised to introduce improvements in terms of non-discrimination. The level of protection against discrimination in Serbia is still far from the EU standards. Discrimination based on sexual orientation is widespread.

As regards **property rights**, the law on restitution of Church property was adopted. However, the legislation concerning the restitution of other properties is still outstanding. The deadline for the registration of files expired in June 2006. According to the owners' associations, a number of persons, notably members of the Jewish community, have not been allowed to register their files, since the registration legislation does not cover the period before the end of World War II. The registration is not a claim for confiscated property. It does not envisage protection of the rights of the property claimants or protection of the property itself against alienation.

Minority rights, cultural rights and the protection of minorities

The newly established office on human and minority rights has been also tasked with providing a technical and logistic service to the Republican Council for Minorities, chaired by the Prime Minister. This Council has continued to play an active role. The new Criminal Code envisages several criminal offences, pertaining to issues of racism and xenophobia.

There have been improvements concerning representation of minorities in public administration through a number of measures: publication of competitions in minority languages, vocational training in minority languages, proportional representation in multi-ethnic regions and continuous monitoring of representation of minority groups in public services. Improvements have also been registered concerning education in minorities' languages. The import of Albanian and Hungarian language textbooks was approved for use in Southern Serbia and in Vojvodina respectively. A teachers' faculty in Hungarian has been set up. Measures were taken to establish an Albanian language faculty as well as to open a campus for the Bulgarian community.

The interethnic situation in *Vojvodina* has improved. There has been a decrease in the number of incidents. The authorities took a number of measures concerning the official use of minority languages and scripts as well as the representation of minorities in the judiciary and police.

However, there has been no progress in the adoption of new legislation needed to better regulate the status, work and election of the National Councils for the minority groups. Problems persisted in the area of information in minority languages.

As for *Southern Serbia*, the Serbian Government approved a dedicated budget for 2006. However, the political situation remains tense. The work of the Government's Coordinating Body for Southern Serbia has again been stalled. The line Ministries continued to show insufficient engagement on the ground. Ethnic Albanian parties in January 2006 published a political platform seeking comprehensive political and territorial autonomy and special institutional links with Kosovo. Municipal elections took place in June 2006 with minor incidents.

The situation in *Sandžak* also remains tense both between the majority Serb and minority Bosniak communities with some serious incidents and hate speech amongst the latter. In April 2006, the Serbian Government decided to dissolve the municipal administration in Novi Pazar with the result that this heightened political tensions.

As regards the *Roma*, the Serbian Government adopted a number of action plans in the areas of education, health care, employment and housing. These plans were based on the comprehensive Strategy for Integration and Economic Empowerment of Roma, prepared by the former State Union Ministry for Human and Minority Rights in the context of the Decade of Roma Inclusion 2005-2015. The National Employment Strategy (2005-2010) and the 2006 Programme of Activities of the National Employment Office contain special sections concerning the employment of Roma.

However, the situation of Roma, in particular of those who are internally displaced, remains precarious. A significant proportion of the Roma population does not possess basic personal documents and does not have access to any social security system. Roma children face a wide range of obstacles in their access to education. They are often considered mentally disabled. Resources remain scarce. The government relies heavily on donor support, notably in the process of readmission. Conditions in a number of settlements are extremely poor. Unemployment is high.

2.3. Regional issues and international obligations

There are no major problems in Serbia's compliance with the **Dayton/Paris Peace Agreement**, except regarding full cooperation with ICTY. Serbian authorities have maintained a generally prudent attitude concerning the links that some political actors in Republika Srpska made between the status of the latter and the referendum in Montenegro.

As regards Serbia's cooperation with the **International Criminal Tribunal for the former Yugoslavia** (ICTY) the National Council for Cooperation with ICTY, which has become a Serbian body after the end of the State Union, has continued to make good work concerning waivers for witnesses and access to documents. In March 2006 the then State Union Council of Ministers adopted a decision on modalities of access to archives of ICTY investigators. In May 2006 the archives of the Ministry of Interior, the Ministry of Defence and the Serbian Presidency opened to ICYY. The then State Union Parliament adopted the Law on Freeze of Assets of ICTY fugitives in February 2006.

However, no progress was made on any of the six remaining fugitives, all of whom have connections with Serbia. In particular, the authorities failed to locate, arrest and transfer Ratko Mladić. In July 2006, the Government adopted an *Action Plan* on co-operation with the ICTY. The implementation of the Action Plan still suffers of a number of deficiencies, notably as regards the co-ordination between the civilian and military security services and the role and

power of the prosecution. Serbia has, therefore, not yet met its obligation to fully co-operate with the ICTY, which is a key priority of the European Partnership.

As regards domestic **war crimes trials**, the legislative framework has significantly improved through the revision of criminal laws. Domestic courts have continued to work efficiently. In December 2005, the trial on the 1991 murder of Croatian war prisoners at Ovčara was completed. Sentences pronounced included some maximum terms of imprisonment. Indictments have been brought against some members of the Serbian paramilitary unit *Scorpions* (and in one case the sentence pronounced). Indictments against nine police officers for crimes against Albanian civilians in Kosovo in 1999 were issued.

However, this is undermined by a major lack of political will to establish accountability in this area. Pressure has been increased on the war crimes judiciary in 2005, involving open denigration by some politicians. Even so, there are no senior military or police officers among the accused in any of the cases. Cooperation with the police continues to be insufficient. The overall political climate is such that there is no guarantee that any high-profile war crimes trials could be conducted in a fair and transparent manner.

The full respect of United Nations Security Council Resolution 1244 concerning **Kosovo** is an obligation for Serbia as a UN member and a key requirement for regional stability. It is also a key priority of the European Partnership.

The Serbian authorities participate in the political talks on the future status of Kosovo under UN auspices. In November 2005, the Serbian Parliament adopted a resolution which highlighted the principle of inviolability of borders, territorial integrity and sovereignty. The Serbian Negotiating team, co-chaired by the President and the Prime Minister, was formed at the end of 2005. The Negotiating platform was adopted in January 2006. The latter essentially envisages the concept of “more than autonomy, less than independence”, insisting upon the preservation of Serbian integrity and sovereignty, while proposing territorial autonomy for Kosovo. Within the Negotiating Team, the government formed five working groups in charge of: 1) constitutional and legal issues; 2) property and economic issues; 3) cultural heritage and church-related issues; 4) decentralization and 5) returns.

Talks have so far addressed the issue of decentralization, cultural and religious heritage and economic issues; limited progress has been achieved. Belgrade's attitude to the participation of Kosovo Serbs in the Provisional Institutions of Self-Government (PISG) has not been constructive. One example is a directive from the Co-ordination Centre requesting all Serbian Government employees in Kosovo also receiving salaries from the PISG to make their choice in favour of one institution. Belgrade has not transferred cadastral records to Kosovo.

Serbia continues to have a positive attitude towards the **International Criminal Court (ICC)**. Serbia has consistently refused to sign bilateral agreements giving exemptions from ICC jurisdiction. It is important that Serbia continues to support fully the ICC and the integrity of its statute in line with relevant EU decisions.

There are some 106,700 **refugees** and 207,923 **internally displaced persons** in Serbia. 6,000 IDPs still reside in collective centres. The precarious situation of this vulnerable population group has a significant impact upon the overall political situation in the country. In June 2006, the Serbian government and the United Nations Interim Administration Mission in Kosovo (UNMIK) signed a protocol on the voluntary and sustainable return of internally displaced persons.

The authorities are continuing their efforts in both voluntary repatriation or return and local integration, in cooperation with UNHCR and other partners in the region like OSCE. More than 60% of refugees and internally displaced persons are reportedly opting for integration. Housing remains a constraint for both local integration and voluntary repatriation.

There has been continued progress in the implementation of the Sarajevo Declaration between Croatia, Serbia, Montenegro and Bosnia and Herzegovina on the return of refugees. However, the process has now slowed down mainly due to the lack of political consensus on two remaining “open issues”: a fair settlement mechanism in Croatia for lost Occupancy Tenancy Rights (OTR) and convalidation of pension rights etc. for working years spent in Serb controlled areas of Croatia during the civil war. There have been several Task Force meetings but it has not been possible at these meetings to make progress on the two remaining issues. However, the Road Map does not deal with all the subjects, which the local representatives of OSCE, UNHCR and EC have recommended to be included in the Road Maps. Further efforts are needed to reach agreements on the remaining issues and to fulfil the plans to present a comprehensive Road Map for each country and to agree on a Joint Implementation Matrix.

Regional cooperation and good neighbourly relations form an essential part of the process of Serbia's moving towards the European Union. Serbia has continued to contribute to regional co-operation and to pursue policies aimed at improving relations with its neighbours.

Serbia is an active member of regional initiatives such as the Stability Pact, the South East Europe Cooperation Process, the Central European Initiative and the Black Sea Economic Cooperation. In May 2006, Belgrade hosted the Stability Pact's Regional Table, its highest decision-making forum. Serbia is also committed to the establishment of the Regional Cooperation Council.

Serbia is party to the Energy Community Treaty, which entered into force in July 2006. It also signed the European Common Aviation Area Agreement in June 2006.

Serbia is taking part in the negotiations to establish a regional free trade area within the framework of an enlarged and amended Central European Free Trade Agreement. Serbia has concluded bilateral free trade agreements with all South East European countries.

As regards **bilateral relations** with countries of the region, following the referendum on Montenegro's independence in May 2006 Serbia recognised *Montenegro* on 15 June 2006. Diplomatic relations between the two countries were swiftly established. The resolution of disputable issues has been proceeding smoothly. On 10 July 2006 the Agreement on membership in International Financial Institutions and the distribution of financial assets and liabilities was signed paving the way to Montenegro's accession to the IFIs. The remaining issues concern citizenship rights and social security in particular.

Relations with *Croatia* have further improved and contacts at the highest level intensified, commencing in November 2005 with the first visit of a Serbian Prime Minister to Zagreb since 1991. In July 2006, two Prime Ministers opened a new border crossing between Serbia and Croatia. A provisional visa free regime remains. However, there are still a number of outstanding issues, namely border demarcation, refugee returns and property rights, and the Croatian suit for genocide before the International Court of Justice (ICJ). As regards border demarcation, the two countries have agreed to re-launch the work in the near future.

Relations with *Bosnia and Herzegovina* remain good. However, there are a number of outstanding issues, notably the suit before ICJ against former Serbia and Montenegro for genocide. Border demarcation has not been completed yet. Trade disputes have also continued (Serbia has complained about the introduction of protective tariff rates by the BiH authorities on some agricultural products originating in Serbia). In the reporting period Serbia has also intensified contacts and cooperation with the Republika Srpska and signed a new Agreement on Special Parallel Relations, in line with the Dayton/Paris Agreement. In July 2006 Serbia and the Republika Srpska signed an agreement on the opening of a new border crossing.

As regards the *former Yugoslav Republic of Macedonia*, relations remain good. The governments of both countries continued to call for caution concerning the persistent tensions between the Serbian and the Macedonian Orthodox Churches.

Relations with *Albania* remain good. The key outstanding issue remains the future status of Kosovo with its implications for the relations between Serbia and Albania.

Serbia continues to have good relations with *Bulgaria, Romania* and *Hungary*.

3. ECONOMIC CRITERIA

3.1. Introduction

In examining the economic developments in Serbia, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires the existence of a functioning market economy, and the capacity to cope with competitive pressure and market forces within the Union.

3.2. Assessment in terms of the Copenhagen criteria

3.2.1. The existence of a functioning market economy

Economic policy essentials

In 2005, consensus on economic policy was maintained. In 2006 however, views on the direction of economic policy began to diverge between the Ministry of Finance and the National Bank of Serbia. In May 2006, the authorities adopted a comprehensive economic policy which sets out a generally sound medium-term macroeconomic framework and an ambitious structural reform agenda. Plans to increase investment from privatisation revenues starting in 2006 cast serious doubt on the Government's ability to implement this framework. Such plans could even jeopardize macroeconomic progress to date. Cooperation with the IMF and the World Bank has continued to be an important anchor for economic policy making in 2005. However, the authorities have not yet decided whether to request a successor arrangement to the recent IMF programme. The latter was successfully concluded in February 2006. Overall, consensus on the direction of economic policy and reform was generally maintained in 2005, but started to diverge in 2006.

Macroeconomic stability

In 2005, real GDP grew by 6.3% compared to 9.3% in 2004. Strong gains in commerce, transportation and financial services, more than offset the drop in agriculture and

construction. Growth remained strong at 6.7% year-on-year in the first half of 2006. Industrial production recovered in the second half of 2005, following a slump in the first half. This resulted in a modest 0.6% annual growth rate for the whole year compared to 7.2% in 2004. The rebound in 2005 was due to a good performance by the electric power, gas and water sector (up 6.9%). The highest growth rates were achieved in those sectors which had undergone substantial privatisation or restructuring in recent years, i.e. food and beverages, tobacco, chemicals, rubber and plastic products and base metals. During the first seven months of 2006, total industrial production expanded at a rate of 7.8% year-on-year. However, manufacturing production, which accounted for 75% of industrial production, declined by 0.8%. Overall, economic recovery continued at a somewhat slower pace.

In 2005, the Serbian current account deficit decreased to 9.8% of GDP, from 12.6% in 2004, due to strong growth of exports (up 13.2% year-on-year) and declining imports (down 6.7% year-on-year). The latter was partially the result of VAT introduction in January 2005 and the related acceleration of imports in December 2004. As a result, the trade deficit fell to 23.1% of GDP in 2005 compared to 29.8% of GDP a year earlier. However, imports still remain at about 2.5 times the level of exports. During the first seven months of 2006, imports resumed to expand at 26.4% year-on-year while export growth remained robust at about 26.2% year-on-year. Consequently, the trade balance has widened again by about 26.6% compared to a year earlier. In summary, stronger export growth has contributed to a lower deficit of the current account.

Capital inflows increased in 2005 and reached € 3.6 billion compared to € 2.4 billion in 2004. Foreign direct investment (FDI) rose to about 5.7% of GDP in 2005 from 4.3% of GDP in 2004, predominantly related to privatisation. Greenfield investment remained negligible. In addition, medium- and long-term borrowing increased to € 1.5 billion from € 1.2 billion in 2004, with the largest increase in borrowing coming from the private sector. Foreign currency reserves of the National Bank of Serbia (NBS) increased by € 1.6 billion to € 4.9 billion in 2005. In the seven months to July 2006, foreign currency reserves increased further and reached € 6.7 billion, which is equivalent to more than 6 months worth of imports. However, external debt of the Serbian economy has risen again, following several years of decline. Inflows of debt-creating external financing, mostly to the private sector, accounted for about 7.1% of GDP in 2005. At end-July, total foreign debt reached about 66% of GDP. The private sector debt stock stood at about 34% of GDP and exceeded for the first time the official sector debt stock which stood at 32% of GDP. Debt service has increased to 5% of GDP. In summary, strong capital inflows and related central bank interventions in the foreign exchange market helped boosting foreign currency reserves, while external debt has risen.

Unemployment increased due to restructuring and rationalisation of several companies. Moreover, overall employment continued to decline by 197,000 to 2.7 million in 2005. The unemployment rate, adjusted for those registered unemployed not actively seeking work, rose to 20.8%. However, partly due to large informal employment, the official unemployment rate has declined to 27%. Long-term unemployment remained chronic, with an average duration of 44 months in 2005. Youth unemployment is severe and stood at a rate of about 48%. Agriculture, including small scale farming remains a sizeable source of employment. The informal sector remains substantial and is estimated to represent more than one third of employment. Important regional disparities exist both in employment and unemployment. High unemployment remained a significant economic problem.

In response to strong capital inflows, the NBS has substantially intervened in the foreign exchange market in an attempt to prevent a real appreciation of the dinar, but also to further

boost foreign exchange reserves. Domestic money market liquidity has grown strongly, linked to the foreign exchange interventions. Dinar reserve money and broad money (M3) grew by 22% and 42% year-on-year, respectively. This has fuelled strong credit growth to the private sector (57% year-on-year) and added to domestic demand pressures. To counterbalance the liquidity effect of the foreign exchange interventions, the NBS attempted to absorb liquidity by selling government and NBS bills and raising reserve requirements several times during 2005 and early 2006. The NBS has also allowed for a slower nominal depreciation of the dinar (8.7% year-on-year compared to 15.4% in 2004 vis-à-vis the euro), resulting in a moderate real appreciation (3.1% year-on-year). In early 2006, the NBS began to reduce foreign exchange interventions and allowed for greater market flexibility. As a result, the dinar has appreciated vis-à-vis the euro by about 7.9% between May and September 2006. In September 2006, the NBS has adopted a monetary policy framework of inflation targeting. Overall, monetary policy has been challenged by strong capital inflows, robust credit growth and high inflation.

In December 2005, inflation stood at 17.5% year-on-year compared to 13.8% in 2004, mainly driven by increases in administered prices following the rising costs of fuel imports and the one-off effect of the VAT introduction. In addition, inflation was further affected by strong domestic demand combined with a relatively unresponsive supply side, lack of competition in domestic markets and widespread exchange rate indexation of prices. Core inflation, which excludes agricultural products, energy and services with administrative price controls, stood at 13.5% year-on-year in December 2005. In 2006, retail price inflation, without the effect of the VAT introduction and supported by the recent appreciation of the dinar, eased somewhat and reached 11.6% year-on-year in September. In general, inflation remained at double-digit rates.

The consolidated general government budget reached a surplus of 0.6% of GDP in 2005, compared to a deficit of -0.9% of GDP in 2004. Revenue collection improved by 1.6% year-on-year in real terms. Apart from VAT, personal and corporate income tax grew in real terms (4.6% and 27.1%, respectively) as well as non-tax and capital revenue (9.7% and 11.2%, respectively). Other revenue categories however, saw a substantial decrease, mainly due to cuts in tax rates. For the same period, expenditures declined by 0.4%, due to permanent cuts in subsidies and transfers. The 2005 reform of the pension system will provide result in additional permanent savings in the coming years. In general, fiscal consolidation continued in 2005, but further efforts have come to a halt in 2006.

For the first quarter of 2006, public revenues grew by 4.5% year-on-year in real terms, driven by strong gains in personal and corporate income tax (15.5% and 75.2%, respectively). This was more than offset by the decline in VAT revenues (by 14.8%). Expenditures grew at 4.7% during the same period, since wages and salaries, purchases of good and services, as well as capital expenditures grew stronger. In addition to increased expenditures already under way since the beginning of the year, the government has launched a national investment plan worth about € 1.6 billion for 2006 and 2007, to be completely financed by privatisation proceeds received in 2006. A continuation of recent fiscal trends could however contribute to an aggravation of macroeconomic imbalances, especially inflation and the current account deficit, and risks jeopardizing macroeconomic progress to date.

The general government debt of Serbia has declined by 7 percentage points of GDP to 61% of GDP in 2005, 54% of which was denominated in foreign currency. This exposed Serbia to considerable foreign exchange risk. In 2006, public debt has receded following the € 600 million Paris Club debt write-off. This was linked to the successful completion of the IMF programme in February. Although structural fiscal adjustment continued in 2005, fiscal

policy turned expansionary in 2006. Monetary policy has been tightened to curb credit growth, as strong capital inflows and a high degree of currency substitution have posed a challenge for policy makers. Further measures, in particular fiscal retrenchment, are needed to increase domestic savings, reduce external imbalances and help reducing inflationary pressures. Overall, the macroeconomic policy mix was largely adequate, but fiscal consolidation needs to be strengthened.

Free interplay of market forces

The share of the private sector in GDP remains at 55%, whereas state and social ownership still governs a large part of Serbia's output. The absence of a larger share of private sector activity is an obstacle for the provision of a dynamic supply of competitive domestic products and services, and adversely affects inflation and external accounts. Overall, despite substantial progress in privatisation in recent years a competitive and dynamic private sector has not yet been fully established.

The privatisation of socially-owned companies has advanced, helped by amendments to several key laws in 2005 (laws on privatisation, share fund and financial markets). The provision which allow for the write-off of debts towards the state at the moment of sale is particularly helpful. However, the process of restructuring the large insolvent companies selected by the Government has progressed slowly. The Government still needs to resolve, through sale or bankruptcy, the core assets problem of Zastava and RTB Bor, which are two problematic socially-owned enterprises from a social and fiscal standpoint. A tender for sale was launched in September 2006 for RTB Bor. In general, privatisation has continued while enterprise restructuring advanced only slowly.

Free market entry and exit

Two new company registers have been set up since August 2005, covering financial leasing and personal pledges. However, delays occur due to issuing tax identification numbers. In 2005, about 1,000 bankruptcy procedures were registered, which is still a relatively small number considering the scope of the problem of ailing firms. Processing cases has also remained slow. In September 2005, a new competition law came into effect. However, much remains to be achieved as far as implementation is concerned. In general, progress has been made in the areas of company registration and bankruptcy and competition legislation.

Adequate legal system

The operation of commercial courts has improved in terms of number of cases handled and the average number of days needed to complete court procedures. The Government has adopted a national strategy for the reform of the judicial system, which is expected to have an impact on the effectiveness of commercial courts. The law on arbitration was adopted in May 2006. The operation of commercial courts has improved. However, the judicial system has scope for further improvements.

Sufficiently developed financial sector

In 2005 and early 2006, five state-controlled banks were sold and two further sales are expected by end-of-year. Foreign ownership in the banking sector accounts for about 77% of assets. The five largest banks account for about 50% of the market. However, in an environment of strongly expanding credit to the household and enterprise sectors (94% and 45% year-on-year, respectively), the ratio of non-performing loans stood at 23% at end-of

2005. In addition, the large share of bank lending effectively denominated in foreign currency pose a potential threat to financial stability. The National Bank of Serbia has strengthened its regulation and supervisory practices. The minimum capital adequacy ratio was increased from 10 to 12%. A new banking law, aligning current practices towards the Basel Core Principles was adopted. However, effective implementation remains an issue, as witnessed by the slow progress in the implementation of the Supervisory Development Plan. The degree of currency substitution remained high as foreign currency deposits accounted for 71% of total deposits. In general, privatisation of the banking sector has continued well.

Little progress was made with the development of the capital market. Equity prices recovered in the last quarter of 2005. Activity in the secondary bond market, dominated by state bonds on frozen foreign currency deposits, has been favourable. Bond yields continued to decline due to the continuous inflow of foreign capital and the improvement in the country's credit rating. Capital market legislation has been updated with parliament adopting the law on investment funds and amendments to the law on security markets and other financial instruments in May 2006. However, volumes have remained low and traded stocks accounted for about € 500 million on the Belgrade Stock Exchange. Overall, the capital market is not yet sufficiently developed.

3.2.2. The capacity to cope with competitive pressure and market forces within the Union

Existence of a functioning market economy

Macroeconomic stability has been broadly maintained. However, the functioning of market mechanism to allow for an efficient allocation of resources has been hampered by the still strong involvement of the public sector in the economy.

Sufficient human and physical capital

Foreign direct investment (FDI) reached a record level of €1,192 million in 2005. In the first seven months of 2006, FDI amounted to about € 770 million. The sectors benefiting most from FDI were the financial sector, construction and the processing industry. FDI per capita more than doubled to € 390 compared to € 165 in 2004. Government expenditure on research and development accounted for about € 50 million or 0.25 of GDP in 2005. Serbia's future association with the 7th research framework programme will generate positive effects in this area. Gross capital formation declined to 18.7% compared to 21.4% in 2004. Public investment declined to 2% of GDP, compared to 2.8% a year earlier. In general, the need of physical capital remains high.

Adequate sectoral and enterprise structure

The restructuring of large state-owned companies continued, from a low base. Preparations for the restructuring and privatisation of several large state-owned companies have intensified concerning non-core activities and assets as well as the reduction in overstaffing. Some privatisation strategies are under preparation. However, major problems regarding the operations of these companies have not yet been addressed. Such problems include the inadequate institutional and legal set-up, over-employment, weak transparency and accountability, as well as substantial vested interests. The authorities have not shown their full commitment to address these issues. In summary, the restructuring of large state-owned companies is still in an early phase.

Serbia made preparations for a proper regulatory framework for network industries. The Telecommunication Agency started operations at the beginning of 2006. The Energy Regulatory Agency currently employs 25 staff and receives support from the European Agency for Reconstruction. Its current work programme focuses on the development of methodologies and tariffs structures. There was progress in the creation of a necessary regulatory framework and establishment of regulatory agencies for network industries.

The structural composition of the economy changed. In 2005 and early 2006, strong gains were recorded in commerce, transportation and financial services whereas agriculture, construction and industry declined. In 2005, transportation and communication grew by 23%, wholesale and retails trade expanded by 22% and financial intermediation reported gains of 17% over the previous year. The agriculture sectors share in total output decreased by 5% mainly due to unfavourable weather conditions that substantially reduced production of some crops. However, the share of the agricultural sector in the total output remains high at about 15%. In general, the structural shift of the economy continued towards the service sector.

Small and medium-sized enterprise (SME) activity has been growing and SMEs now account for about 55% of total employment, 32% of total capital and 53% of total revenue. Although credit to the private sector has been growing strongly, access to long term financing continues to adversely affect SMEs' fixed capital investments. In addition, SMEs are hampered by a low level of financial liquidity and a high degree of indebtedness. The relevance of (SMEs) is growing. This sector faces financing difficulties.

State influence on competitiveness

There have been instances of substantial direct government interference with the economy. In January 2006, the government revoked the licence of a mobile phone operator and temporarily took control of its operations. This was achieved by overriding the telecommunication regulatory agency's competences. In general, direct government intervention in the economy remains prevalent.

Net average earnings grew by 23.6% and 6.4% year-on-year in 2005 in nominal and real terms, respectively. Wage growth accelerated during the first five months of 2006 and net average earnings recorded an increase of 25.4% and 9.5% year-on-year in nominal and real terms, respectively. In summary, wage growth remained strong, but broadly in line with productivity gains.

Trade integration with the EU

In 2005, exports and imports to and from the EU accounted for 56% and 49% of total exports and imports respectively. For the first five months of 2006, exports to the EU grew to 59% of total exports, while imports from the EU fell marginally to 48% of total import. The other major trading partners of Serbia remain the Central and Eastern European countries and the Commonwealth of Independent States, accounting for 30% and 7% of exports and for 12% and 21% of imports respectively. Overall, foreign trade continued to grow and integration with the EU advanced.

4. EUROPEAN STANDARDS

This section examines Serbia's capacity to gradually approximate its legislation and policies with those of the *acquis* related to the internal market, sectoral policies, and justice, freedom

and security, in line with a Stabilisation and Association Agreement and the European Partnership priorities. It also analyses Serbia's administrative capacity.

4.1. Internal market

4.1.1. Free movement of goods

Significant progress has been achieved in the areas of **standardisation, certification and metrology**. Preparations for alignment have been launched with the entry into force, in early 2006, of framework legislation such as the Law on Standardisation, the Law on Accreditation, the Law on Metrology and the Law on Technical Requirements for Products and Conformity Assessment of Products. Good progress in preparations for implementation can be reported as, in the second quarter of 2006, a package of decrees for the implementation of these laws has been adopted, namely the decree on the establishment of the accreditation and standardisation bodies, a decree on conformity assessments and on the designation of bodies for conformity assessment and certification as well as a decree on adoption of technical regulations. Although the legislative part would be in theory consolidated, all above mentioned legislation was adopted at State Union level and needs to be transferred to Serbian legal order as all former common bodies in the area of quality infrastructure have become Serbian bodies after the dissolution of the State Union.

In the field of metrology, the decree on legal measuring units has been adopted in the first quarter of 2006. Some progress has been made in the fields of measuring standards and precious metals.

The new Serbian Standardisation Body is a Partner Standardisation Body of the European Committee for Standardization (CEN) and an affiliate member since October 2005 of the European Committee for Electrotechnical Standardization (CENELEC).

No particular progress can be reported in the area of market surveillance.

Although Serbia is making progress in its preparations for alignment, no concrete timetable for the alignment of Serbian legislation to the Community New or Old Approach Directives exists.

Following the adoption of a framework Law on **Consumer Protection** in 2005, the Government has set up a Consumers Protection Council which started its work in the second quarter of 2006. Serbia has also created local consumer offices at three major cities Belgrade, Niš and Novi Sad.

However, the administrative capacity remains weak and active consumer protection policy should be further strengthened. Serbia needs to make sustained efforts to achieve adequate administrative capacity for active consumer protection in line with EC consumer protection policy.

Some progress can be reported in the area of **health protection**. The Serbian legislation on the prohibition on indoor smoking was amended in November 2005, introducing sanctions in case the legal requirements were not respected. Serbia also adopted a new Law on Tobacco in 2005 introducing certain labelling requirements on packet of cigarettes.

Overall, Serbia's preparations in the field of free movement of goods has advanced, but needs to be further developed both in terms of alignment to the *acquis* and the strengthening of relevant administrative bodies.

4.1.2. *Movement of persons, services and right of establishment*

In the area of **movement of persons**, Serbia has ratified a further bilateral social security agreement with Hungary.

Good progress can be reported in the area of **movement of services**.

A new banking law, aligning current practises towards Basel Core Principles, was adopted and will be effective from 1 October 2006, with the exception of the provisions on consolidated supervision and consolidated financial reports that will enter into force on 31 December 2006. In addition, following the transfer of supervisory responsibility over the insurance sector to the National Bank of Serbia, the latter's robust action to enforce solvency requirements and the introduction of new minimum capital requirements lead to a reduction in the number of insurance companies from 36 to 19.

A new set of financial laws in the field of financial markets, including a new Law on Investment Funds and amendments to the Law on Securities Markets and Other Financial Instruments, was adopted in the second quarter of 2006. However, there are serious concerns about the institutional provisions of the new securities legislation and in particular about its implications for the independence of the capital market supervisory authority.

No particular progress has been registered in the area of **right of establishment**, for which Serbia already implements a relatively liberal regime.

Substantial progress has been achieved in the area of **company law**. A new law on Takeover of Joint-stock Companies entered into force in June 2006, which provides for the equal treatment of all shareholders of the target company.

The Serbian Business Registry, which started operating in January 2005 has finalised the re-registration of the companies that were previously registered at the commercial courts and continued to register new companies. Although the process of registration has been reduced to only one to five days, the issuance of various licences needed before or after registration – often issued by the authorities at municipal level - takes additional time and slows down the whole process. Non-harmonised laws often constitute an additional problem.

A new Accounting and Auditing Law entered into force in June 2006. The Law mandates all legal entities and entrepreneurs to prepare their financial statements in accordance with International Accounting Standards. There are questions about the proportionality of this requirement, as well as about the capacity of the authorities and of the domestic accounting and auditing professions to apply them in practice. The new law sets up a National Accounting Commission in charge of presenting to the Government guidelines, action plans and other suggestions to improve accounting and audit laws and regulations.

Preparations for alignment with the *acquis* in this area are moderately advanced.

4.1.3. *Free movement of capital*

Good progress can be reported in the area of **free movement of capital**. With the aim of further liberalising the movement of capital, Serbia has adopted a new Law on Foreign Exchange Operations in July 2006. The Law prescribes further liberalisation of operations with foreign countries – the term of payment for the exported goods/services has been extended from 90 to 180 days, as well as the term of import of the goods/services that have been paid in advance. Furthermore, the Law envisages the possibility for all residents, natural persons included, to perform payments in order to invest abroad in ownership and other first-class debtor long-term securities. The Law also prescribes residents abroad and non-residents in the Republic may freely pay for acquired ownership of real estate in line with the law regulating property relations.

By adopting amendments to the Law on Landplanning and Construction, Serbia has taken first modest steps to comply with the future SAA provisions on the purchase of real estate.

Overall, Serbia has continued its preparations to fulfil the requirements of the future SAA.

4.1.4. *Customs and taxation*

Good progress has been achieved in the area of **customs**. Following the amendments of the customs tariff law and customs law, Serbia passed a number of implementing legislative acts. Warehouse legislation has been amended to be aligned to the *acquis* and some simplified procedures have been set up (summary declaration procedure and simplified declaration).

Serbia has adopted a new law on free trade zones offering tax breaks and simplified procedures, while enabling foreign owned companies to establish and manage free trade zones in Serbia.

Overall, progress has been made and Serbia has reached a relatively good level of alignment with the EU customs *acquis* (except in areas such as transit or newly adopted *acquis*) and there is substantial progress regarding origin.

In particular, significant improvements have been noted in the field of control and management of the preferential trade measures (origin). This results from not only the existence of a satisfactory management of customs procedures through computerized systems, but also an intensified training of customs officers. All elements are in place to apply correctly the preferential system when exporting to the EC as well as to other Balkan countries.

Progress has also been registered in the fight against corruption in the customs administration, in particular through the establishment of an open telephone line where all corruption cases can be reported.

As a result of a step up of the fight against corruption and improvements in the efficiency of customs administration, collection of customs revenues in Serbia has improved substantially over the past few years.

Concerning **taxation**, following the introduction of value added tax and the amendments of the law in first half of 2005 (expanding the reduced rate of 8% to some additional goods, the regular rate being 18%), some progress has been registered.

A set of implementing legislation has been adopted regulating issues in the areas of excise duties and taxation of tobacco. Regarding excise duties, Serbia has not aligned its legislation to the requirements of the *Acquis*. A discriminatory tax differentiation between imported and domestic products is still in force for certain products.

Currently the corporate income tax rate is 10%. For personal income tax, there are two different taxes, first, taxation at source of 14% of the gross wage and then another annual income tax of 10%. In May 2006, procedures have been initiated to amend the personal income tax by the Government of Serbia introducing progressive taxation for annual personal income tax (with two different rates – 10% and 15%). The law adopted in July 2006 also provides for tax incentives to stimulate job creation.

Serbia has not yet undertaken a gap analysis aimed at identifying the existing harmful measures which could contradict the principles of the EU Code of Conduct on business taxation.

Tax reforms in the field of direct taxation should begin, particularly taking into account the company tax directives. A Treaty Network based on the latest OECD model should be completed.

Revenue collection remained at a low level. Administrative capacity is weak in particular in relation to collection and control capacities on VAT and excise duties. The Serbian tax administration should therefore cooperate more actively with the EU experts on the spot.

Overall, Serbia's preparations in the area of customs are well advanced while it would need to continue to make sustained efforts to meet set targets and the requirements under the SAA in the area of taxation. Consultation of business with regard to preparation of new legislation in the area of customs and taxation also needs to be improved. The fight against corruption requires continued attention in both administrations.

4.1.5. *Competition*

Following the adoption of the Law on Protection of Competition in September 2005, Serbia has established an independent competition protection body, the Commission for Protection of Competition, consisting of the Council, a decision making body, and an administrative service. It became operational in May 2006, soon after the rules of procedure were adopted. The supporting staff, with some experience in application of anti-trust rules, has been taken over from the Antimonopoly Department within the Ministry of Trade, Tourism and Services, allowing the Commission to start its work without considerable delay. Nonetheless, additional budgetary means would be required in order to help this body to properly fulfil its tasks. It should also be ensured that the fact that Competition Council members are not engaged full-time and may have dual commitments does not lead to a conflict of interests. No enforcement practice has been reported so far.

In the field of the **state aid control**, Serbia has made a good progress by designating a separate unit within the Finance Ministry to deal with state aid monitoring and reporting. This unit, however, needs further capacity building and for that purpose more staff would need to be employed and trained. Serbia adopted in May 2006 its state aid inventories for 2003 and 2004. At present, there is no legal framework for State aid control in Serbia. Serbia needs to strengthen its State aid structure and to set up a system of ex-ante control of all new aid measures and alignment of existing aid measures, through an operationally independent state

aid authority, with the power to authorise or prohibit all aid measures and to order recovery of unlawfully granted aid.

4.1.6. *Public procurement*

No particular development can be reported in the field of **public procurement**. The legislation on public procurement is to a large extent based on the Community *acquis*. However, the implementation of a consistent, non-discriminatory and effective public procurement system was halted pending the adoption of a new Public Procurement Law. Further efforts are needed in strengthening the implementation capacity of the Public Procurement Office and the Public Procurement Commission, by increasing their independence vis-à-vis the Government and ensuring transparency in decision-making. Preparations for alignment with the *acquis* in this area have been launched.

Overall, Serbia's preparation is relatively well advanced in the area of public procurement.

4.1.7. *Intellectual property law*

Further legislative improvements have been achieved with the adoption in May 2006, of the Law on Implementation of Regulations governing protection of intellectual property rights. The Law strengthens enforcement powers of the inspection services and introduces strong penalties for violators. With a few laws, especially the Law on Optical Discs still pending, Serbia has to a large extent approximated its legislation to that of the EU.

Piracy and counterfeiting remain widespread in Serbia and implementation and enforcement mechanisms require strengthening. The expertise and capacity of trade and market inspectorates, as well as law enforcement agencies (tax and economic police, customs) to deal with IPR infringements needs to be reinforced and co-ordination between all agencies needs to be improved. Moreover, the current status of the Intellectual Property Office and the budgetary restrictions it faces continue to hamper recruitment, training and retention of staff, thus undermining its ability to fulfil its statutory mandate.

A clearer division of competencies and better co-operation between customs, police, right-holders, market and tax inspectorates, public prosecutors and the IPR office is essential for an effective protection of IPRs.

Co-operation between the Serbian custom authorities with neighbouring countries is important to further raise efficiency in the fight against piracy and counterfeiting. With regard to technical constraints regarding the stocking and destruction of seized goods, only a partial solution for the recycling of CDs/DVDs could be found in Serbia, but further efforts to solving these problems should be undertaken.

Serbia's preparations in the area of intellectual property rights are relatively advanced to meet the requirements of the SAA.

4.1.8. *Social policies*

Progress has been good in the area of employment and social policy. The Serbian **Labour Law**, adopted in 2005, contains provisions which take into account certain prescriptions of Community *acquis* in particular on information of workers and non-discrimination. However, despite new tax incentives, sustained efforts are needed to combat unemployment and promote employment, by supporting labour market reforms and the modernisation and

development, management and institutional capacity of the public employment services. There is also a need to develop legislation and policies on **gender equality** and reconciling work and private life, especially for women.

Important developments have taken place in the field of **health and safety at work**. The Law on Labour Safety and Health was passed in the fourth quarter of 2005, approximates Serbian legislation to the requirements Community *acquis*, as well as with the main ILO conventions. Under this Law, the Labour Safety and Health Agency has also been established in late 2005. 350 inspectors received training in the first quarter of 2006.

As far as **employment** is concerned Serbia has started to implement the National Strategy for Employment for the period 2005–2010, the main objective of which is to decrease the very high levels of unemployment. An amendment of the Law on Personal Income Tax introduces a number of incentives to spur job creation among the youth, older unemployed and disabled persons.

In the field of **social inclusion**, a new Law on Prevention of Discrimination of Disabled Persons was adopted in the second quarter of 2006 with comprehensive provisions to prevent discrimination in employment, education and healthcare.

There has been some progress in the area of **education**. A new Law on Higher Education was adopted which establishes the basic framework for the implementation of the principles of the Bologna process. The new legal framework encouraged the development for in particular BA programmes that are compatible with the Bologna process.

In the area of science and research a new Law on Science was adopted at the end of 2005.

Serbia's preparations in the areas of social policies, employment and education are well advanced to meet the requirements of the SAA.

4.2. Sectoral policies

4.2.1. Industry and SME

Good progress can be reported in the area of industry and SMEs. The efficient implementation of 2005 Law on the Registration of Business Registers has significantly enhanced Serbia's performance on reducing costs and delays of company registration. The Agency for Business Registration has now become operational in managing a company registration procedure which allows start ups in approx. 5 days at a cost of € 60. Further progress can be achieved with the introduction of an online registration facility, for which the legal and technical framework is in place. Initial capital requirements have also been significantly lowered to € 500.

Serbia is progressing with regulatory impact assessments, for which the Council for Regulatory Reform has been mandated.

Serbia has improved entrepreneurship education, business support and training services and on the promotion of innovation and competitiveness, with SIEPA (Serbian Investment and Export Promotion Agency) in a leading role.

In relation to **SMEs**, Serbia has been very effective and professional in the implementation of the European Charter for Small Enterprises and delivers quality input for the process.

Serbia has started to make improvements in business advocacy and representation. It has set up the Council for SMEs, which should operate as an inter-service consultation mechanism within the Government with participation of the chambers of commerce and the employers' union, as well as the SME Forum, a broader platform for business advocacy. Both organisations have yet to become operational.

Serbia has been relatively modestly endowed with certain sophisticated business support structures such as clusters, incubators and business/technology parks. A plan has now been developed which should see the launch of 10-15 new incubators, of which Serbia has one since last year (Knjazevac). A handbook on clusters is also being developed. Serbia has launched in 2006 three new clusters in the automotive sector, small agriculture machinery and rubber & plastics i.e. a useful diversification compared to the three clusters in more traditional areas (textile, fruit and furniture) operating in Serbia - and these clusters have already set up links with similar clusters in south eastern Europe.

On **industrial policy**, Serbia has, over the last years, moved progressively forward in a number of areas covered by SME policy. It has been fairly systematic in identifying weak areas and introducing measures to strengthen these. Company registration procedures have been radically improved. However, the Government's industrial strategy is outdated and tends to be protective and defensive of certain industrial sectors. The Government recognises that the strategy needs to be renewed in compliance with the industrial policy principles of the European Union. The steel sector requires modernisation and financial restructuring to achieve viability and better competitiveness

Overall, preparations in the area of industry and SMEs are well advanced.

4.2.2. *Agriculture and fisheries*

The overall strategy for the agriculture sector has been adopted and is being implemented. Legislation on veterinary matters, identification of animals, TSE/by-products, and notification of diseases, was adopted in October 2005. Serbia has established an animal identification and registration system. Serbia has already achieved good results in terms of administrative capacity building for policy formulation by establishing a policy unit within the Ministry of Agriculture. Responsibilities for feed and food controls are distributed between the Ministry of Agriculture and the Ministry of Health. Although management and organisation of official controls are in place, overlapping and unclear repartition of competences hampers the effectiveness of the system.

Furthermore, Serbia is still missing a separate food safety strategy establishing a sustainable food chain system and a subsequent action plan. In terms of adoption of some remaining legislation, such as the Law on Agricultural Land, Food Safety Law, Law on Fisheries, Law on Agency for Laboratory Management, Law on Plant Protection and some others; Serbia is progressing slowly.

Overall, Serbia's preparations are advancing well in the area of agriculture and fisheries. Preparations in the area of food safety, in particular on the phytosanitary matters, are moderately advanced. The repartition of competences in the area of food and feed control needs to be clarified.

4.2.3. *Environment*

As regards **horizontal legislation**, progress can be reported as Serbia has adopted by-laws for the implementation and enforcement of the Law on Protection of the Environment in order to implement the provisions of the Strategic Environmental Assessment and Environmental Impact Assessment legislation. Progress has been made towards ratification and implementation of respective international conventions in the field of environment.

Very limited progress can be reported in the field of **water management**, and legal approximation as well as appropriate investment in water supply and sanitation remains a key challenge.

Limited progress can be reported in preparation of legislation in the fields of, **noise** and **chemicals** and **GMO's**.

Progress can be reported in the field of **Integrated Pollution Prevention and Control** with the adoption of new legislation and development of plans for compliance by all existing installations by 2015. The ambitious plans should be completed by developing financing strategies for the required investments including the involvement of the private sector.

As regards **administrative capacity**, the capacity of the Directorate for Environmental Protection within the Ministry of Science and Environment is improving, but efforts need to continue. The water administration within the Ministry for Agriculture, Forests and Water is seriously understaffed and coordination between the two ministries needs to be improved. At local level, the lack of staff hampers satisfactory implementation of environmental legislation and the absence of regional structures makes the planning process and implementation of environmental and water legislation difficult. Training activities for environmental inspectors have taken place but the administrative capacity for implementation and enforcement for both environment and water legislation remain unsatisfactory and need to be considerably strengthened, especially at local level. The Criminal Code allows for the filing of criminal charges in cases where the environment is put at risk or major pollution has happened and the Law on Environmental Protection foresees fines for actions against the environment. To ensure satisfactory enforcement of environmental legislation, further training of judges and prosecutors and greater efficiency of the courts in charge of environmental issues are needed.

Financing plans have to be developed as regards **investments** required to meet European standards, particularly in the field of water and solid waste, and to tackle pollution at existing hot-spots. The Fund for Environmental Protection became operational in 2005, with funds from the Ministry of Finance. It carries out activities related to financing of preparation and development of programmes, projects and other activities in the fields of environmental protection and energy efficiency, including renewable energy. The overall budget for Environmental Investments remain low with approximately 0,4% of GDP.

Overall, Serbia preparations, in the area of environment are moderately advanced.

4.2.4. *Transport policy*

In the development of **transport networks**, Serbia is actively participating in the implementation of Core Regional Transport Network and in the South East Europe Transport Observatory (SEETO), in particular by approving the first Rolling Five Year Multi-Annual Plan 2006-2010 (MAP). Continued cooperation in the framework of SEETO is required in the

context of the annual revisions of the plans in order to make further progress on the definition of regional priorities and the coordination of investments.

As regards **road transport**, the Law on Public Roads was amended in November 2005, based on which the Republic Directorate for Roads was transformed into the Public Enterprise for Roads in Serbia. Capacity building in the road directorate is on-going. Serbia has yet to adopt its new Law on Transport Safety.

In the field of **rail transport**, the unbundling of the railway system between operations and infrastructures is not yet effective. Potential conflicts of interests still exist by the presence of the same executives in the management boards of the two companies. Public service obligations are not compensated and passenger traffic is decreasing.

In the sector of **air transport**, Serbia adopted the decision to create its civil aviation authority following to the end of the State Union. The state-owned carrier JAT remains to be restructured. By signing the European Common Aviation Area Agreement (ECAA), Serbia has undertaken to integrate into the EU internal aviation market and to apply EU aviation standards. This will require the application of the ECAA agreement in practice and the fast implementation of the first transitional phase of the relevant aviation *acquis*, including market access conditions, safety, security, airport policy, environmental and social issues and air traffic control.

In the field of **inland waterways**, progress is underway with the release of the final version of the Serbian Inland Waterways Transport Network Master Plan, and its associated feasibility studies presented in Belgrade in June 2006, and portraying the present situation and capacity of waterway transport in Serbia.

Overall, Serbia's has made good progress in the area of transport but regional cooperation on the development of the core regional transport network in the framework of the South East Europe Transport Observatory needs to be strengthened.

4.2.5. *Energy*

As regards oil stocks and security of supply, no progress has been registered. Serbia does not hold sufficient oil stocks.

Following the ratification by the Serbian parliament in July 2006, the Energy Community Treaty entered into force in Serbia. The adoption of the relevant *acquis* has started.

In the electricity sector, following the unbundling of the power generation utility (EPS) and the transmission system and market operator (EMS), the adoption and implementation of the necessary tariffs and methodologies are pending. While the process of restructuring of the state owned utility (EPS) is stalled. No particular progress has been registered regarding the gas sector.

In the area of energy efficiency and renewable energy, the Serbian Energy Efficiency Agency has initiated several programmes to promote energy efficiency. A mission of the Agency is to draft proposals for implementing energy efficiency and the exploitation of renewable energy sources.

Administrative capacity remains weak and needs to be strengthened. The Ministry of Energy and Mining faces problems to cover all its tasks. The Energy Agency (AERS) has adopted its

internal structure. The necessary market regulations need to be finalised, adopted and enforced and the financing of the Agency is still to be secured in the mid term perspective (3-5 years) so as to guarantee the establishment of a functioning energy market.

Concerning nuclear safety, an appropriate regulatory body needs to be put in place, and the necessary legislation should be adopted in order to comply with the Community legislation, in particular regarding the environmental monitoring and the radiation protection in connection with medical and industrial applications, including provisions on waste management and on control on radioactive sources.

Serbia needs to accede as soon as possible to the "Convention on Nuclear Safety", as well as to the "Joint Convention on the Safety of Spent Fuel Management and on the Safety of Radioactive Waste Management", to which Euratom has been a contracting party since April 2000 and January 2006, respectively.

Overall, some progress can be reported in the area of energy. Serbia's preparations in the energy sector are advancing but are still on a relatively early stage.

4.2.6. Information society and media

As regards **electronic communications and information technologies**, the Law on Telecommunications was amended in April 2006 to ensure the legal separation of entities providing different telecommunication services (internet, fixed telephony or mobile telephony).

The telecommunication regulatory authority (RATEL), set up in 2005, has become operational in December 2005. After a lengthy and difficult start, it is still in the very first phase and therefore has not produced many decisions aimed at the introduction of competition in the telecommunications sector. Since its establishment most of its efforts have been aimed at getting sufficient human and financial resources. RATEL is now in a position to issue licenses, monitor activities and thus can start to establish its authority.

The electronic communication sector is not sufficiently liberalised. The conditions for competition, investment and innovation are still highly unfavourable for new entrant operators, both on the fixed and mobile telephony market.

The issues of tariff rebalancing, interconnection tariffs and the introduction of competitive safeguards have not yet been sufficiently addressed.

Administrative capacity for the telecommunications and information society sectors and in the Ministry for Capital Investment remains weak. The staff in charge of the telecommunications and postal sector has decreased. Furthermore, Serbia does not have a strategy for the development of the electronic communications sector.

As regards **information society services**, legislation on electronic commerce and data protection still needs to be adopted. Concerning audiovisual policy, the latest positive developments concern the alignment with European standards as regards the regulation of defamation (exclusion of imprisonment as a sanction for libel and insult) and the transformation of Radio Television Serbia (RTS) and Radio Television Novi Sad (RTNS) into Public Service Broadcasters.

However, several provisions in the recent amendments to the law, extending the scope of application to cable and satellite transmission are not in line with the *acquis*.

The situation of the Republican Broadcasting Agency in Serbia is a matter of concern. The problem goes beyond the issue of the agency's independence. It also concerns professional standards, accountability and legality. The administrative capacity remains weak. There has been a lack of transparency in the decision-making process of the Broadcasting Council with regard to the allocation of national, regional and local radio and TV frequencies.

Overall, Serbia preparations in the area of information society and media still remain on an early stage.

4.2.7. *Financial Control*

Serbia lacks a strategy for establishing and developing a comprehensive public internal financial control (PIFC) system at the level of all government institutions.

Some progress can be reported in the area of external audit. Serbia has adopted a Law on a Supreme Audit Institution which provides for the legal basis to set up the national audit authority. The national audit authority is not yet operational. This process is ongoing but has been delayed as the deadline for this was May 2006. The new constitution also foresees the establishment of a supreme audit institution.

Overall, Serbia preparations in the area of financial control are still on an early stage.

4.2.8. *Statistics*

Some training has taken place to improve the management capacity of the statistical office of Serbia (SORS).

The business register is still not fully operational as routines for uploading and updating data are not in place yet.

As regards **classifications** and standards, the compliance with EU standards is limited in Serbia and no progress can be reported for the past period.

As regards the different **sector statistics**, progress can be reported in a number of areas. For demographic and social statistics SORS has assessed and improved the household budget survey (HBS) especially to be able to use it as a source for poverty statistics. In the period, SORS has made progress in the area of gender statistics by publishing the booklet Women and Men in Serbia. There has also been some progress in internal migration statistics.

For macro-economic statistics SORS has increased cooperation with key data providers.

For business statistics there has been good progress in the area of energy statistics with the energy balance for electricity and heat being published. For the industrial production index, progress has also been made in terms of timeliness and seasonal adjustment. For short term statistics and structural business statistics new surveys have been introduced and plans for full harmonisation have been made. The first results are available for the construction sector.

For statistics on regional level, external trade statistics and transport statistics no progress can be reported. For agriculture and fishery statistics, the results from the population census 2002

have been tested to assess the suitability for being used as sampling frame with encouraging results.

The statistical infrastructure, the legal basis and the management capacity have improved slightly. Cooperation with the partners in the national statistical system increased. The new corporate identity, the increased user orientation and the started project on measuring internal time use to be used in the planning of SORS activities. Basic knowledge in statistical methodology has improved but progress is limited by the lack technical, financial and human resources.

Overall, Serbia's preparations in the area of statistics are relatively well advanced.

4.3. Justice, freedom and security

4.3.1. Visa, border, control, asylum and migration

Serbia has taken over the State Union competences in defining **visa** policy. Serbia has also taken over the State Union Ministry of Foreign Affairs and the diplomatic and consular missions abroad. However, the law on ministries that aims at institutionalising the Foreign Affairs portfolio has not yet been adopted.

The current regime is based on several by-laws adopted by the former State Union Ministry of Foreign Affairs to regulate the visa issuance procedure and on an instruction manual for consular staff responsible for issuing visas. The Law on Foreigners which is to define the future visa regime in detail has still to be adopted. Steps taken to include biometric indicators in travel and identity documents were delayed due to the uncertainties on the future of the former State Union.

As regards **border management**, the Law on State Borders has not been adopted, and the takeover of borders from the military has not been completed. After taking over the border with Hungary, in June 2006 the police took over a segment of the border with Romania. After the adoption of the national integrated border management strategy in January 2006, the implementing action plan was adopted in June 2006.

The reform of the border police is affected by the slow implementation of the new Law on Police. There is no proper training system for border police personnel, only basic courses available and occasional, donor driven specialised training. In addition to the serious lack of adequately trained staff, there is neither proper infrastructure nor modern equipment at the borders.

In the field of **asylum**, the State Union level framework law from 2005 guarantees only the right to asylum. The implementing legislation to regulate procedures for reception and protection of the asylum seekers has not been adopted. Lack of adequate legislation has been somewhat compensated through by-laws adopted in 2004 allowing for the issuance of temporary residence permit.

There is a lack of adequate infrastructure and qualified staff and the majority of cases are being handled by UNHCR. There are, however, cases of deportation without the right to appeal, after custody in the existing reception centre under inadequate conditions.

The number of asylum seekers in Serbia remains limited - there were 47 applications in 2005, concerning 55 persons. 11 of the applicators have been accepted, temporary protection has

been granted to 109 Iraqi nationals. 21927 asylum claims were filed in 2005 by citizens of Serbia and Montenegro.

Further to the end of the State Union, the competences that the former Ministry for human and minority rights held in the area of asylum have been transferred to the Serbian Ministries of Justice and Interior.

As regards readmission, there are at present 15 readmission agreements in force with 17 countries. A number of other agreements that have been negotiated but not yet signed. Readmission agreements have been negotiated or signed so far with 20 EU member states. Serbia has expressed its readiness to conclude a readmission agreement with the Community.

In 2005, out of 6,178 requests for readmission of the citizens of Serbia and Montenegro, 4,350 have been positively resolved. In cases of third country nationals, Croatia forwarded 584 requests in 2005 concerning mostly citizens of Albania, Moldova and Romania, 187 of them was positively resolved. In the case of Hungary, 11 requests out of 31 submitted in 2005 have been accepted.

In December 2005, the Ministry for Human and Minority Rights opened a reception office for returnees at Belgrade airport, offering initial legal assistance and counselling.

At present there is no normative framework for integration and basic social and financial preconditions are lacking.

The national strategy for the reintegration of returnees which has been prepared with the significant involvement of the NGO sector has not yet been adopted.

Illegal **migration** continues to be a source of concern although some operational results are being achieved. The total number of illegal entries of 1,076 foreigners in 2005 represents only a 3 percent increase on the previous year. However, there has been a significant increase in the number of minors and women illegally entering the country. The possible connection with trafficking in human beings is a matter for concern.

In line with the present criminal legislation, which distinguishes between the two offences, in 2005 there were 37 criminal charges filed against 87 perpetrators for trafficking of 219 migrants, the largest number of them were citizens of Albania, and 19 charges filed for illegal border crossing. The request for visas for 2,320 Chinese citizens, 1,693 Romanian citizens and 149 Moldovan citizens have been refused. Following tighter controls at the borders, 24,535 foreign citizens were denied entry and 1,727 falsified documents were discovered. UNHCR provided assistance in identifying cases of potential asylum seekers.

4.3.2. *Money laundering*

There were positive changes in the relevant legislation. The new Criminal Code has improved the definition of the offence and the maximum imprisonment has been increased to 10 years. A separate offence of terrorism financing has been introduced. The law on Money Laundering, in force since January 2005 covers a broader range of laundering activities and there is a more exhaustive list of obligors and regulations on data processing. The training of relevant agencies is ongoing.

Insufficient cooperation between all competent agencies is a serious obstacle to effectively preventing and fighting money laundering.

4.3.3. *Drugs*

Serbia represents a major transit route in drugs, while still considered a relatively small market for drug dealers. There has been an increase in consumption of synthetic drugs.

The National Strategy on drug abuse prevention has been finalised by the Health Ministry, but there is no clear timeframe for adoption. The draft is not in conformity with the provisions and standards from the EU Action Plan on drugs, since it does not envisage the establishment of the proper system of control of illicit cross border trade in drugs, including mechanisms to facilitate regional and international cooperation.

There was no progress in developing sectoral strategies and specialised services within the police to enable better cooperation with the international bodies operating in the drug control field. At present their capacities are assessed as inadequate.

The Law on Precursor Substances is in line with relevant EU standards and has been in force since 2005. However, the implementing bylaws are still pending. The Law on Production and Trade in Narcotic Drugs has been prepared.

In detecting illegal sale, the unauthorised production and sale of narcotic drugs, the police directly cooperates with customs, the prosecution and judiciary, and informal cooperation also exists with the health and education ministry.

4.3.4. *Police*

The implementation of the new Law on Police, aiming at enforcing professionalism, accountability and transparency in the organisation and future work of the police, has been rather slow. There has been a delay in the adoption of the relevant implementing by-laws. The regulations on internal organisation of the police are still lacking. The lack of staff has worsened the level of communication and cooperation with the international partners.

The Inspectorate General, established as the internal control department of the police, has reported difficulties in functioning, notably due to the lack of cooperation within the police as well as in relation to the restrictions to the access to information concerning complaints filed against police officials. This lack of cooperation is also visible in key sectors, such as war crimes and organised crimes.

The Law on Higher Education in the Police has not yet been adopted and the establishment of the Police Academy has been delayed. This is equally affecting the reform of the Border police, where the lack of trained staff is a problem. The legislation on the security services has not yet been adopted.

4.3.5. *Fighting organised crime and terrorism*

Organised crime remains a source of serious concern. The action plan to implement the National Strategy for Organised Crime has not yet been finalised. There is a need to further reinforce specialised services within police, especially the ones tasked with investigating financial crime. There is a need to enhance the multidisciplinary cooperation between law enforcement, state prosecutors and judicial authorities at local, regional and national level based on EU best practices. The use of special investigative techniques, risk analysis and intelligence gathering should be further intensified. No common database has been established. Serbia should further contribute to the promotion of regional cooperation in

combating organised crime in Western Balkans especially in regard to fight against all illicit trafficking offences more effectively.

Serbia should cooperate closer with Europol in concluding a strategic agreement and providing input to the European organised crime threat assessment.

The seizure and freezing of assets, bank accounts and the proceeds of crime is problematic in the absence of appropriate legislation and institutional capacity to ensure seizure of assets obtained.

In line with the new internal organisation, the Department for the Suppression of General Organised Crime was established in January 2006. Several specialised sections have been established.

The implementation of the Law on Witness Protection has revealed deficiencies in practice and the present system of witness protection system proved to be inadequate. An important witness-associate in a high profile case was killed by a criminal group. This could have an adverse effect upon the conclusion of ongoing trials.

The new Criminal Procedure Code, coming into effect in June 2007, redefines the role and competencies of the police and the judiciary in the investigative process. The role of prosecutors will be strengthened in the investigative phase, whereas the police will exercise additional powers at this stage of criminal proceedings. Special rules will apply to the prosecution of organised crime offences, including provisions on the temporary seizure of assets, revenues and properties and in international cooperation in discovering and prosecuting perpetrators.

The ongoing trials for organised crime, before the specialised department of the Belgrade District Court are proceeding slowly. The complexity of the cases, large numbers of participants and the lack of adequate resources (there are only three courtrooms in Belgrade that fully meet technical and security criteria) have contributed to prolonging proceedings. Due to the importance of these trials, the work of the judiciary involved in these cases has constantly been the focus of public attention and was often subject to various forms of pressure, including threats to personal safety.

The legislation relevant for the confiscation of proceeds of crime has not been adopted.

Concerning **trafficking in human beings**, Serbia has been recognised as a source, transit and destination country. The criminal legislation has been amended, and the improvements in detection and prosecution of offenders resulted in first sentences pronounced against members of organised criminal groups. Victims have been offered more sustainable assistance, mainly through NGO-operated shelters. These were previously funded by international assistance although some inclusion of the authorities in cost sharing has been recorded recently.

At the former State Union level, the Council of Europe Convention on Action against Human Trafficking was signed in May 2006.

The Criminal Code which came into force on January 2006 has broadened the definition of human trafficking. The terms of punishment have been increased for the basic and qualified form of the criminal act. A separate criminal offence of trafficking of children for adoption has been introduced. The main deficiency of the new legislation is the lowering of the penalty for trafficking of minors – from a minimum five to three years of imprisonment. The positive

attempt to better protect the rights of the victims whose life and health are endangered has failed to include citizens of Serbia. There is good cooperation established between the specialised law enforcement agencies, notably the National Anti trafficking Council and Team at the Ministry of interior. There is a need to establish a fully operational network of specialised departments at the local level. Further efforts are needed for better protection of victims. The lack of relevant asylum legislation was somewhat corrected through the by-laws adopted in 2004, allowing for the issuance of temporary residence permits. 12 of those were granted so far by the Interior Minister.

There have been 190 trafficking victims identified from 2002 to end of 2005, another 22 to date in 2006. They are mostly from Ukraine, Romania, Moldova, Russia, Bulgaria, Lithuania, Georgia. Twenty criminal charges have been filed in the past year and two sentences passed for the criminal groups. There has been a worrying increase in number of children and citizens of Serbia/Montenegro identified as victims of trafficking.

The low level of professional training amongst the judiciary and the prolonged proceedings the absence of the effective witness protection, - in spite of the legislation that came into force in January 2006, - represent serious impediments to successful trials. On the positive side, efforts have been undertaken in the past period to provide specialised training for greater numbers of police and judicial officials. Some 600 judges were trained, and a public awareness campaigns have been launched.

Terrorism and its financing have been introduced as separate offences in the Criminal Code. The ratification and implementation of the International Convention on the fight against terrorism needs to be accelerated, as well as the ratification of the International Convention for the suppression of acts of nuclear terrorism.

4.3.6. *Protection of personal data*

As regards the right to the protection of personal data, the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data and its Additional protocol regarding supervisory authorities and transborder data flows entered into force in Serbia in January 2006. However, the Convention is not applied to automated databases containing personal data being kept in accordance with criminal records and state security regulations.

Serbia has not yet signed the Additional Protocol to the Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, regarding supervisory authorities and transborder data flows.

The currently existing Law on Personal Data protection of 1998 needs to be aligned with the *acquis*, in particular with the Data Protection Directive. Furthermore, an independent data protection supervisory authority with sufficient powers over the public and private sectors and sufficient means to effectively implement the law is not yet in place.

This situation makes the existence of data protection rules remain purely theoretical, does not ensure their implementation, and is a matter of concern.

STATISTICAL ANNEX