



IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

Mihailo Crnobrnja and
Ana S. Trbovich, eds.

SINGIDUNUM UNIVERSITY
FACULTY OF ECONOMICS, FINANCE AND
ADMINISTRATION (FEFA)

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Editors

Mihailo Crnobrnja, Ph.D.
Ana S. Trbovich, Ph.D



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Assistant Editors:
Dušan Vujović, Snežana Popovčić Avrić, Miloš Erić,
Tanja Mišćević, and Vladimir Todorčić

Translation: Slađana Ilić and Biljana Simurdić

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EDITORS' PREFACE

Serbia, a transition economy, is very sensitive to changes in the economic environment and shifts in its international relations. Integration into the European Union is probably one of the largest (partly) controlled transformations, which produces major economic and social changes. Drawing on different studies conducted in EU candidate countries and on historical experience, we may say beyond any doubt that Serbia will benefit from the process. However, the quality and the quantity of the benefits and, more importantly, the costs or investments relating to EU accession can only be estimated.

In this early stage, when Serbia has not even started the accession talks, the Belgrade-based Faculty of Economics, Finance and Administration (FEFA) has decided to conduct a study on the impact of Serbia's integration into the European Union. This cost-benefit analysis of Serbia's EU accession relies on a rather broad methodology and aims at determining the quantitative and qualitative effects of the process.

Partners to FEFA in this study have been the Serbian Chamber of Commerce, representing the business sector, and the Serbian Government, as its main beneficiary. The study is intended to assist the relevant government institutions and business entities in planning more rationally the reforms pertaining to the EU accession: the legislation, policies, strategies, institutional development, economic policies etc., in order to allocate the available resources more efficiently. Simply put, the objective is to facilitate Serbia's progress toward EU membership by reducing the required time and minimizing the investments.

This study is only a starting point in the process of expertly shaping Serbia's European integration. The integral study, organised by thematic areas, has over 1300 pages. This volume contains the summaries of the main findings and recommendations. The book also contains articles by domestic and international authors that were initially presented at the annual FEFA conference "Impact of Serbia's Integration into the European Union", which took place on 9 May 2009, the Europe Day.

To our knowledge, this is the first time that a broad analysis of the potential costs and benefits relating to the integration processes has been undertaken in Serbia; a broad, but not a comprehensive one. This research has encompassed less than 20 areas. In the coming years, we will strive to expand the number of areas that will be examined. Secondly, the European Union is, in a way, a “moving target” that is constantly transforming itself. We will need to gauge occasionally where we stand in relation to the new and transformed EU. Thirdly, the transition processes in Serbia are not entirely predictable. This has been clearly proven by the past experience. The question is, therefore, whether some of the assumptions upon which we have based the studies we have just completed will be equally significant within two or three years. Finally, during our research, as it often happens, we have “stumbled upon” some issues that need to be further investigated, which requires additional time. This all suggests that the impact analysis will need to be periodically revised. The meaning and the value of this study is that it has laid the foundations and the basic framework for a complex monitoring of the integration processes and the expected effects.

Beside the Serbian Chamber of Commerce, the study was financially supported by the Delegation of the European Commission to the Republic of Serbia, the UK Department for International Development – DFID, the Embassy of the Kingdom of the Netherlands, the French Embassy and the Fund for an Open Society. These institutions have recognised the importance of this study as a platform for the upcoming negotiations on Serbia’s EU membership, but also as an opportunity for raising awareness of the Government and the general public about the key consequences of the reforms implemented toward EU membership. The research may also help pinpoint the economic sectors that will be hardest hit by the changes. On behalf of the Faculty we thank all the donors for their support.

The volume in front of you is just the tip of the iceberg, presenting the key findings and conclusions. The integral version of the study is available on the FEFA website, www.fefa.edu.rs. We, the editors, wish to thank our partners – the Serbian Chamber of Commerce and the Government of the Republic of Serbia. Furthermore, we wish to express our thanks to all experts, 68 of them from 26 different Serbian institutions, who have participated in this research.

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CONTENTS

EDITORS' PREFACE	3
-------------------------------	----------

I

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

MACROECONOMIC AND FINANCIAL IMPACT OF SERBIA'S EU ACCESSION – EXECUTIVE SUMMARY	9
IMPACT OF SERBIA'S EU ACCESSION ON FREE MOVEMENT OF CAPITAL – EXECUTIVE SUMMARY	19
IMPACT OF SERBIA'S EU ACCESSION ON AGRICULTURE – EXECUTIVE SUMMARY	26
IMPACT OF SERBIA'S EU ACCESSION ON THE TRANSPORT SECTOR - EXECUTIVE SUMMARY	38
IMPACT OF SERBIA'S EU ACCESSION ON THE ENERGY SECTOR –EXECUTIVE SUMMARY	44
IMPACT OF SERBIA'S EU ACCESSION ON THE ENVIRONMENTAL SECTOR - EXECUTIVE SUMMARY	55
IMPACT OF SERBIA'S EU ACCESSION ON RESEARCH AND DEVELOPMENT - EXECUTIVE SUMMARY	62
IMPACT OF SERBIA'S EU ACCESSION ON EDUCATION – EXECUTIVE SUMMARY	73
IMPACT OF SERBIA'S EU ACCESSION ON THE LABOUR MARKET – EXECUTIVE SUMMARY	83
IMPACT OF SERBIA'S EU ACCESSION ON THE JUDICIARY – EXECUTIVE SUMMARY	91
IMPACT OF SERBIA'S EU ACCESSION ON COMPETITION POLICY – EXECUTIVE SUMMARY	98
AN OVERVIEW OF THE NORMATIVE FRAMEWORK FOR CONSUMER PROTECTION IN THE PROCESS OF SERBIA'S EU ACCESSION – EXECUTIVE SUMMARY	105

STATE AID CONTROL IN THE EU AND ITS APPLICABILITY IN SERBIA – EXECUTIVE SUMMARY	110
IMPACT OF SERBIA'S EU ACCESSION ON INFORMATION SOCIETY AND MEDIA – EXECUTIVE SUMMARY.....	115
IMPACT OF SERBIA'S EU ACCESSION ON SME SECTOR – EXECUTIVE SUMMARY.....	124
IMPACT OF SERBIA'S EU ACCESSION ON REGIONAL DEVELOPMENT – EXECUTIVE SUMMARY	132

II

ARTICLES FROM EUROPE DAY 2009

• <i>Aleksandra Čavoški and Ana Knežević Bojović</i> ROLE OF THE JUDICIARY IN THE PROCESS OF EUROPEAN INTEGRATION	145
• <i>Tanja Mišćević</i> ADMINISTRATIVE CAPACITY, EUROPEAN INTEGRATION PROCESS AND CHALLENGES OF THE CRISIS.....	168
• <i>Ana S. Trbovich</i> SERBIA'S EU ACCESSION SEEN THROUGH THE PRISM OF COMPETITIVENESS OF SMALL AND MEDIUM-SIZED ENTERPRISES....	184
• <i>András Inotai</i> EFFECTS OF ACCESSION ON THE NEW MEMBER COUNTRIES: THE ECONOMIC DIMENSION	201
• <i>Tomáš Výprachtický</i> THE CZECH REPUBLIC IN THE EU EXPERIENCE OF A YOUNG MEMBER STATE FROM THE VIEW OF STATE ADMINISTRATION	211
• <i>Anže Burger and Marjan Svetličič</i> FIVE YEARS OF SLOVENIAN EU MEMBERSHIP: IMPLICATIONS AND LESSONS LEARNED.....	225
“IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION” RESEARCH TEAM.....	246

***IMPACT ASSESSMENT
OF SERBIA'S EU
ACCESSION***

EXECUTIVE SUMMARY



MACROECONOMIC AND FINANCIAL IMPACT OF SERBIA'S EU ACCESSION – EXECUTIVE SUMMARY

Recent macroeconomic performance

Since 2001, Serbia has recorded a dynamic economic growth (5.4% annually). Domestic demand has been the main engine of growth despite the relatively high exports growth rate (28%). This, together with real dinar appreciation, has resulted in an expanding current account deficit, which has become the main structural imbalance. The high import growth (29.5%) and the subsequent increase in net exports provided for a disproportionately high level of private consumption and government spending. Remittances, foreign direct investment and substantial external borrowing have financed the goods and services deficit. The availability of external capital was greater than the current account deficit, and, consequently, the foreign exchange reserves were increasing until 2008. Public external debt was reduced, but intensive borrowing abroad by companies and banks led to a substantial increase in the private sector's external debt, which soared from EUR 2.35 billion in 2001 to EUR 15.4 billion in 2008.

This period was characterized by improved stability in the goods, money and foreign exchange markets against the background of high economic growth and considerable inflow of foreign capital, while the fiscal balance benefited from privatisation revenue. The volatility of the macroeconomic environment and, in part, of the fiscal position, was predominantly influenced by non-economic factors (unstable government majority and frequent elections, unilateral declaration of independence by Kosovo and Metohia etc.).

At the end of 2008, the global economic and financial crisis considerably reduced the pace of investment, foreign trade and the economic activity in Serbia. The first signs of the crisis were reflected in more re-

stricted access to external finance and psychologically induced decline of confidence in the banking system and government's ability to sustain macroeconomic stability. This led to withdrawal of foreign investors from the Serbian market and a reduction in foreign exchange deposits by domestic households. The trade volume on the interbank foreign exchange market contracted substantially, which resulted in a notable nominal and real dinar depreciation. Domestic demand decreased faster than export demand, which resulted in lower trade volumes and a smaller current account deficit.

A drastic economic downturn in Serbia's largest export partners led to lower foreign trade and a decline in the value of trade in goods (imports fell by 34%, while exports decreased by 22% y-o-y). Despite the surplus in the overall balance of payments, the BOP trends have been unfavourable in light of the considerable contraction of global economic activity caused by the current downturn (estimated to be as high as -5% for 2009) and substantially lower FDI inflow. A considerable reduction in domestic aggregate demand has constrained the inflation within the targeted range, but end-year inflation (estimated at 9%) remains substantially above the levels recorded in other countries in the region.

The awareness of the risks caused by a sudden reduction of capital flows prompted Serbia to be the first country to seek IMF support when the crisis erupted, although it had at its disposal substantial (primarily foreign exchange) reserves and a range of instruments built during the reform period, to neutralise the effects of the crisis. At the end of 2008 and beginning of 2009, Serbia maintained the stability of the banking system and relative price stability notwithstanding the substantial nominal depreciation during that period. The combined impact of the global economic crisis and real depreciation was the downward adjustment of the aggregate demand and reduced deficit in the exchange of goods and services deficit. The impact was somewhat cushioned by structural factors since important sectors of Serbia's economy (food, spare parts, capital goods, etc.) have been less affected by the declining global demand.

Expected macroeconomic impact during the EU pre-accession period

Beside the social, political and security-related reasons, Serbia's intention to apply for EU membership is largely motivated by economic factors. The main assumption is that accession would enable the expan-

sion of the (already high) economic cooperation with the EU member states and help advance Serbia's economic growth and development. The alternative, EU enlargement without Serbia, would lead to steady deterioration of the country's position in the medium term.

From the economic point of view, EU accession assumes that a country must first achieve micro and macroeconomic stabilisation, followed by broad liberalisation and structural changes. These policies and reforms do entail certain costs, but Serbia will have to deal with them regardless of its EU membership. The advantage of joining the EU is that the EU funds can be used for these purposes, which makes it easier to reach a social consensus on the methods for providing the necessary macroeconomic stability.

The brunt of macroeconomic accession gains relate to long-term effects of market expansion for domestic producers and enhanced competition in the domestic markets. Stable business environment and expanding development possibilities provide a basis for higher employment, improved standard of living, and better (technical and technological) performance of the economy.

Should the country opt not to join the EU, access to ample European markets will be more limited, and the cost of policy and institutional reforms will have to be borne without the use of pre-accession funds. The resulting lower level of competition may provide some sectors with relatively small gains, while other sectors and consumers at large would probably suffer substantial losses from trade protection. The exact effects will also depend on the timing.

Fiscal adjustment and macro-financial support of the EU

The assessment of the gross and net budgetary impact was based on the assumption that Serbia will join the EU budgetary system in 2014 and that the rules effective in 2004 will continue to apply. These estimates should be taken as approximations since forecasts of economic growth and future GDP levels are subject to great uncertainty in the global economic crisis.

Presently, the EU *Financial Perspective* allocates financial assistance to member states in the range between 1.6% and 3.3% of GDP. Assuming that similar level of financial resources is retained in 2014, **Serbia may expect to obtain net financial benefit of around 1.5% of GDP,**

excluding the pre-accession assistance, which presently averages almost EUR 200 million per year.

Under the IPA (*Instrument for Pre-accession Assistance*) programme, Serbia presently receives financial assistance for the process of European integration, implementation of the reforms required to meet the EU criteria, the advancement of the Stabilisation and Association Process and fulfilment of the Copenhagen Criteria. The IPA program encompasses five components, but as a non-candidate country, Serbia is eligible only for two types of assistance: the transition assistance and institutional building component – IPA I, and the cross-border cooperation component – IPA II. Serbia may receive assistance under other IPA components (regional development, human resources development and rural development) only when it receives the candidate status.

The adjustment of the tax system to the EU rules will entail certain changes in the amount and structure of tax revenue. The impact of the fiscal adjustment concerning customs duties will be negative, as Serbia will have to eliminate the customs duties to other member states upon accession (many have already been eliminated) and apply a common customs tariff towards non-EU countries (which is lower, on average, than the current customs duties in Serbia). On the other hand, the adjustment of excise duties on cigarettes and energy sources (electricity, natural gas and petroleum) will increase the fiscal revenue. It is expected that higher excise taxes will generate additional revenues of some 0.5% of GDP, while revenue losses associated with changes in custom duties may range between 0.2% and 0.5% of GDP. This result is obtained on the basis of actual data from the group of countries that joined EU in 2004 and Croatia.

Taking all this into account, during the first three years of EU membership Serbia may expect a positive net effect on the economy, in addition to the rule that a country cannot be a net creditor in the initial period. On the other hand, accession countries experience negative fiscal impact in the initial years primarily due to revenue losses on imported goods (customs and VAT). Later on, the pressure on the public finances continuously subsides, with the overall impact estimated at around 1% of GDP annually.

While direct and mostly negative (public finance) effects prevail in the pre-accession period, indirect effects prevail in the long term with a net positive or at least neutral net impact.

Following the initial fiscal adjustment (marked by changes in taxes and customs), the pressure on public finance gradually goes down.

Concurrently with restructuring and privatisation, the share of private investment in projects that require national co-financing increases. Furthermore, during the early years of membership countries need to make additional expenditure cuts to absorb the negative fiscal impact of accession and prevent the worsening fiscal position in the future. Later on, the member states could enjoy the positive impact of the improved expenditure structure on their public finance.

It is estimated that EU accession contributes 2-3% to **economic growth** and that every additional percent of GDP growth improves the fiscal result by 0.4%. It is also clear that the effects of accession to the EU budgetary system gain importance only in the long run. On that basis, it is estimated that in the long run the accession contributes 1 percentage point of GDP to the overall fiscal result.

Before summarizing the overall impact, it is worth noting that EU accession will likely reduce country risk premia, lower the cost of public debt service and, thus, make a positive contribution to public finances. Therefore, during the accession period, Serbia would be a net beneficiary of the EU funds and the overall net financial effect would be positive, while the broader budget impact would most probably be negative. In the long run, however, the EU membership would create a positive effect on Serbia's public finances due to higher economic growth, improved efficiency and better public finance management, and lower cost of public debt service

Price convergence and impact on real exchange rate and interest rates

Serbia will not feel any serious price pressure from the accession processes in the near future. This certainly does not fully rule out inflationary pressures, but they will not be a direct result of joining the single market. The accession process will support the price convergence mostly through stronger appreciation pressures created by higher inflow on the capital account of the balance of payments (foreign direct investment, borrowing), which will outpace the rising outflow related to foreign trade (higher growth of imports due to accelerated economic growth). The change in the relative price levels in a country is directly linked to the increase in the real value of its currency relative to the euro. The extent to which this process will affect the increase in inflation differential and

the nominal value of the national currency will depend on the economic policy, as well as on indirect effects of the expanding capital inflows.

The impact of the EU accession on real (dinar) exchange rate was analysed primarily through the Balassa-Samuelson effect on domestic inflation and real exchange rate appreciation. The analysis took into account that economic and structural changes in the new EU member states or candidate countries make it difficult to assess the equilibrium level of the real exchange rate. Given that empirical studies usually identify a tendency towards real appreciation (around 3% annually in Serbia), it is difficult to evaluate the equilibrium level of annual real appreciation. With this caveat in mind, it has been estimated that due to Balassa-Samuelson effect the dinar will appreciate by around 1% annually in real terms. This leads us to conclude that at the time of Serbia's EU accession, prices will tend to rise by around 1% annually relative to the Eurozone due to appreciation pressures.

The impact of EU accession on real interest rates is primarily reflected through access to the single money and capital markets, which indirectly translates into availability of cheaper credits and investment resources. EU membership provides a certain guarantee and substantially improves the credit and investment ratings of a country, which subsequently lowers the risk premia. Lower risk premia and access to cheaper financing are expected to reduce long-term real interest rates, particularly interest rates on the external debt. Hence, the expected decline in real interest rates may benefit most the countries with the highest share of public debt in GDP, but also the citizens and the private sector through cheaper loans.

Country risk perception is critical for investor decisions to invest either through foreign direct investment or credit arrangements, as it affects the spread and hence the lending rate or the expected risk adjusted profit. Wide variations in risk perception have been evident over a longer period, and became particularly strong during the current global financial crisis. The highly sensitive capital markets were hit hard through a heavy decline in the stock exchange indices and withdrawal of foreign investors. The situation with FDI was more stable but Serbia's eroded risk perception adversely affected the availability of direct investment in the medium term. As privatisation-based inflows are almost exhausted, the only source is Greenfield investments, which require a stable macroeconomic environment. Unlike five or ten years ago, Serbia's chances to attract risk-bearing capital are much slimmer today. Without a clear, EU-supported macroeconomic perspective, it will be impossible to provide sufficient financing to

secure economic growth required for servicing the already incurred external obligations and sustain the attained standard of living. Should the country opt not to join the EU, the share of foreign direct investment in total investment would not exceed 30%. This share is somewhat higher than the preliminary number for 2009 (around 25%), since it assumes that Serbia would ensure macroeconomic stability independently of EU membership. This, together with exogenously set level of foreign trade, defines the financial gap that can only be closed by borrowing at high cost.

Impact on foreign trade

Both theory and empirical data indicate that full integration into international trade flows is an imperative for growth of small economies. With exports of goods and services at EUR 1 350 and imports at around EUR 2 400 per capita, compared to EU-27 Serbia is among the least open national economies with the lowest GDP per capita.

To improve its position relative to the EU-27 average by about 1/3 (to some 50% of the average) and achieve similar level of openness, Serbia would need to expand the euro value of its exports of goods and services by nearly four times. This implies that some 80% of the projected increase in GDP should be based on export growth.

Securing internal macroeconomic stability is a strategic imperative of economic policy, whether the country is heading toward the EU or not. Based on that assumption, the two projection scenarios differ fundamentally in the balance of payments forecasts.

To ensure macroeconomic stability under limited foreign capital inflow (i.e. if the country does not join the EU), Serbia's current account deficit in the medium term would have to be reduced to 7% of GDP. In this scenario, the foreign exchange reserves would be used to provide the necessary liquidity, secure payments and stability in the goods and the foreign exchange markets. Although the projected economic growth would increasingly be based on import substitution, a large share of GDP growth would still be created through exports (around 60% in our estimate). To create room for investment financing, public consumption would need to be restrained while the standard of living would remain the same. The resulting dynamics of the economic growth would also be comparatively lower since a part of output would be based on import substitution mentioned above. By the end of the projection period exports could reach EUR

2,300 per capita, while per capita imports would be around EUR 3,100. The lower (negative) net exports per capita in this scenario would harness the aggregate demand within stable limits, while the burden of securing external liquidity would temporarily be transferred to the foreign exchange reserves until they are depleted.

Should Serbia strive to join the EU, its foreign trade would reach a comparatively higher level. This applies both to imports, as there would be adequate sources of finance, and to exports, because EU accession presupposes an economic policy that is sustainable in the medium term. Based on these assumptions, we may expect that the value of exports in this scenario would increase substantially – more than twofold, while the imports would expand by almost 2/3. Although negative net exports per capita would be higher in this case (around EUR 1,000 per capita), stability would be maintained through strong capital inflows. Foreign exchange reserves, contrary to the previous scenario, would be strong at the level equivalent to three months of imports. The debt would be comparatively larger, but its servicing would be cheaper and easier, due to lower interest rates, increased export revenues and higher gross domestic product.

Assessment of the macroeconomic impact of EU accession

The assessment of the macroeconomic impact of EU accession has been based on the comparison between two alternative macroeconomic frameworks: one built on the assumption that Serbia remains outside the EU, and the other based on the premise that Serbia would join the EU at the end of the projected period. The starting assumption in both scenarios was a commitment to maintain price stability, balance of payments and budget equilibrium through relatively tight economic policy. Although this assumption appears highly demanding, especially in the non-EU scenario, it provides the right framework to assess the impact of EU accession, assuming that other possibilities are used to the maximum extent.

Furthermore, we have assumed in both scenarios that the core dilemma would not affect the economic aggregates in the current year (2009) since the estimates are based on the key relations between the gross domestic product and balance of payments, and the implications they have on reserves, debt, savings and investment. The model is static in nature, and it derives dynamics from the expert evaluations and the conclusions presented above.

A summary of the macroeconomic impact of EU accession

		Without EU entry	With EU entry
Gross domestic product			
growth rate, %	2010-2015	3.4	4.7
per capita, EUR	2015	5,530	6,075
Personal consumption expenditure			
per capita, EUR	2015	3,820	4,250
Investment			
per capita, EUR	2015	1,380	1,880
% GDP	2015	25	31
Exports			
per capita, EUR	2015	2,250	2,850
% GDP	2015	37	47
Imports			
per capita, EUR	2015	2,850	3,900
% GDP	2015	47	64
Current account deficit			
% GDP	2015	5	10
Foreign direct investment			
per capita, EUR	2010-2015	1,400	2,300
% GDP	2010-2015	5.5	8.2
Serbia's foreign exchange reserves			
EUR billion	2015	6.1	10.2
External debt			
per capita, EUR	2015	2,870	3,350
% GDP	2015	51.9	60.6
% exports	2015	127.9	127.9

The key distinction of the EU accession path is easier access and availability of non-lending sources for financing the current account deficit. The gap in financing created by lower foreign direct investment would be borne by the taxpayers or declining foreign exchange reserves if Serbia fails to join the EU. Expectedly, this would result in substantially lower in-

vestment and subsequently weaker economic growth. The cumulative difference in GDP per capita may appear insignificant (9.8%), as initial convergence of GDP levels would take place even if Serbia does not join the EU. In that case, the growth would be supported at the expense of lower public and private consumption, and declining foreign exchange reserves. The two scenarios critically diverge in the sustainable private consumption growth (average annual growth of 1.2% in the non-EU scenario and 2.8% in the EU accession scenario), the level of investment (1,380 euros and 1 880 euros per capita), and especially FDI (1,400 euros vs. 2,300 euros over a five-year period) and much higher exports (2 250 Euros vs. 2 850 Euros per capita annually on average). Should Serbia join the EU, this would be accompanied by substantially higher imports that would benefit both consumers and investors (businesses).

Although the above figures speak for themselves, one must emphasize that EU entry entails a substantially more stable macroeconomic environment. This indicates clear investment opportunities to potential investors. Economic entities (companies and commercial banks) will appreciate the certainty and predictability of business environment and an opportunity to focus on their core business. The state will direct its resources towards implementing the necessary policy and institutional reforms. The labour will face enhanced employment opportunities and greater income stability. The consumers will enjoy a better selection and improved quality of goods and services, and more opportunities for financing the purchase of durable consumer goods and real estate.

Economy by nature carries risks – both at micro and macro level. Regarding this impact assessment, important risks are pertaining to both internal and external factors. Undoubtedly, Serbia will not be able to build its future outside the EU, especially in the long run. Even in the medium term, reliance on one's own resources would obviously produce quite different effects compared to access to a wider community market. In either case, the position of the Serbian economy will critically depend on its ability to adjust to the wider economic environment that will shape the internal economic milieu beyond the scope of our influence. In such circumstances, there will be little or no difference between operations in the domestic and wider EU market. This will open new markets and increase competition. The EU accession process will greatly benefit the Serbian economy provided it becomes more competitive.

IMPACT OF SERBIA'S EU ACCESSION ON FREE MOVEMENT OF CAPITAL – EXECUTIVE SUMMARY

Capital flows today affect a large number of macroeconomic variables: the scale of economic activity, foreign exchange rate, interest rate, balance of payments, etc. Liberalisation of capital flows invokes many controversies. On the one hand, the proponents of capital account liberalisation claim that free flow of international capital encourages capital inflow, optimal allocation of capital, diversion of assets toward projects with higher rate of return, risk diversification, faster financial system development etc. On the other hand, free capital flow may clash with domestic economic policy and lead to its many distortions. A sudden capital outflow, which may trigger a crisis, can be particularly dramatic. This scenario replayed itself in Asian, Russian, Turkish and many other downturns. It comes as no surprise, then, that a large number of countries have attempted to regulate capital flows. Capital regulation has most frequently entailed measures to prevent capital outflow, such as prohibiting residents from investing capital abroad and setting the conditions that either hamper or disable flight of invested capital. The opinions on effects of capital liberalisation are inconsistent, though the prevailing view presented in the literature is that the benefits of capital liberalisation exceed the related costs.

Majority of authors recommend a phase-in approach to capital account liberalisation for economies in transition. The experiences of transition economies that became EU member states have been chequered. Estonia, Latvia, Lithuania and the Czech Republic conducted a fast liberalisation of capital flows that was completed by mid-nineties already. On the other hand, Hungary, Poland, Slovakia and Slovenia opted for gradual capital flow liberalisation that was concluded in the period between 2001 and 2004.

Free movement of capital is one of the four freedoms envisaged by the Rome Treaty Establishing the European Economic Community. The EEC Treaty (Title III, Chapter IV, articles 40-45) prohibits any restrictions to free movement of capital between EU member states. These provisions of the founding treaty have been defined in more detail through a set of directives, decisions, regulations and other legislative acts. However, these provisions do not prevent the member states from conducting autonomous tax policies, controlling and overseeing financial institutions or collecting statistical data.

The first step the EU aspirants are required to make is unconditional liberalisation of current transactions and of medium-term and long-term capital flows with maturity longer than one year. Liberalisation of these flows usually poses no major problems for economic and monetary policy management. The second step involves liberalisation of short-term capital flows concerning transactions with maturity shorter than one year, such as securities trading, opening of savings accounts abroad and physical import and export of money. Real estate trade also needs to be liberalised in this stage. This move integrates a country entirely into the international financial market and establishes full capital account convertibility. As this stage may generally lead to several problems, it presupposes macroeconomic stability and adequately developed instruments of economic policy (monetary policy, above all).

EU integration is one of the main strategic choices for Serbia. **Hence, there can be no debate as to whether capital movement liberalisation should take place, but only as to when it should happen.** Before it joins the EU, Serbia must liberalise all its capital flows. By signing the Stabilisation and Association Agreement (SAA), Serbia committed to liberalise capital movements within **four years**. The following pages will present the key areas of the liberalisation and the assessment of their impact. We will not analyse overall capital flows, but only those that are the outcome of capital account liberalisation. Unfortunately, these effects usually cannot be quantified and we have only proposed the course that the capital flows may take. As regards current transactions, they have been almost fully liberalised, while capital transactions have not and a phase-in approach has been taken in their liberalisation. The principal obstacles to capital transactions presented by the Law on Foreign Exchange Operations include:

- prohibition for residents regarding investment into foreign short-term securities and portfolio capital,

- prohibition for residents regarding investment into long-term securities that were not issued by OECD countries or international financial organisations,
- prohibition for non-residents regarding investment into domestic short-term securities,
- limitations imposed on legal entities for keeping their assets on foreign accounts without authorisation of the National Bank of Serbia (NBS),
- prohibition for natural persons to have foreign bank deposits (unless their place of residence is in another country),
- restrictions imposed on individuals for taking loans abroad, and
- restrictions imposed on legal entities for taking short-term loans abroad.

As regards liberalisation of these flows, a considerable outflow might take place only in the event of liberalisation of deposits held abroad by natural and legal persons. Liberalisation of other flows may lead to capital inflow or negligible capital outflow, and there is no reason to postpone it any longer. Further liberalisation of the financial system is also necessary. The main areas for further insurance liberalisation involve allowing domestic legal entities and individuals to use services of foreign insurance companies and eliminating constraints imposed on insurance companies, which can now invest only up to 20% of their core capital abroad and exclusively with prior authorisation from the NBS. Liberalisation of these flows would not lead to major capital outflow.

With regard to voluntary pension funds, they are only in their infancy and own a modest capital; therefore, any negative effects of liberalisation in this area would be limited in scope. The most important limitations concern the inability of residents to be members of foreign voluntary pension funds and the ceilings imposed on investment into securities and real estate abroad.

The banking system is largely liberalised. However, there is need for further liberalisation that would result in abolishment of prior authorisation by the NBS required for foreign transactions or for banks wishing to open their office abroad. It would create the possibility for banks originating in the EU to operate in Serbia through a branch office. The net effect of these measures should be capital inflow.

Investment funds, just like voluntary pension funds, are characterised by a modest pool of collected capital. There is a slender chance of capital outflow in the event of liberalisation of other flows in this area.

Domestic and foreign legal entities may acquire ownership in Serbia only if there is a reciprocity agreement with their country of origin and if they can provide evidence that they are engaged in business activities in Serbia. Legal entities that wish to buy real estate in Serbia have to be registered in Serbia. Individuals may purchase real estate (in both directions) only if there is a reciprocity agreement. These constraints should be lifted immediately, which might generate certain capital inflow. Also, we must not lose sight of the fact that once Serbia has joined the EU, real estate prices will probably rise, just like they did in other transition economies upon EU accession.

For Serbia, full capital liberalisation would definitely mean **better resource allocation, an incentive for faster financial market (primarily the non-banking sector) development, improved credit rating and investment climate in general, but also higher exposure to capital flight**. The experiences of countries in transition have shown that the countries that liberalised entirely their current and capital payments saw substantial inflow of foreign capital, as the liberalisation enhanced the general investment climate.

Macroeconomic stability is an important factor in preventing capital outflow. Low inflation, stable foreign exchange rate, low budget deficit, low level of public debt and stable and efficient financial system are the factors that may influence positively capital inflow in the event of capital liberalisation. Therefore, Serbia must strive for a sustainable macroeconomic stability that entails, in the long run, a single-digit declining inflation, budget deficit and public debt aligned with the Maastricht criteria (up to 3% and 60% of GDP, respectively), positive GDP growth rates, the current account deficit reduced to a single-digit share of GDP and a stable foreign exchange rate. On the other hand, massive inflow of foreign capital may in turn help macroeconomic stability, resulting in low inflation, stable exchange rate and sustainable public finances.

Exchange rate trends pose a potentially high risk. In the past, the dinar has proved to be a very volatile currency and despite longer spells of stability, its value sometimes plummeted within a short period. For instance, between end October 2008 and end February 2009, dinar lost around 25% of its value. In these circumstances, both domestic and foreign capital will "flee" the dinar for a foreign currency, and probably even

flee the country. To pre-empt such negative tendencies, the adequacy of the conventional inflation-targeting regime for Serbia should be revised and the decision-makers should decide whether it would be more suitable to apply a flexible inflation targeting that would take into account the exchange rate trends. High risks for capital outflow may occur also in case of rising inflation, or emergence of political or any other instability. High level of capital liberalisation may also mean easier transmission of external shocks.

However, in line with rules of the EU and World Trade Organisation, Serbia will have the option to introduce short-term (up to six months) restrictions on capital movements toward third countries, but only if capital movement has caused or threatens to cause serious problems for the economy.

Capital account liberalisation will not play the decisive role concerning capital flows in Serbia in the following period, but macroeconomic and political stability, the impact of the crisis on Serbian economy, interest rate trends and the potential yield will. Foreign investors and capital prefer countries that impose only minor constraint on capital flows and Serbia will need to lift the restrictions in order to create a stimulating investment climate.

Finally, we must not forget the impact of hidden barriers, whose elimination is an integral part of free movement of capital. They include distortions resulting from double taxation or unfavourable tax treatment of foreign investors, inadequate international payment system and existence of public commercial monopolies that hamper free competition. Regulations governing this area must include adequate rules and procedures aiming at **prevention of money laundering and signing of double taxation agreements and investment protection treaties.**

The expected aggregate impact of Serbia's EU accession in the area of free movement of capital is presented below:

Activity area	Expected impact
Possibility for domestic individuals to keep foreign bank accounts	Maximum potential outflow EUR 1.17 billion, the real expected outflow somewhere between EUR 60 million and EUR 120 million
Liberalisation concerning foreign bank accounts kept by resident legal entities	Potential capital outflow between EUR 205 million and EUR 615 million

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

Liberalisation of residents' investment in short-term securities and foreign portfolio capital	Minor capital outflow
Allowing foreigners to purchase domestic short-term securities	Capital inflow
Possibility for residents to invest into long-term securities in any country	No considerable impact
Possibility for individuals to take loans abroad	Capital inflow, but insignificant in size
Possibilities for firms to take short-term loans abroad	Capital inflow
Possibility for insurance companies to invest their equity abroad freely	No major capital outflow
Possibility for residents to be insured with foreign insurance companies	Minor capital outflow
Possibility for domestic individuals to become members of foreign voluntary pension funds	Slight capital outflow
Allowing investments by voluntary pension funds in government securities issued by EU member states	No capital outflow or slight capital outflow
Allowing investments by voluntary pension funds in real estate on the EU market	Maximum potential outflow of EUR 8.1 million, no real outflow expected currently
Abolishment of prior authorisation by NBS for banking operations abroad	No impact on capital flows
Abolishment of prior authorisation by NBS for opening domestic bank establishments abroad	Minor capital outflow
Unrestricted opening of subsidiaries of banks originating in the EU	Capital inflow
Liberalisation of investments made by investment funds	No capital outflow or slight capital outflow

IMPACT OF SERBIA'S EU ACCESSION ON FREE MOVEMENT OF CAPITAL

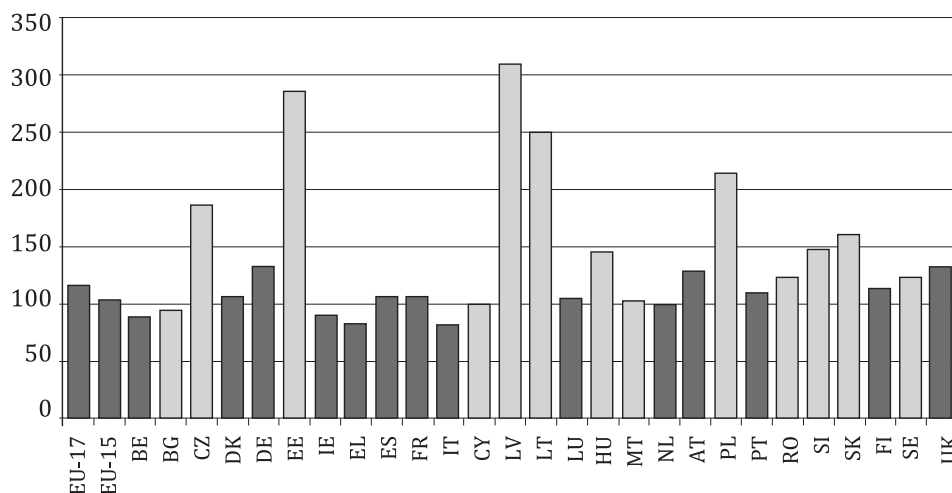
Real estate market liberalisation	Capital inflow
EU accession	Real estate prices may increase by some 30% within a few years
Macroeconomic stability	Improved macroeconomic stability may result in higher capital inflow and vice versa
Rising inflation	Capital outflow
Dinar devaluation	Capital outflow
Credit rating	Credit rating expected to improve
Financial crisis	Capital outflow
Political instability	Capital outflow
Foreign direct investment	Mostly liberalised already. By eliminating the reciprocity requirement, minor additional capital inflow may be expected, because of the current reciprocity obligation with the major partners.
Better offer of quality securities	Capital inflow
Financial market	More developed market, higher inflow
General liberalisation of capital flows	Higher inflow, but also a higher outflow if there are any larger internal or external shocks

IMPACT OF SERBIA'S EU ACCESSION ON AGRICULTURE – EXECUTIVE SUMMARY

The agriculture sector often faces the most difficult road to the European Union of all the areas under negotiation. However, once a country has entered the EU, farmers are expected to reap the biggest benefits. The number of farmers in Hungary today has declined by 9%, in Slovenia by 13% and in Slovakia by 3.5% relative to the five-year period before they joined the EU. On the other hand, the increase in the index of agricultural income (2000-2007) for EU-27 was 115.9 (change in 2007 relative to 2000), while much higher indices reaching 190 on average were recorded in the acceding countries or recent EU entrants: 213 in Poland, 186.2 in the Czech Republic, 144.8 in Hungary, 308 in Latvia, 250.2 in Lithuania. The trend observed in other countries encompassed by the Common Agricultural Policy of the EU will probably be mirrored in Serbia for two reasons.

First, the EU Common Agricultural Policy (CAP) is based on principles of the single market, financial solidarity and EU supremacy and, as such, is very open to and beneficial for the new member states. Second, Serbian agriculture has the potential to make a substantial contribution to this policy, not only with the quantity, but also with the quality of its output. CAP is a well-organised policy applied by EU member states to regulate primary output and processing of agri-food products. On the other hand, the Serbian agriculture sector is on the way to build its own market mechanisms and a stable agricultural policy. Some results are already visible, but there are many problems as well, from structural ones concerning the undeveloped markets, low levels of technical and infra-structural capacities, lack of knowledge, fragmented farm structures, to those concerning agricultural policy – the small budget, unstable policy, undeveloped institutions, and lack of adequate legislation and its implementation, in particular. These imperfections still restrain the potential of the agriculture sector, and prevent it from being a sector that contributes significantly to the country's wealth. Serbia's share of agriculture in GDP

IMPACT OF SERBIA'S EU ACCESSION ON AGRICULTURE



Overview 1: Index of agricultural income in EU member states, 2000-2007 (2000=100)

is high (over 11%) compared with the EU (around 2%), but its monetary value is modest and amounts to RSD 128 billion (300 euros per hectare of arable land; unlike the EUR 1 000 in the EU). **A similar ratio between Serbia and the EU is arrived at when the data on productivity of agricultural workers and farmers or data on appropriations or output results are juxtaposed¹.**

The estimates of basic EU accession costs for the agriculture sector

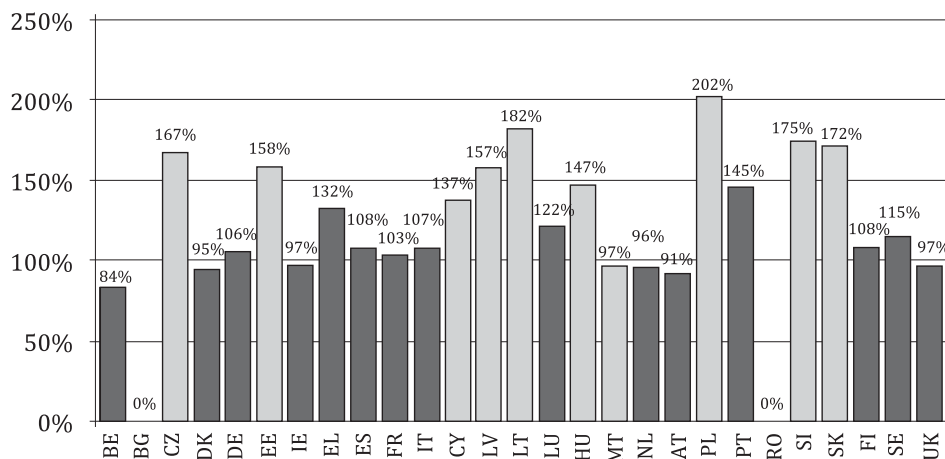
The costs of Serbia's compliance with CAP can be classified as public – expressing the price of the efforts required to build a system that enforces the EU standards – and private – representing the personal expense of participants in the market chain due to the evolving environment.

Administration and the cost of implementation of the new laws

- A large share of the expenses is related to **administration of EU funds and safeguarding of standards**. Despite the expenditure cuts stemming from abolishment of particular agencies (e.g. by accepting the EU Com-

¹The reliability of the data can be questioned, because official Serbian statistics is not aligned with the EU norms, and particularly not with regard to agricultural accounts, which are considered to be one of the most complex statistical analyses.

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION



Overview 2: Percentage of increase in agricultural spending in 2007 relative to 2006

mon Catalogue, the service for recognition of foreign varieties of agricultural species will be made redundant; in a single market, agricultural inspectors will no longer be needed on the borders, etc.), far more is expended on new administrative bodies, which also increase the number of civil servants. The setting up of the EU Paying Agency that administers the EU funds comes with the highest price tag. For instance, the Polish Paying Agency employs 8 700, while the Hungarian hires around 2 500 persons. The estimates are that Serbia will need to employ some 50 new persons for the implementation of the IPARD funds and over a thousand to be responsible for the payments within Pillar 1² upon EU entry. New hiring will be needed for control of payments, FADN³ reporting, monitoring of prices and coordinating the Common Market Organisation – CMO. The Ministry of Agriculture will lose some of its traditional functions, but gain many new ones that will require considerable new hiring – between 1 300 and 1 500 new employees will be needed. The total cost will be approximately EUR 15 million, which cannot be paid by the EU and has to be financed by domestic sources.

²The EU support is divided between Pillar 1, for direct payments per hectare, and Pillar 2, which encompasses payments for rural development

³The Farm Accountancy Data Network (FADN) is a system of questionnaires that are completed every year by representative farmers. It comprises data on diverse indicators.

The cost of output decline due to increased imports upon opening of borders – This is probably the biggest fear that farmers have with regard to EU integration. It is largely justified, because the uncompetitive sectors of Serbian agriculture will have to tackle rising imports of the respective products, due to the easier access to the domestic market, and will have either to curtail their output or adjust to the new circumstances. However, the same access to cheaper and better quality products on the frontier-free market will provide an opportunity for growth of many new productions, as agricultural business comprises a tightly interlinked and dependent market chain in which one output is the input to another product (e.g. seed maize – corn – fodder – livestock – side of meat – meat – sausage). This is the very reason why the trends in the new EU member states show that while imports are on the rise, exports are increasing as well. Both exports and imports of agricultural products to and from the EU have been expanding at an average 17%. It can be expected that imports growth will outpace exports immediately upon opening of the borders, but the trend will turn the corner later on, after Serbian agriculture has adjusted to the new conditions (access to cheaper raw materials and financing).

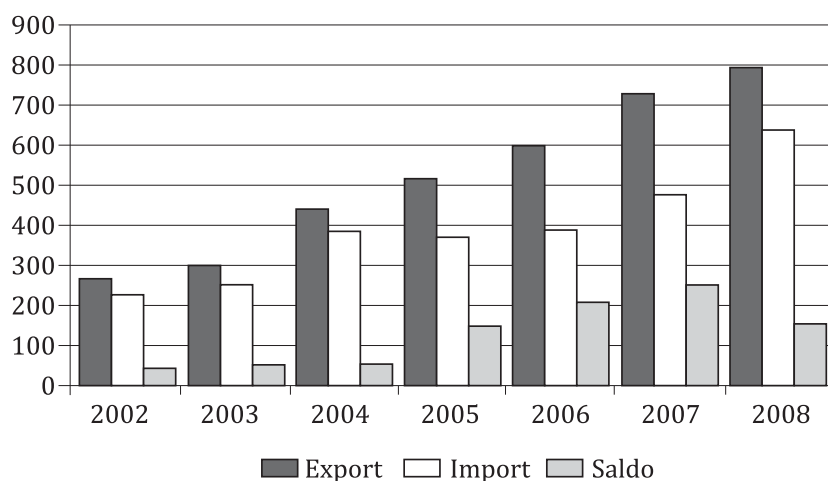
The cost of introduction of required standards – For a country to function as part of CAP, it needs to be able to enforce the criteria that are binding for farmers in other member states. If we wish for EU citizens to



Overview 3: Serbia's overall foreign agricultural trade, 2002-2008, USD

buy our products, they must at least be of the same quality and of the same price available to Europeans, and be produced in line with mandatory EU production methods. The production and retail standards are usually the basic requirements defined by *OIE*, *EPPO* or *CODEX ALLIMENTARIUS* and implemented by the World Trade Organisation (WTO), while the EU imposes only a few additional regulations or companies that operate in the EU may impose their own, specific standards. If all the WTO rules are implemented fully, it will not be difficult to align with further EU norms concerning food traceability, livestock marking, animal welfare, mandatory scrutiny and keeping of registers, additional quality assurance requirements and a special set of legislation concerning protection of the environment from pollution from agricultural sources (the Nitrate Directive, for instance). As a rule, a portion of these private expenses is transformed into public expenditure through subsidies given for introduction of standards. This was precisely the way Serbia not only complied with a very exacting EU regulation concerning introduction of the HACCP system, but also incorporated it into Serbian legislation, which allows the country to demand the same quality of those wishing to place their products on the domestic market.

The costs of higher social allowances for those unable to keep up with reforms – Some farmers, constrained by their personal capacities, or the less-favoured areas they live in, will not be able to continue farming in the pre-accession period, because the period leading up to EU



Overview 4: Serbia's agricultural trade with the EU, 2002-2008, USD

entry is reserved for development, boosting competitiveness and introduction of standards. In the recent EU entrants, the percentage of these farmers varied between 0% and 15%. The largest share of the decline in the number of farmers was accounted for by discontinuation of farming in elderly households. The number of elderly households who support themselves by farming is high in Serbia, while social protection of farm households is low and considerably different from the level of social protection enjoyed by the rest of the population. By all criteria, the numerous farm households should be beneficiaries of social assistance. However, as the state has not acknowledged the farmers' problems and their needs, it has not been obligated to incur this expenditure. In the EU accession process, one of the costs that will arise will involve social allowances to farm households that will be unable to keep step with the reforms.

The cost of shutdown of processing industries that are unable to keep pace with development – Some processing capacities will not be allowed to operate upon Serbia's EU accession, as they will not comply with the required standards, while the cost for them to attain the requirements would exceed the potential benefits. These establishments will need to close. For instance, Serbia has around two-hundred dairy producers and four-hundred slaughterhouses. Only 5-6 large and 15-20 medium-sized dairies are expected to remain, while the number of slaughterhouses will plummet. The experiences of other countries show that this process would not contract or restrict the overall output, because the existing capacities will increase or mobility toward processing capacities in other countries will improve. The only real expense will be the economic value of the closed plant.

The cost of financial contribution to CAP – Every EU member state, in line with the principle of financial solidarity and defined rules that take into consideration the economic power of a country, gives its annual contribution to the EU budget, a part of which is used for functioning of CAP. **Serbia will be among the five biggest net recipients, but will have to contribute annually about half of the sum it will receive from the EU.**

Assessment of the main benefits of EU integration to agriculture

While a major part of the cost of integration of Serbia's agriculture in CAP will be borne by all citizens, because it is a public expense, farmers, as well as consumers, will feel the largest share of the benefits. In every

impact analysis, there are effects that are easy or difficult to measure and those that are more or less complicated to express. They frequently involve a change in mentality, emotions, feelings of confidence or fear, which are difficult to gauge relative to those that only have an economic basis, but are all the more important. One of the prime characteristics of CAP is **predictability**, concerning, on the one hand, the benefits of certainty as to the policies and related allocations included in the seven-year financial framework, intervention prices or rules for payment of damages caused by weather disasters. On the other hand, the costs may be predictable, with the knowledge of which standards ought to be applied and in what way, or how large administration is needed to handle subsidies. Clear, one-size-fits-all rules are an important characteristic of CAP that is difficult to measure, but will be especially welcomed by the Serbian farmers, who are accustomed to an erratic agricultural policy.

Trade promotion and market access - The EU market and the half million EU consumers are very demanding and willing to pay for quality. This market has almost engulfed Serbia and is already the most important individual market for Serbian agricultural products. The main reason for some USD 800 million worth of Serbian agricultural exports and agricultural trade surplus with the EU is the preferential access to the EU market that was granted to Serbia in November 2000. **The benefit created only from the unpaid levies on export of agricultural goods in this period has totalled EUR 1.6 billion, or three-quarters of overall benefit from unpaid customs duties.** It is an easily quantifiable and direct benefit. The advantages that are more difficult to measure concern the accompanying exports-related effects that have totalled **over USD 3 billion in the past five years** and have been reflected in the contribution to macroeconomic stability, higher investment, job creation, stability of domestic prices etc. Though Serbia enjoys a unilateral preferential treatment by the EU, which entails levy-free export of goods (except for sugar, baby beef, wine and fish, where tariff quotas apply), full trade liberalisation requires eliminating barriers to trade. Many agricultural products cannot tolerate waiting on borders. The very existence of borders and the long hold-ups have considerably curbed our export potential. Practice has shown that Serbian exporters can expect to place their products on the EU market and large EU importers to purchase goods in Serbia only after the integration of Serbian agriculture into CAP. Our products will then be characteristic only by their price and quality, instead of being encumbered by the many tariff barriers.

Prices - Upon EU entry, **the prices of agricultural products become more stable** - they fluctuate less and have a tendency to converge

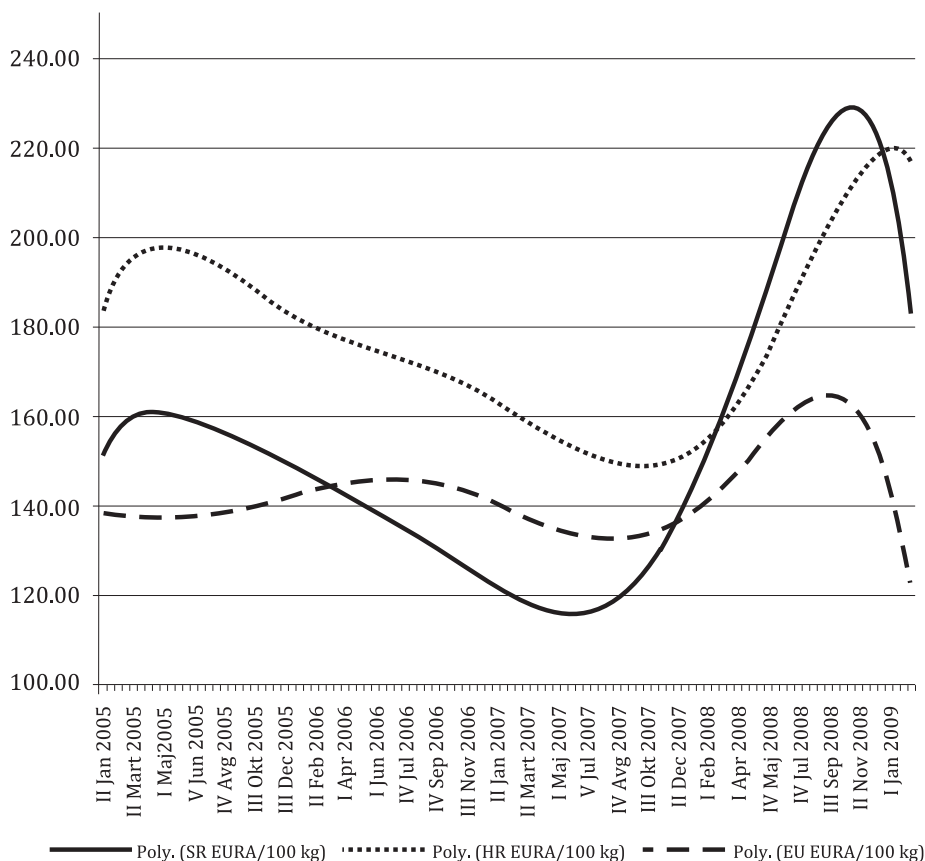
throughout the EU market. However, they never become even, as differences between countries and regions continue to exist. This means that all prices in Serbia will vary, but some will go down and others increase, driven by the competition from products on the EU market. The highest increase will be seen in the prices of:

- goods in which Serbia has uncompetitive prices, at all times or in some years, and which cannot be exported as their producers do not comply with standards regulating, for instance, pork, dairy and their products;
- goods whose producer prices are lower, but final prices are higher in Serbia due to market errors – these include milk, oil and some less important foods;
- goods, such as different kinds of fruit and vegetables, in which Serbia has not been able to fully use its competitive advantages due to obstacles imposed by borders or lack of interest by EU partners in third-country markets.

It is difficult to assess the overall financial benefit for farmers and retailers in Serbia created by higher producer prices, but by analogy with the new member states, this sum will be much larger than it is today. In recent EU entrants, the trade with the EU soared and in many countries even doubled within several years. As Serbia already has a surplus in trade with the EU and quite a few products competitive by price and quality, whose number will increase with use of pre-accession instruments, we may assume that the profit gained from higher prices will reach one-quarter of Gross Value Added (GVA) within a matter of years upon EU accession. The higher prices and market expansion will induce higher output.

Subsidies – The Common Agricultural Policy is the costliest EU policy that absorbs nearly half of the EU budget. For the same reason, once the country has joined the EU, farmers can benefit from utilizing the many **subsidies**. This is the most easily gauged and most frequently cited benefit. Whether expressed as euros per hectare or Euros per farmer, these sums exceed by several times those that Serbian farmers receive today. They are intended to support both the market and investments and building of infrastructure in the rural areas. In 2007, the Polish farmers received EUR 3.12 billion in subsidies, Hungarians got close to EUR 1 billion, while EUR 180 million went to Slovenian farmers. These funds grow constantly because, in contrast to the old member states, the recent EU entrants were not entitled to full subsidies from the central budget. It will take nine years of phasing-in before the new member states will have the right to the full amount of

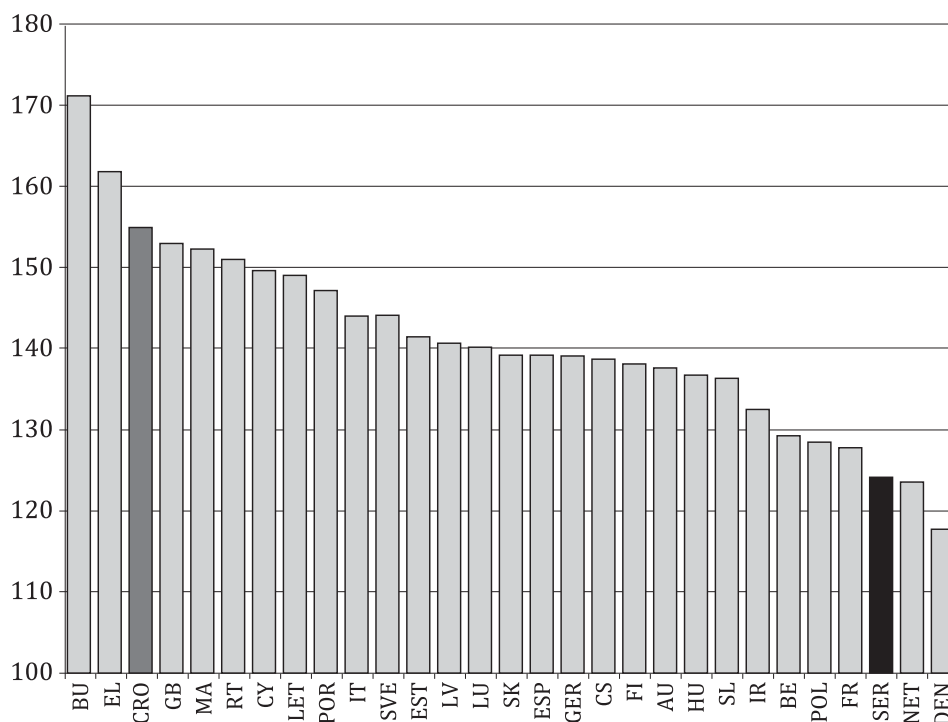
IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION



Overview 5: Price trends for finisher pigs in the EU, Serbia and Croatia, 2004-2008

direct payments from the EU budget and become equal in this regard relative to the old member states. In the accession year, the new member states became entitled to direct payments equivalent to 25% of that available to EU-15. However, the governments of the recent EU entrants were allowed to top up the direct payments to their farmers by a maximum of 30% of total subsidies. On the other hand, the funds intended for investment and rural development support have been available in full since day one. The same formula will probably be applied to Serbia. The estimates show that the total EU allocation for farmers ranges between 250 euros per hectare in the United Kingdom and 800 euros per hectare in Greece. As additional amounts from the budget may be earmarked for particular programmes,

IMPACT OF SERBIA'S EU ACCESSION ON AGRICULTURE



Overview 6: Average price of finisher pigs in the EU, Serbia and Croatia, 2007

the minimum subsidy may be a little below 300 Euros, while the maximum payment may reach EUR 1,100. Serbian farmers currently receive less than 30 euros from the budget. Upon EU accession, **the total transfer to Serbia should be close to EUR 10 billion⁴ for the respective seven-year financial framework. While fewer funds will be available initially, the payments will be phased-in each year to reach the full amount in the last year of the financial framework.**

During the process of European integration, the EU has special support programmes for acceding countries. Instrument for Pre-accession Assistance provides financing for agriculture and rural areas through

⁴ The estimate was made on the average of the amount given to the 12 new EU member states and the average quotients of the number of farms and the size of agricultural land. The number of farms and land surface that will be included in the system of payments was adjusted for Serbia, i.e., instead of the statistical estimate, lower figures were used, by reference to the experience of the new member states.

three of its five components. Components I and III serve for advancement of administrative capacities and regional development (part of the funds are used for rural infrastructure). The most important is Component V (IPARD), whose objective is rural development. The estimates are that around EUR 50 million per year will be distributed through IPARD funds. To be eligible for the funds, Serbia needs to receive the candidate country status, to have an IPARD programme approved by the European Commission (EC), to have Sector Agreements signed, to establish IPARD operational structure that has received national accreditation, to receive accreditation from the EC for management of the fund and to sign a Multi-annual Financial Agreement.

Investment – One of the main problems of Serbian agriculture is stiff competition at the level of primary output and low competition or even a monopolised market at the processing level. Serbia has not managed to attract enough investment into processing and retail capacities. Consequently, **the producer price paid to the farmer is usually lower than in the EU, while the final price paid by the consumer is higher.** In Poland, Hungary and other new EU member states, foreign direct investment into processing capacities and the wholesale sector has been the engine of agricultural development. Serbia will have to follow their example and the best way to achieve that is to create a favourable and predictable business environment. EU accession is the biggest magnet for investors. There is a clear correlation between the level of **foreign investment** and the stage of EU convergence. Foreign investments promote increased consumption and output of domestic agricultural goods and by doing so provide a new market for domestic products. Opening of the market boosts investment into supermarkets, which are usually quick to organise their vertically integrated procurement and retail chain, frequently export-oriented. The largest investments will flow into:

- production sectors for which Serbia has competitive raw materials, like vegetables, fruit, milk, cereals and some meats;
- production sectors that are not ready for the EU market game due to the insufficient know-how and investment into the existing processing capacities, which pertains to a large number of processing capacities for industrial crops, milk etc;
- production sectors into which the investors transfer the entire technology in order to benefit from Serbia's competitive advantage of inexpensive land and labour; as well as in
- the wholesale sector.

Conclusion

The Common Agricultural Policy, painfully efficient with regard to attainment of its main objectives and painfully expensive from the perspective of the budget, still is a successful policy, especially today, after the many reforms it has gone through. The measure of its success is not only the tonnes of the exported products, the amount of yield or the standard of living of rural population, but the fact that this has been achieved with considerable attention given to food safety, environmental protection and development of rural areas. Serbia has been offered to be one of the rare, privileged countries that are part of this policy. The Serbian agriculture sector must seize this historic opportunity, not only for all its quantifiable and unquantifiable benefits. The truth is that if Serbia fails to become a part of the EU and loses all the preferential treatments it now has, Serbian agriculture will not be able to survive. The stages on the way to EU membership involve their costs and benefits. As we approach the EU, the costs decline, and the benefits grow. Subsidies will increase upon EU entry and reach their full amount through phasing-in during the course of an EU financial framework. It cannot be argued that there are no accession costs, but it is also indisputable that the benefits, measured in billions of euros, are several times higher. The cost-benefit balance will largely depend on:

- the timing of Serbia's EU accession and the tempo of its passing through particular stages;
- Serbia's willingness to reform its agricultural policy in the pre-accession period and the political (populist) compromises it makes;
- which tack the changing CAP takes.

Finally, Serbia's EU accession date will depend on political decisions, the progress of the overall economy and the society, while the convergence in the agriculture sector will hinge on:

- willingness of the Government of Serbia and the National Parliament to pass the laws that are highly aligned with the *acquis communautaire* and to establish efficient implementation mechanisms;
- capacities of the Ministry of Agriculture and other institutions engaged in this major task. This will not be feasible with the current employee numbers and profiles and will be contingent upon state administration reform;
- readiness of all the participants in the agriculture sector to embrace the changes and take the "Road to Europe".

IMPACT OF SERBIA'S EU ACCESSION ON THE TRANSPORT SECTOR - EXECUTIVE SUMMARY

Acceptance of *acquis communautaire* is one of the most important challenges for the transport sector in the process of Serbia's EU integration. The introduction of new legal rules in the Serbian legal system is accompanied by direct economic effects, both in the transport sector and in the overall economy of the country. In addition, the transport sector has to observe the numerous international conventions and bilateral agreements. In recent years, pivotal changes have been caused by liberalisation and deregulation of the transport system, decoupling and privatisation, market opening, improving conditions for doing business in the transport sector and the related sectors, etc.

Road transport is the most developed and most widely used mode of transport, both globally and in Serbia. Its advantages in Serbia are primarily the quality of service and the ramified road network. The transit routes connecting Europe and the Middle East add to attractiveness of Serbia's location. However, in recent years, as some neighbouring countries joined the EU and harmonised their transport regulations with those of the EU, the volume of road transport has contracted. Beside the non-conformance with transport regulations, poor quality of roads resulting from poor maintenance is identified as the main drawback of the road transport network in Serbia. The sector of road transport has good HR potential and is technically well-equipped, but it is restricted by relatively superannuated laws, such as the Law on Road Passenger Transport and the Law on Road Goods Transport, the amending of which is underway. The work on these laws is in its final phase, whereas the Law on Road Transport Security has already been amended.

Rail transport is in a very poor condition, particularly with respect to infrastructure and rolling stock. The consequences of a long-lasting monopoly in the railway transport system in Serbia are substandard transport services, over-indebtedness and operating losses of railway companies, non-competitiveness of the railway transport market, as well

as the inability to allow access to foreign operators due to the obsolete state relative to European railways. The railway transport in Serbia is preparing to operate in a liberalised transport market. There have been delays in passing the relevant laws, adopting necessary reforms, defining responsibilities in rendering public services and conditions for market liberalisation. Separation of infrastructure ownership from transport, as the most important step in the railway system restructuring, has not yet taken place.

River transport is very important, as Serbia has a 1680-kilometre long network of inland navigable waterways, comprising the Danube, the Sava, the Tisa, the Tamiš and the Begej rivers and the Danube-Tisa-Danube Canal. River resources in Serbia make river transport preferable to road transport. However, the lack of investment in recent past has resulted in the extremely poor condition of navigable waterways in Serbia. Nonetheless, a modest progress has been made in the sphere of river transport. The new Law on Transport on Navigable Waterways has not been passed yet, and Serbia still needs to ratify the relevant European agreements. Development of river infrastructure and ports as intermodal terminals requires special attention and significant resources. European tendencies to redirect commodity transport from roads to rivers indicate the significance of investing in the further development of inland waterways in Serbia, as well as in advancement of intermodal transport.

There has been slight progress in **air transport**, particularly with regard to security, safety and air traffic control. The national air carrier, Jat Airways, has commenced a process of organisational, personnel and market restructuring. For the purpose of privatisation, its status was changed from a public utility to a state-owned stock company on 28 July 2008. Regulations on air transport in Serbia were amended to allow for establishment of the Flight Control Agency and Civil Aviation Directorate.

With regard to the general level of development and condition of the transport system of Serbia, the following assessments can be given:

- the transport system is not entirely adapted to the needs of the economy and citizens;
- domestic engineering, technology and management capacities are weaker relative to the average situation in the EU countries;
- the transport network is not completely constructed and at some sections fails to provide the adequate level of services required for the respective class of road;

- the existing natural and infrastructural advantages in some modes of transport are underutilised (particularly with regard to railway and river transport);
- the transport system is insufficiently effective;
- integrated transport is in the early stages of development, while the level of traffic safety is among the lowest in Europe – partly due to inadequate alignment with the new EU standards on traffic safety, as well as due to obsolescence and dilapidation of means of transport and infrastructure;
- almost all types of transport infrastructure were damaged during the NATO bombing of Serbia in 1999; and
- there are no road network planning documents, studies or designs, which are vital for investing into the transport network.

Countries aspiring to join the EU are expected to take the necessary measures for the development of sustainable transport systems, which were set forth in the document on the European transport policy adopted in 2001 (2001 White Paper). The Serbian Railway, Road, Water and Air Transport Development Strategy 2008-2015 is based on Serbia's commitment to EU membership, aspirations toward a sustainable development of the transport system and stability of institutions. However, the Strategy has failed to tackle the reorganisation of institutions and financing, and it needs to be accompanied by several action plans dealing in a more detailed way with these issues.

The prime objectives of the Serbian Transport Development Strategy are as follows:

- Render higher-quality transport services, improve traffic safety, **foster competitiveness** (both on the particular and on the general level), liberalise the transport market;
- **Harmonise Serbian transport regulations with the relevant EU legislation.**

To meet the objective of harmonising transport regulations with those of the EU, Serbia needs to take the following steps:

- eliminate the remaining artificial barriers within each mode of transport;
- simultaneously ensure liberalisation and pass regulations aligned with the EU rules concerning professional classification, safety, social welfare measures and responsibilities relating to provision of public services;

- harmonise the rules on access to the occupation of carrier of goods by road or water with EU standards;
- grant compensations to public transport companies within the state aid without distorting competition;
- actually and completely separate railway infrastructure ownership from railway transport companies;
- sign agreements on joining the air services market;
- comply with other EU regulations in this area.

The short-term strategic recommendations regarding convergence of the Serbian transport system with that of the EU focus on the **revitalisation of the transport system** in all its segments, current infrastructure maintenance and investment, and maintenance of and investment into vehicles and acquisition of new ones (particularly basic replacement of the vehicles that cannot be put back in operation, or whose restoration would not be cost-effective).

The path to the EU requires a much more market-oriented approach in the sphere of transport than has been the case so far. This particularly refers to public railway company and the air carrier. **The completion of the privatisation process is one of the short-term goals. Revitalisation and substantial investment into the inland waterway transport** are also necessary. A prominent place should be given to **development of intermodal transport**, as a more efficient way of forwarding goods, particularly by inland waterways, to the largest centres in the EU member states. Simultaneously with the transport market deregulation and liberalisation, the state should ensure equal starting position for all modes of transport by making **priority and balanced investments in infrastructure, but still slightly favouring the railway** (long and medium-distance destinations – over 200 km) **and inland waterway transport** (investing into ports – particularly in the vicinity of large enterprises and plants) and integrated transport infrastructure. This should rely on modern European concepts, which set out that **each user has to pay for a share of regular maintenance in proportion to the level of his or her use of the respective infrastructure**. This has been resolved relatively successfully in the air and river transport, while the long-lasting formal problems in railway transport (the same company manages both infrastructure and transport services) will be solved by the implementation of the new Law on Railways. The equity concerning payment of tolls in the road transport needs to be improved as well.

In order to evaluate possible economic effects of the integration of Serbia into the EU in the sphere of transport, it is possible to define **two options**. Option 1 implies taking no further measures to harmonise transport regulations of Serbia with those of the EU, or a slow and random convergence with these standards. This will entail a number of repercussions, such as:

- delay in transport market liberalisation, which will weaken Serbia's competitiveness;
- investment decline in all transport sectors due to lack of investment attractiveness;
- slower modernisation of passenger transport services due to impeded development;
- commonly difficult and complicated transit procedures for freight vehicles travelling through Serbia and the subsequent loss of a significant transit revenue.

Option 2, which implies complete harmonisation with the EU rules in the transport sector, has the following advantages:

- liberalised transport market;
- possibility of market access and fair competition for all operators;
- greater investment in transport infrastructure;
- higher-quality transport services;
- greater security in transport;
- improved environmental protection;
- increased transit transport through Serbia.

Notwithstanding the obvious advantages offered by this option, some major **risks** should be mentioned, such as the possibility of public transport companies failing to adapt to a liberalised market, due to which they would lose the existing users and be forced into layoffs. On the other hand, the absence of adequate coordination and collaboration between transport authorities could lead to problems, halts and delays in the process of harmonisation with the EU rules. However, if Serbia fails to harmonise its transport regulations with those of the EU, it will be denied access to EU funding opportunities for maintenance, revitalisation and modernisation of transport infrastructure and vehicles. This would directly affect implementation of many already presented projects. Therefore, it must be pointed out that **the investments by the state or state-owned transport**

companies are almost negligible, and if this situation should persist, the Serbian transport system would deteriorate.

The evaluation of direct economic effects in the field of transport was not made separately for each mode of transport due to unavailability of the data needed and the lack of insight into projections made by companies with regard to the effects of the harmonisation of Serbian regulations with those of the EU. As an example, an economic impact on the railway transport in the case of a non-compliance with the EU regulations, i.e. the loss of advantages to be brought by the compliance, is given. This example could, with great certainty, be replicated by other forms of transport as the situation in all of them is, as the analysis has shown, very similar. Data from the "2006 Business Programme Implementation Report" by JP Železnice Srbije (Serbian Railways Public Enterprise) were used to assess the effects of compliance or non-compliance with the EU regulations. According to the report, JP Železnice Srbije implemented investment programmes worth 33 million euros in 2006. Out of total investments in 2006, approx. 48% was spent on building, modernisation and reconstruction of infrastructure; approximately 50% was spent on purchase, modernisation and revitalisation of vehicles; whereas 2% of the stated amount was spent on purchase and modernisation of other assets. Yet, what is relevant is the ratio of planned and realised investments – only 6% of those planned was realised. Additionally, only around 21% of the realised investment was funded from the enterprise's own income. To finance the investment programmes, foreign loans were used (52%), as well as own funds (21%), appropriations by the Ministry of Infrastructure (15%), foreign grants (2%), and a portion of investments was realised through a finance lease contract (10%). These data lead to a conclusion that the trend will continue unless smooth access to capital is ensured, which would also help increase the revenue received by the enterprise. **Nevertheless, this will be possible only by harmonising the legal regulations of Serbia with EU legislation, as well as by market restructuring and liberalisation.**

IMPACT OF SERBIA'S EU ACCESSION ON THE ENERGY SECTOR –EXECUTIVE SUMMARY

In recent years, energy has become one of the priority issues in the EU. Although it is still primarily the responsibility and competence of the member states and their national policies, the EU is intensifying its efforts to define a common, European energy policy. For the EU, energy and fighting climate change are two sides of the same coin. When discussing the EU and energy, it is frequently pointed out that energy was one of the drivers of European integration through the establishment of the European Steel and Coal Community.

Can the energy influence Serbia's EU convergence and the membership it aspires to and to what extent? What will it mean for Serbian energy sector? We shall take a look at the state of Serbia's energy sector and the position of the EU energy policy today. We will then check where Serbia stands relative to the energy sector in the EU in general and consider the importance of membership in the Energy Community as a form of Serbia's sectoral integration into the EU, in particular. We will give an outline the administrative action with regard to implementation of the regulations concerning the Energy Community. We will also present the three potential scenarios for the development of the energy sector in the process of EU accession. Finally, we will state the challenges and benefits of the "Energy integration".

The energy policy of the Republic of Serbia comprises the following developmental objectives: consistent and quality energy supply, long-term and balanced development of the energy industry as an economic sector, encouraging competitiveness in the energy market on principles of non-discrimination and publicity of operation, creating conditions for safe and reliable operation of energy systems, provision of conditions for improvement of energy effectiveness, and improvement of environmental protection. The Energy Development Strategy of Serbia defines the long-term development objectives for certain energy activities, priorities of development, sources and manner of securing required quantities of en-

ergy, incentives for financial investments in energy facilities powered by renewable energy sources and other elements aimed at the accomplishment of energy policy objectives. The document was adopted by the National Parliament in 2005. The Energy Development Strategy provides for an institutional adjustment in accordance with the assumed international obligations. Nevertheless, the strategy implies the continuation of the energy development strategy dating back to the mid-seventies of the last century and accordingly, further increase in lignite usage and increase in energy, i.e. carbon-dioxide intensity (although it provides for ratification of the Kyoto Protocol).

Since it prepared and drew up the current Strategy for Energy Development, Serbia has signed the Energy Community South East Europe Treaty, Kyoto Protocol and ratified the Aarhus Convention. In addition, Serbia has signed the Stabilisation and Association Agreement with the EU and the Energy Agreement with the Russian Federation. These international treaties, agreements, conventions and protocols have reshaped significantly the obligations of Serbia in the area of energy and imposed obligations and deadlines not provided for by the Strategy. The very fact that the Strategy will cease to be effective after 2015 indicates that it does not comprise crucial obligations in the implementation of the EU directives.

Some of the basic characteristics of the energy sector in Serbia are the following:

- Consumption of energy per capita in Serbia is close to the world average, but it is approximately 3 times below the OECD average. This indicates that labour productivity in Serbia is low and there are smaller quantities of energy available for production.
- Power consumption in Serbia is approximately 25% above the world average and only approximately 2.6 times below the OECD average. This is the best quality and potentially the most productive form of energy and the figures suggest that the Serbian economy could have higher GDP per unit of energy relative to the world average. However, this is not the case.
- Energy use per unit of GDP in Serbia is more than three times the world average and approximately five times the OECD average, which is an indicator of not only low energy efficiency, but also of a very low efficiency in using the most efficient form of energy – the electric power.

- Inefficiently used energy in Serbia comes from sources that require energy transformation and produce extremely high carbon-dioxide emissions. Serbia emits more carbon per unit of energy than the global or OECD average, the two being pretty much identical in this case. Such intensity stems from a significant difference in production and use of energy in Serbia compared to the EU countries, indicating a low-level of responsibility of Serbia concerning the issue of climate change.
- Intensity of carbon-dioxide emissions in relation to gross domestic product is therefore several times higher in Serbia compared to the world or OECD average.

There are three major pillars of the new European energy policy. The first pillar is the establishment of an **integral internal market** aimed at fostering competitiveness through additional measures of liberalisation and sustainability and security of supply. The central position is assigned to a clear **division between supply and production of energy**, on the one hand, **and its transmission**, on the other hand. The second element is a shift to energy with the lowest low carbon-dioxide emissions possible, i.e. a binding objective of a **20-percent share of renewable energy sources** (solar, biomass, wind energy etc.) in the energy mix by 2020. Currently, the level of participation is 6.5 %. To attain this objective, high growth in three basic forms of renewable energy consumption will be needed: production of electric power, biofuel and heating, i.e. cooling. The objective is to increase the share of biomass in transport to 10% by 2020. The third component is enhanced energy efficiency, and practically rationing of the energy consumption. If this objective is achieved, by 2020, the EU would consume as much as 13% less energy than it did in 2006. The methods and tools employed in achieving these economic effects are varied: more efficient internal combustion engines, more efficient household appliances, better insulation of residential and business buildings, as well as greater efficiency in energy transport and distribution. Increasing dependency of the EU on energy import requires an adequate foreign policy. Energy has become a priority issue in external relations of the EU. Additionally, it is one of fundamental assumptions of the European security strategy. Practically, the first and complete Energy Policy for Europe has been defined. It is focused on the following issues and priorities: internal market for electric power and gas, security of supply, international energy policy, energy efficiency and renewable sources of energy and en-

ergy technologies. Accordingly, amendments to the European legislature are underway.

Serbia joined the Energy Community in 2006. The key objectives of the Energy Community are to create an integrated energy market in the South-East Europe that will enable cross-border trade and linking with the EU internal market, enhance the security of supply, attract investment into electric power production, help reconstruction and building of the transmission network and improve environmental protection. Community members are "sectorally" integrated within the EU and committed to the implementation of the EU rules and directives. This will attract investment and strengthen the market position of the region and the member states. According to the assessments, **up to EUR 20 billion** will be required in the next two decades to secure a stable and reliable energy supply of the countries within the Community. In addition to that, the development of cross-border networks for electric power and gas creates opportunities not only for larger-volume commerce, but also for solidarity in case of problems in supply or accidents. This reinforces energy security of the countries in the region through diversification of energy supply. A special important dimension of the Energy Community is the fact that it is an "exercise" for the Western Balkans in the European integration through the "export" of a model of management and the *acquis*. The logic of regional integration takes as a point of departure highly competitive areas, such as energy, and gradually shifts to other areas, simultaneously with the process of stabilisation and enlargement of the EU to the Western Balkans. The implementation of the Energy Community Treaty implies the implementation of regulations of the EU energy policy in four interconnected areas: energy, environmental improvement and protection, competition and renewable energy sources. It may be interesting to note that the treaty provisions concerning competition leave no room for collusion and anti-competitive practices, abuse of firms' dominant position or state aid, which may disrupt competition.

The energy sector is included in the EU-Serbia Stabilisation and Association Agreement. According to the SAA, the cooperation "shall focus on priority areas related to the Community *acquis* in the field of energy. It shall be based on the Treaty establishing the Energy Community, and it shall be developed with a view to the gradual integration of Serbia into Europe's energy markets". Furthermore, "the cooperation may include the following: the formulation and planning of energy policy, including modernisation of infrastructure, improvement and diversification of supply and improvement of access to the energy market, including facilita-

tion of transit, transmission and distribution and improvement of energy interconnections of regional importance with neighbouring countries; the promotion of energy saving, energy efficiency, renewable energy and studying the environmental impact of energy production and consumption; the formulation of framework conditions for restructuring of energy companies and cooperation between undertakings in this sector”.

With regard to activities of state authorities, the 2007-2012 Programme for Implementation of the Serbian Strategy for Energy Development until 2015 will be adequately modified in 2009, in line with the dynamics defined by the Law on Energy. In the area of energy efficiency and use of renewable energy sources, there are several novelties on the regulatory level. In the area of energy interconnection, when gas is concerned, the realisation of the Energy Community Ring concept is supported, as well as all projects ensuring its secure supply. In addition to that, the priority projects concerning natural gas in Serbia are the construction of the underground storage Banatski Dvor, linking with gas-supply systems in the neighbouring countries and realisation of the South Stream project. In the domain of electric power, the construction of a power transmission line between Macedonia and Serbia has been a significant advancement, as well as construction of power facilities toward of Bosnia and Herzegovina and Romania. With regard to priority infrastructure projects within the Energy Community that are of significance for Serbia, the Government of the Republic of Serbia has accepted a proposal to publish calls for tenders for the construction of a thermoelectric plant on the initiative of the public enterprise Elektroprivreda Srbije (JP EPS). This concerns the construction of Nikola Tesla B3 and Kolubara B thermoelectric plants. In the area of oil industry, of particular significance is the project of the PEOP (Pan-European Oil Pipeline) construction. A project is defined as an EU priority if it concerns diversification of oil routes and sources of supply. The most significant activity in the process of accession to the Energy Charter Treaty and the accompanying Protocol, carried out through consultations of the acceding country with experts of the Energy Charter Secretariat, is drawing up the Report on Harmonisation of Legislation with the Provisions of the Treaty, Report on Investment Climate and Exceptions to the National Treatment and Report on Energy Efficiency. Drawing up of these documents takes approximately one year and their adoption is a necessary precondition for signing the Treaty and Protocol. On the basis of talks held in the period under review, a Joint Declaration between the Government of the Republic of Serbia and the Energy Charter Secretariat was drafted.

Energy is present in the programmes carried out through EU pre-accession funds – IPA. Within the framework of the 2007 financial agreement, EUR 18 million was approved for the projects Emissions Reduction from Nikola Tesla thermoelectric plant – EUR 12 million, and Support to the Implementation of the Energy Community Treaty – EUR 6 million. The latter project has two general objectives. The first one is to foster the capacities and technical competence within state institutions and energy enterprises in order to meet the legal and technical requirements of the Treaty establishing the Energy Community. The second objective is to foster the necessary investments in the construction of cross-border capacities for electric power transmission in order to create a functional regional energy market.

As there is no **clear strategic orientation in the area of energy for the period until 2020, and particularly not for the period after 2015**, a few possible scenarios of energy development can only be conceived. As the undertaken obligations need to be met by the end of 2017 and 2020, Serbia will have to take several decisions of strategic importance not only for the energy sector, but for its overall economic, social and political development within the next two years. Energy technologies are neither socially or politically neutral. The technologies and management methods or regulation applied in the energy sector may have paramount social and political consequences.

Having in mind the current situation, anticipated adjustments and potentials of state-of-the art technologies, three scenarios for the Serbian energy sector's adjustment to the EU could be formulated, taking into account at least the following circumstances:

- Approx. 2/3 of electric power in Serbia is produced by lignite combustion;
- Approx. 2/3 of population of Serbia use wood (and/or lignite) as the primary source of heating in winter;
- Almost all liquid fuel (which is not less than 2/3) is provided by processing imported oil in domestic refineries;
- More than 90% of natural gas is imported from one source and by one route;
- There is a historical tendency of correlation between GDP trends and energy consumption.

According to the first scenario, the interdependence of gross domestic product and energy consumption remains for the most part unchanged. The second scenario anticipates the continuation of the current

trends against a minimum fulfilment of conditions from the Energy Community Treaty for South-East Europe. The third scenario works out a full benefit of EU accession.

A summary overview of the possible scenario outcomes is presented in the table below:

Scenario:	I	II	III
Energy market opening and competition	Minimum and only to the extent in which a possible imposed introduction of environmental protection costs makes imported energy competitive. High barriers to enter the sector conditioned by the right to exploit natural resources granted in an arbitrary procedure.	Minimum, but increased environmental protection costs and accordingly stiffer external competition may be expected. Barriers to entrance in the sector remain high.	Entire integration into the regional and international market. Beginning of the cooperation and competition process.
Implementation of the Large Combustion Plant Directive (LCPD)	Postponed	Implementation according to a timetable enabled by foreign aid.	Implementation according to a timetable agreed in the Energy Community Treaty for South-East Europe or faster.
Implementation of EURO 5 standard for liquid fuels	Minimum and in accordance with the NIS sales contract. Domestic refineries remain competitive in relation to foreign products (burdened with additional transport costs) due to lower costs of large-scale production of lower quality fuel and small production of EURO 5 fuel.	Foreign assistance reduces transport costs and introduces competition on the market. Survival of domestic refineries is uncertain in the absence of larger investments.	Full integration into the regional market. Lowering barriers to import. Significant investments in improving the complexity of refinery production.

IMPACT OF SERBIA'S EU ACCESSION ON THE ENERGY SECTOR

Renewable energy sources	Minimum introduction of renewable sources based on entrepreneurial initiative and foreign aid.	Minimum introduction of renewable sources based on entrepreneurial initiative and foreign aid.	Introduction of additional 25 - 30% of renewable sources in the energy mix and convergence with European objectives.
Energy efficiency	Keeping the existing level of energy efficiency in energy transformations and transmission. Minimum reduction of energy intensity based on entrepreneurial initiative and foreign aid.	Keeping or further deterioration of the existing level of energy efficiency in energy transformations and transmission. Minimum reduction of energy intensity on the consumption side based on entrepreneurial initiative and foreign aid.	Dramatic, organised hike in energy efficiency to the world average level.
Security of supply	Based on exploitation of domestic resources and the Agreement with the Russian Federation.	Based on exploitation of domestic resources and the Agreement with the Russian Federation.	Complex provision of security of supply through diversification of sources of supply, increase in energy efficiency and participation in international integration processes.
Climate change - carbon-dioxide intensity	Unchanged. Increases in proportion to the increase in energy consumption.	Changes and increases proportionally faster than the increase in energy consumption.	Approx. four times lower: two times lower quantity of carbon dioxide in the energy mix, creating a 100% higher GDP.

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

Price subsidising and its effect on the national budget	Unchanged. Increase in hidden budget deficit. Augmented fiscal risks.	Unchanged. Eased increase in hidden budget deficit. Alleviation of fiscal risks.	Subsidising in order to hike energy efficiency and use of renewable sources of energy. Elimination of fiscal risks.
Requirements for joining the European Energy Community	Political compromise and significant derogation in almost all key technical conditions from the Energy Community Treaty for South-East Europe or provision of substantial foreign aid.	Implementation of the Energy Community Treaty commensurate to provided aid against minimum delays. A compromise with regard to the security of supply.	Full inclusion into the EU against fully meeting the anticipated standards by combining economic aid, private and domestic public investments.
Impact			
Investment expenditure by the end of 2017	Lack of further substantial investment, apart from the maintenance of the existing structure	Around USD 14 billion	Around USD 10 billion
Reduction of external costs of energy	No reduction of external costs expected. Increased danger of fiscal risk rising to 3-8% of GDP	Relative external costs reduced to the average level in Central Europe	Relative external costs reduced below the EU average

IMPACT OF SERBIA'S EU ACCESSION ON THE ENERGY SECTOR

Improved efficiency of production, conversion, transmission, distribution and use of energy	Energy efficiency trends unchanged. In case of rising fiscal risk, a part of the costs may be manifested as a GDP decline	Reduced efficiency, the assessed cost manifested as around 2% decline in economic growth	GDP growth of around 5% annually. Cumulative GDP growth by 2020 over 60%
Reduced transport costs for importation of quality energy sources	No impact	No impact	Reduced costs equal to around 0.5% of GDP
Improved security of energy supply	Due to high energy intensity, the economic growth is highly sensitive to security of supply. Some 10-20% of GDP is directly in danger in case of risk escalation. The current methods of security of energy supply have almost eliminated competitiveness of domestic exports. Exports sustained by subsidies	Rising expenditure on subsidies to maintain competitiveness relative to the scenario I	The cost of security of supply has no impact on competitiveness
Lower fuel poverty	No change	No substantial change	Provides for and promotes the 5% economic growth

A cost-benefit analysis of the EU accession in the field of energy is presented with reference to five goals: **reduction of external costs of the energy sector; enhanced efficiency in production, conversion, transmission, distribution and use of energy; reduction in transport costs for importation of quality energy sources; improvement of energy supply security; reduction of fuel poverty.** The critical importance of investment decisions, energy policy and strategy in the context of EU accession is evident. We should bear in mind that the chosen investment options may have a wide and disparate range of effects, spanning between an 8% decline and a 5% increase in GDP, while the actual impact need not be in direct proportion to the investment expenditure. In fact, lower investment expenditure may have greater effects and vice versa. Therefore, depending on the selected scenario for the energy sector development, EU accession may entail sizable costs relating to reduced GDP or a substantial benefit in the form of continued economic growth. However, absence of decisive action toward EU accession may not only have a massive impact and push the economic growth downward, but may also produce a dramatic escalation of fiscal risks comparable to those recorded in the last decade of the past century.

IMPACT OF SERBIA'S EU ACCESSION ON THE ENVIRONMENTAL SECTOR - EXECUTIVE SUMMARY

Environment is one of the most challenging chapters of EU accession negotiations, both for the acceding country and for the European Union. The entire process of European integration is “a natural ally” of progress in the area of the environment, acting as a catalyst for placing this theme into a more prominent position. The countries aspiring to join the EU are expected to establish autonomously sustainable mechanisms for financing, assuming and implementing obligations that stem from the environmental *acquis* (in line with Article 175, paragraph 4 of the Treaty of Rome).

The authors of the present analysis believe that it would be difficult, at this moment, to separate a “baseline” scenario from an “EU accession scenario” in the area of the environment. The challenges and the pressures – cross-border cooperation in environmental protection, conditions for international trade, advancement of national legislation and its implementation in order to achieve welfare and better quality of life for the citizens, infrastructure improvement (waste management, water, sewerage, roads etc.), the lack of appreciation of the environmental issue in the EU integration process on the part of government officials (the decision makers) – all exist regardless of the EU accession. Therefore, a country’s sustainable development and EU convergence concerning the environment are part of the same road to the EU. **It must be stressed that a precise picture of costs and benefits of European integration for Serbia depends on assessment of the specific situation regarding environmental quality, production, product, legal protection and other standards that are an integral part of the relevant EU legislation and need to be attained and maintained. A clear overview of the state of affairs cannot be given at this point, due to the lack of relevant data.**

The spread of pollution recognises no national borders. Serbian environment (air, water, biodiversity) is essentially a part of the European environment and the EU. Consequently, a swift establishment of a system of environmental protection in Serbia that would be compatible with that of the EU would be in mutual interest of both the citizens of Serbia and the EU. Here lies the unused potential of “environmental diplomacy” to enhance efficiency of Serbia’s European integration. The environmental sector has a strong impact on European integration in other areas (agriculture, energy, transport, trade etc.) either by propelling or by retarding the process. The past pollution, created for decades and at the time when the environment did not receive much attention, is usually analysed separately, but is taken into account in the overall impact analysis.

An overview of implementation of Serbia’s National Programme for Integration into the European Union (NPI) made in mid-2009 showed an **outstanding result of 40% more environment-related laws adopted than originally planned**. This highly positive outcome is an incentive for further EU integration efforts concerning the environment. It must be stressed that this dimension of the NPI implementation applies only to requirements that fall under competence of public administration and are related with legislative activities and strengthening of institutional and administrative capacities, including the statement of financing needs (a comparison with Slovenia and Macedonia shows that the “weight” of these effects in both countries was around 10%).

In 1997, the European Commission’s initial estimate of costs of compliance with the environmental *acquis* in the countries of Central and Eastern Europe was around **1 140 euros per capita**. The available data suggest that EU accession costs related with environmental compliance in specific countries would be:

- Slovenia, 1 300 euros per capita,
- Macedonia, 1 100 euros per capita,
- Croatia, 1 500-2 000 euros per capita.

The experiences of the ten countries that joined the European Union in 2004 showed that between **1.5% and 2.5%** of GDP was allocated for environmental protection in those states. Nevertheless, the appraisal of required investment varied between the countries – from 2% of GDP for the Czech Republic to 11% of GDP for Bulgaria. There are estimates that the biggest share of the environmental burden associated with the EU accession would be carried by the economy in Macedonia and by local

authorities and the economy in Turkey. In Slovenia, local authorities paid for most of the environment-related accession costs.

Serbian environment and EU integration

An examination of the available data and studies on the impact of European integration on the environmental sector in Serbia points to the important segments that have been neglected and to the limited scope of earlier analyses. The constraints of the overview presented in this analysis should be viewed against that background, as this is an attempt to systemise the previous efforts, call attention to the areas that have not been included in the evaluations to date and set up a basis for future assessment of costs, investments and benefits.

It may be noted that no one in Serbia has ever inquired into:

- Systematic assessment of existing pollution that has been created over the years. In the context of the impact of the integration, the past damage should be limited to cleaning and remediation connected directly with attainment of quality standards set out in relevant EU laws. We should bear in mind that the unmitigated environmental impact of the bombing has also become a part of the past pollution to be tackled. As the state is responsible for that pollution, it can expect to continue to bear certain expenses on this account (e.g. the cost of remedying past pollution at the site in Kragujevac, where Fiat is to launch its production);
- Planning the implementation of the investment-heavy EU environmental directives, which usually require negotiations on phasing-in before full application of the environmental *acquis*.

One of the rare studies dealing with the environmental costs in Serbia⁵, while excellent from the perspective of the employed MOSES methodology⁶ was limited only to the environmental segments that were at the centre of the analysis (waste, water, air). These are the available environmental damage data for Serbia in 2003:

⁵Environmental Capacity Building Programme 2003: Assessment of the Economic Value of Environmental Degradation in Serbia, Interim report by J. Jantzen and R. Pesic, 03/SER01/09/002, Belgrade, May 2004

⁶Model on Sustainable Environmental Economic Scenarios (developed for the World Bank by Jochem Janzen and associates between 1989 and 1992 at the Institute for Applied Environmental Economics, the Hague)

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

	Environmental damage			
	Low economic growth		High economic growth	
	EUR million	% GDP	EUR million	% GDP
Total: air, water and waste	861	5.11	2 500	14.85

The authors of the study developed nine alternative environmental damage scenarios for a ten-year period (2003-2013), where only simultaneous occurrence of three scenarios combined would result in environmental improvement in Serbia. For these data to be credible in 2009, especially when they are expressed as per annum or per capita, it would be necessary to conduct a serious scrutiny of the scenario that has actually taken place since 2003 and to further take into consideration the global economic crisis. If interpreted adequately, this need not detract from the value of the study. In light of the failed plans to make direct investment into environmental improvement between 2005 and 2009, the assessment made by the environmental ministry in 2008 that **EUR 4 billion would be needed for overall environmental expenditure should be taken with precaution**⁷. The same basis served for the claim that with an assumed economic growth rate of five percent, 2.4% of GDP would be needed for preventive measures by 2016, plus between 4.4% and 13% of GDP for environmental remediation (translated into monetary terms: 545 euros per capita + between 1,150 euros per capita and **3 340 euros per capita**).

The table below gives a snapshot of public sector investment in environmental protection in Serbia, by year:

year	2000	2003.	2004.	2005.	2006.	2007.
% GDP	0	0.3	0.4	0.2	0.3	0.3

An additional way of generating revenue for this purpose is by means of fines stipulated by environmental laws. The Serbian Environmental Protection Fund received EUR 12.3 million on these grounds in 2007.

⁷Authors of this study believe that this sum should be increased at least by the funds that were supposed to be expended in 2005-2009, but have not been invested into the environment.

The data concerning environmental investment made by the business sector have been neither integrated nor systematised. However, it is evident that **business entities have invested substantially (but still insufficiently, overall) into environmental protection**. Companies targeting the regional market are leaders in adjusting their business processes to environmental requirements. For example, though ISO 14000 (environmental management) standards are not mandatory, many organisations have introduced or are in the process of introducing them in order to boost competitiveness of their products and to demonstrate their social and environmental responsibility. From 2000 through mid-2009, Serbian economy invested around EUR 1.4 million (some 200 businesses each paid an average of EUR 7 000 for introduction of the standard) to introduce ISO 14001, ISO 4001:2004, SRPS ISO 14001 and SRPS ISO 14001:2005 standards. In every impact analysis, one should not forget that the business sector is making the environmental investment independently of EU accession. Because of that, Serbian economy is not only a partner, but in some segments also the propellant and promoter of European integration.

It is even more difficult to provide an overview of the benefits (qualitative and quantitative) that stem from environmental improvement. These primarily concern the impact of the environment on public health and improved living conditions and quality of living. An approximate assessment for Serbia can be deduced from the following analysis:⁸

Monetary value of benefits from alignment with EU environmental legislation

Air	Annual benefit of EUR 351-621 million, as of 2020
Water	Drinking water: annual benefit of around EUR 422.3 million upon full implementation of the directive
	Improved quality of surface waters (for users): annual benefit of EUR 33.2-87.3 million
	Improved ecosystem of surface waters: EUR 11.4 million benefit per annum

⁸Benefits for FYROM and other countries of SEE of compliance with the environmental acquis, Final report – Part II: Country-specific Report Serbia, ARCADIS ECOLAS / IEEP for EC/DG Environment (2007)

**Benefits from alignment with EU environmental legislation –
a qualitative and quantitative overview**

	Qualitative overview	Quantitative overview
Air	<ul style="list-style-type: none"> - advanced monitoring, records and information on air pollutant emissions into the atmosphere and air quality parameters - general benefits for human health (declining mortality rates, illnesses), ecosystems (prevention of eutrophication, acidification, ozone layer damage), economy (reducing impact on crops etc.) and the society (e.g. eliminating damage to historical buildings, improved visibility in the cities) 	<ul style="list-style-type: none"> - the equivalent of 3 083 chronic bronchitis cases annually, 801 of them in Serbia, avoided - 2 437 fewer cases of premature deaths annually, 493 of them in Serbia
Water	<ul style="list-style-type: none"> - improved quality of drinking water - better quality of internal surface waters for bathing and recreation - improved ecosystems of surface waters 	<ul style="list-style-type: none"> - increased quality of drinking water in 3 822 092 households - higher water quality in all watercourses, to achieve the level of Class I and Class II watercourses - due to better ecosystem quality, higher quality of all surface waters
Waste	<ul style="list-style-type: none"> - improved waste management and control of shipment of waste - reduced health risk as a result of hazardous waste management, closing and remediation of illegal dump sites - lower underground and surface waters pollution related with leachate from uncontrolled and unprotected dump sites - reduced climate change impact through landfill methane capture 	<ul style="list-style-type: none"> - avoided methane emissions range between 34 000 and 339 000 tonnes per year by 2020 - reduced landfill disposal level by 35-48% by 2020, through introduction of a system of recycling, composting and other waste treatment methods - increased recycling levels: some 398 000 tonnes of recyclable materials (paper, glass, plastic and metal) per year in 2020
Nature	<ul style="list-style-type: none"> - the current, unsustainable types of tourism upgraded; benefits generated by ecotourism 	<ul style="list-style-type: none"> - increased quality and surface of protected areas (between 5.6% and 10% by 2010) - reduced forest depletion (planned reforestation on 1.3 million hectares)

Though indicative, a comparative analysis of costs incurred by the recent EU entrants from the Central and Eastern Europe cannot be used as a basis for analysing the impact of Serbia's accession. The results of the IPA 2007 project Serbian Environmental Approximation Strategy, financed by the European Commission, are expected to supply many answers that are currently lacking, incomplete or inconsistent. An investment evaluation will serve to agree on phase-in deadlines for full application of the environmental *acquis* and boost substantially the potential to use different EU funds. Serbia is yet to tackle the most difficult tasks concerning implementation and control of adopted legislation, as well as rising environmental expenditure.

IMPACT OF SERBIA'S EU ACCESSION ON RESEARCH AND DEVELOPMENT - EXECUTIVE SUMMARY

Integration of Serbian science, i.e. of the research and development (R&D) sector, into the European Research Area (ERA) is an important part of the overall EU association process. Its role is to:

- Ensure integration of the national intellectual and development community into a powerhouse of knowledge, shaping the development on the global level. It removes barriers to the flow of knowledge, ideas, technologies and, above all, people, in both directions – by not only making the results of the European R&D available to Serbian scientists, but also by offering an opportunity to the Serbian scientists to demonstrate their full potential for collaboration with their EU counterparts;
- Create preconditions for the implementation of major R&D projects of national and/or regional significance that would engage leading European research teams and laboratories, and use state-of-the-art R&D infrastructure and other human, material and financial resources of the European Research Area;
- Enable the most efficient transfer of knowledge, technologies and best practices in developing the National Innovation System as a precondition for establishing innovative, knowledge-based culture, economy and society in Serbia.

The *acquis communautaire* in the area of science and research does not require transposition of EU legislation. Capacities for the implementation of EU norms relate to efficient participation in the Framework Programmes for Research (FP), Euroatom Research Programme and the best possible integration within the ERA. However, to attain the goal of full and successful inclusion in the FP, member countries need to engage in major endeavour of creating the needed capacities in the sphere of research and

technological development – the human resources, adequate research and innovation infrastructures, and adequate administrative staff.

Obligations with regard to meeting the standards in the area of science and research are not explicitly stated even in the official documents Serbia signed with the EU: Council Decision on principles, priorities and conditions contained in the European Partnership with Serbia (18 February 2008), and Stabilisation and Association Agreement (26 April 2008). In the first document, priorities concerning science and research are referred to only indirectly (“*Education and Research: Adopt a national qualification framework for vocational and education training, promote regional cooperation in the field of higher education; Adopt an integrated research policy.*”). The Chapter 25 of National Programme for Serbia’s Integration into the EU (NPI), however, gives a prominent place to science and research.⁹ The activities relating to the EU *acquis* in the sphere of science and research are conducted in accordance with the obligations set forth in the NPI, which are not, as noted in the document, strictly binding. By signing the Memorandum of Understanding with the European Community on Association to the Seventh Framework Programme for Research and Technological Development (FP7 2007-2013) in June 2007, Serbia was granted the right to take part in the FP7 activities. At the end of 2003, the Serbian Government adopted a conclusion that drew on the **Lisbon Strategy**¹⁰ (initiated in 2000), and included the target of increasing R&D investment to **3% of GDP** (the “**Barcelona Objective**”). This conclusion envisaged 1% of GDP would be earmarked from the budget for R&D in 2007. However, due to the sluggish economic development, the **current budget appropriation is approximately 0.3% of GDP, whereas investment by the business community is negligible (below 0.1% GDP).**

In its annual reports on Serbia’s progress in meeting the EU accession requirements, the European Commission also monitors the development of science in Serbia. The November 2008 report stated that Serbia has been very successful in its participation in the EC FP7, as funding was approved for a high percentage of its projects¹¹. However, Serbia still needs to adopt a national strategy aimed at increasing public and private investment in research and promoting scientific careers and mobility of

⁹National Programme for Serbia’s Integration into the EU, Belgrade, 2008, pages 642-645.

¹⁰The Lisbon Strategy sets out that by 2010 the EU is to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion.

¹¹SERBIA 2008 PROGRESS REPORT, Brussels, 05.11.2008, SEC(2008) 2698 final.

researchers. In addition, Serbia has not yet developed an integrated research policy.

Some authors have suggested that R&D systems in Central and Eastern Europe did not contribute to a faster and more efficient transition from command to market economies in these countries.¹² A more recent analysis of R&D in the new Western Balkans countries emphasises their obsolete scientific and technological infrastructure, the disproportionately high concentration of R&D resources in basic research compared to applied and development research (with poor financing of all R&D activities), and a large deficit in the industrial demand for applied R&D. This is combined with trifling R&D expenditure of the business community, relatively ageing human resources in the R&D sector (struggling with the negative effects of both internal and external "brain drain"), and with a minimum integration of R&D into EU projects.¹³

This paper adopts a methodological framework based on the concept of a National Innovation System (NIS), including all the factors that affect development, diffusion and use of innovations, and their interrelations. Special emphasis is placed on the changes in the Serbian R&D since 1991, which generally occurred without any structured approach or action on behalf of relevant government bodies. The text goes on to analyse the impact of those changes on the R&D sector, and the findings accentuate the urgency of action on the part of the public institutions responsible for restructuring the Serbian R&D, in line with the process of integration of Serbian science into the ERA. The restructuring will put in place the basic NIS mechanisms and infrastructures, as foundations of a knowledge-based economy.

Within the Serbian National Parliament, the highest legislative authority in the country, the Committee for Science and Technological Development reviews and proposes to the Parliament the laws regulating the area of science, technology and innovation. Two parallel bodies concerning R&D have been established at the level of the Serbian Government. The Ministry of Science and Technological Development (MSTD) governs the functioning and development of science and technology in Serbia

¹²Radosevic, Slavo, "Science, Technology and Growth: Issues for Central and Eastern Europe", Summary of the project: "Restructuring and Reintegration of Science and Technology Systems in Economies in Transition", funded by DGXII of the EC under TSER Programme, 1996-98, SPRU, University of Sussex, Brighton, UK, 1999.

¹³GFF, 2006, "Research and Development in South East Europe", Gesellschaft zur Förderung der Forschung (ed), Neuer Wissenschaftlicher Verlag GmbH, ISBN 3-7083-0377-6, Wien - Graz 2006.

and is responsible for fulfilment of the country's obligations in this area. On the other hand, the main task of the National Council for Science and Technological Development is to design and propose to the government a strategy for scientific and technological development and to monitor its implementation.

The R&D system of Serbia is built on three blocks:

1. R&D organisations in the public sector. This block comprises seven public universities with 78 faculties, the Serbian Academy of Sciences and Arts with its 10 scientific institutes, 28 other scientific institutes, a centre of scientific excellence, 30 research institutes, 65 innovative organisations, five business associations for support of innovation and 107 registered innovators. It also includes scientific and technical infrastructure that encompasses: the academic intranet, a gene bank, an accelerator, libraries of the institutes and faculties, the University Library and the National Library of Serbia, which boasts the KoBSON network that provides access to scientific and technological information worldwide;
2. R&D organisations in the private sector. They include seven private universities with 45 faculties, research resources of foreign companies in Serbia and research and innovation resources of domestic firms. The efforts and results of small and medium-sized enterprises in the field of software engineering, new materials and biotechnology are particularly noteworthy;
3. The third block, pivotal to the functioning of the entire system, is composed of organisations for support, networking and financing of research, development and innovation in Serbia. It comprises the Intellectual Property Office, Serbian Institute for Standardisation, Office for Measures and Precious Metals, National Information Technology and Internet Agency, Accreditation Board of Serbia, agencies for small and medium-sized enterprises and entrepreneurship, Telecommunications Agency, chambers of commerce, innovation centres, business and technology incubators, technology and industrial parks, foreign agencies for support of technological and economic development etc.

The total number of persons employed in R&D was on the rise from 1980 and reached its peak in 1990, but went into decline until 2001 and has been recovering from 2001 onward. The wars on the territory of the former Yugoslavia and the grave economic situation in Serbia led to

a massive "brain drain": researches emigrated and/or abandoned R&D, shifting to activities in which they could make a living. The democratic change in October 2000 and the more active involvement of the Government helped retain those already employed in this sector (in most cases), whereas special measures concerning housing policy and professional development have attracted young people to start their careers in R&D. Hence the growth in staff and FTE¹⁴ numbers in this sector, which, combined with the rising unemployment in Serbia, resulted in the increase in the relative share of R&D employees in total employment. From 1980 through 2007, Serbian researchers were spread across the academic sector, the public institutes, and for-profit institutes and organisations. In 2001, 64.6% of researchers in OECD countries, on average, were employed in the business enterprise sector, 26.3% in higher education, and 8.8% in the government sector. This means that **research and development were pushed by the business, instead of being the other way round**. In 2001, 74.83% of Serbian researchers were working for the universities, 18.8% for the government institutes and 6.37% for the industry. It should be noted that while in OECD countries the business sector finances over 60% of all R&D expenditure, on average, and government spending accounts for less than 30%, in Serbia the opposite is the case, with a downward trend in the share of the industry. As the number of researchers in companies never exceeded 8% of the total number of researchers in Serbia in the period between 1980 and 2004 (maximum 7.96% in 1991), we may conclude that the business enterprise sector never developed a critical mass of R&D employees that would promote the development and meet the market needs.

An indicative and worrying trend for technological development of Serbia is the significant decline in the number of researchers in technological and biotechnical sciences. The number of researchers in natural sciences oscillated and then declined at the end of the period under review. Humanistic and, to a certain extent, social and multidisciplinary sciences experienced growth in the number of researchers. **The minimum value or the threshold** to be attained to support R&D is **1% of GDP**. Only a few of EU-15 countries did not reach the 1% GDP threshold for R&D, while R&D spending of the 12 recent EU entrants failed to hit 0.5% GDP by 2005 only in Romania, Bulgaria and Malta. On average, the EU countries spent 1.84% GDP on research and development in 2005. Among the

¹⁴FTE – *Full Time Equivalent*, e.g. 2 associates involved in a research for 6 months a year each make 1 FTE.

Western Balkans countries, Croatia sets a notable example with 1.22% of GDP expended on R&D, whereas Serbia with **0.43%** and Macedonia with 0.24% are still far from the 1% threshold.

The budget for science in Serbia was close to EUR 28 million in 2001. It grew approximately to EUR 60 million in 2002 and 2003, then stagnated at about EUR 56 million in 2004 and 2005, but surged to EUR 100 million in 2008. The upward trend was halted in 2009, due to the global economic crisis. Optimistic assessments anticipate that the 2009 budget for R&D activities in Serbia will total EUR 85-90 million. The government has clearly stated its goal for the period from 2009 through 2014 is to reach the level of 1% of GDP earmarked for research and development from the public sources. On average, EU countries spent approximately EUR 412 per capita on R&D in 2005, when GDP per capita was almost EUR 22 400. **With EUR 11.83 per capita, Serbia spends nearly 35 times less on science and research compared to the EU average.** Of all the countries it has been juxtaposed against, only FYR Macedonia (EUR 5.51) spends less on research than Serbia. As the intensity of R&D activities hinges directly on the size of the related investments, this indicator most clearly portrays the ability of a country to support its development activities. The average number of FTE researchers per 10 000 citizens in the EU is 24.8. In Serbia, this number totals less than half the EU average (11.55), which is still slightly better than in FYR Macedonia (7.05), but considerably worse than in Croatia (16.07) and Slovenia (19.19). As education in general and professional development and training in R&D in particular are long-lasting and costly processes, any delay on the part of the government to increase the number of researchers in Serbia may endanger the country's development aspirations. The principal message drawn from the comparison of Serbia with the neighbouring countries is that it is **necessary to have an organised approach to attracting young people into science and research as (at least) a part of their chosen career path.**

Measured by the number of scientific and professional papers published in relevant international journals, Serbia started from a very low position with 1 388 papers produced in 2000 only to reach 3 452 in 2007, brushing shoulders with Croatia (3 455) and Slovenia (3 513). FYR Macedonia and Bosnia and Herzegovina were considerably falling behind Serbia in terms of the number of scientific and professional articles. Unlike the article output, invention is still at a very low level, but it is in harmony with the long-lasting trend of poor results of Serbian inventors.

The small number of patent applications by researchers from scientific and R&D organisations is especially indicative. It demonstrates the following:

- In Serbia, the patenting culture is very low; the importance of intellectual property is drastically underestimated, which points to insufficiently developed market economy mechanisms, especially in the R&D sector, which predominantly focuses on publishing papers, monographs, etc.
- Commercial application of R&D results is at a very low level. Conclusions regarding underdeveloped patenting culture in Serbia hit home when the number of patent applications per million of citizens in different countries is compared.
- The number of inventions in Serbia is nearly 50 times lower than in Japan and South Korea, and more than 10 times lower relative to the USA, Germany, etc. However, this area also has seen some improvement compared to the situation in 2000.

Innovation and knowledge are the key words to describe the knowledge-based economies of the 21st century. Investment in education and training of human resources, research and development, encouraging creativity, entrepreneurship and other forms of innovation top the list of development policies of OECD and EU, as well as the BRIC countries (Brazil, Russia, India and China, whose burgeoning economies have been gaining ground on the international market).¹⁵ In 2007, the *EIU (Economist Intelligence Unit)* developed the **Innovation Index** that ranked 82 countries by their **innovation capacity**. The EIU defined innovation as “*the application of knowledge in a novel way, primarily for economic benefit*”. In February 2009, the EIU updated the Innovation Index. Serbia was ranked 55th of 82 countries that were compared (having progressed from the 67th position in 2002).

Serbian science has made some major results in European projects: it received the “third country” status within FP6, registered 111 participations in 89 projects financed, with a total of EUR 13.1 million received for their implementation. Its best results have included 8 out of 10 Centres of Excellence (CoE) within WBC 2005 INCO Capacity Call, which totalled EUR 2.5 m, and 8 out of 20 CoEs within WBC 2006 INCO Capacity Call, worth EUR 2.1 m. The major results of Serbian scientists within the FP7

¹⁵Economist Intelligence Unit Limited 2009: “A new ranking of the world’s most innovative countries”, April 2009, London, UK

have been the granting of the status of an associated member in June 2007 and participation in REGPOT 3, where coordination of 7 out of 11 collaborations was assigned to Serbia. The country also participated in 10 out of the 11 FP7 projects and registered 63 participations in them by the end of January 2009. The value of contracted FP7 projects in the first two years totalled EUR 15.19 m. Representatives of the Ministry of Science and Technological Development (MSTD) and EC¹⁶ have asserted that Serbia has been very successful in applying for the FP7 calls, although additional efforts are required to achieve better results in some areas. Serbia has also participated in other multilateral and bilateral cooperation programmes, the major among them being FP7, *COST*, *EUREKA* and *NATO SPS*.

The Law on Research Activity defines that a “public interest within the research activity, in the sense of this law, is achieved through the programmes of general interest for Serbia.” The Serbian Ministry of Science and Technological Development proposes to the government the R&D policy, monitors and encourages the development of the R&D activity in Serbia, allocates budget resources to R&D organisations for the programmes defined in Article 10 of the Law and ensures the funds are used as planned. In July 2009, the ministry revealed the draft **Strategy for Scientific and Technological Development of the Republic of Serbia 2009-2014: “Focus and Partnership”**. As this period overlaps with the period of Serbian integration into the EU, the Strategy includes actions through which the Ministry of Science and Technological Development intends to integrate Serbian science into the European Research Area (ERA). The fact that it is only a draft does not detract from the importance of the Strategy, as it reflects the intentions of governing structures. A public discussion may contribute some amendments to the basic text, but its purpose is mostly to assemble the R&D community around common interests and stimulate the implementation of urgently needed measures and instruments for restructuring of the Serbian R&D sector and its integration into the ERA.

The Strategy envisages establishment of an **International Projects Consultancy Bureau** with the Ministry of Science and Technological Development. The Bureau will be responsible for improving the quality of projects and boosting the number of Serbian participants in R&D projects of the European Commission through daily contacts with scientists and representatives of innovative small and medium-sized enterprises. The

¹⁶EU Research Information Event: Toward Integration into the European Research Area, Belgrade, 29 July 2009.

Strategy also proposes to set up an R&D Agency and a Technological Development and Innovation Agency of the Republic of Serbia. There are two main types of **costs** necessitated by the changes. The first one involves the planned investments in the R&D sector, with the aim of making it sufficiently ready for the initial integration and functioning within the ERA. The second one pertains to Serbia's liabilities toward the EU that have been set forth as prerequisites for applying for R&D funding within the EU framework programmes (the amount and ratio are negotiated with the European Commission, as the level of the economic development of a country to be integrated into the ERA is taken into account). On top of these, there are also the costs of the regular functioning of the national R&D system that need to be considered in order to gain insight into the total spending the R&D sector will need to operate within the new environment. In line with projections of Serbian economic development in the near future, the planned amount of budget appropriations for R&D activities in the period between 2010 and 2014 totals **EUR 1 392.98 m**: EUR 143.31 million in 2010, EUR 218.88 million in 2011, EUR 280.09 million in 2012, EUR 346.88 million in 2013, and EUR 403.82 million in 2014. **The total cost of integrating** the Serbian R&D system into the ERA will amount to **EUR 2 493.05 million** in the period from 2010 through 2014. This will be partly funded from the loans granted by the European Investment Bank, World Bank, European Bank for Reconstruction and Development and other financial institutions, as well as from donations (IPA and other) – a total of some **EUR 300 million** for the period between 2010 and 2014. Serbia's contribution for participation in the FP7 will be financed from the current budget of the Ministry of Science and Technological Development. Other regular R&D costs on the national level are covered from the budget (**EUR 1 392.98 million** for 2010-2014). The projection concerning the share of business enterprise sector in financing R&D activities in Serbia has been reached by extrapolating the current investments by the sector, adjusted for the planned GDP growth – a total of **EUR 35.14 million** for 2010-2014. The same method has been applied in projecting the share of the high education sector in the R&D financing, which is expected to total **EUR 764.93 million** from 2010 to 2014. Another potential financing source for the Serbian R&D sector in the same period are the funds expected for the participation of Serbian research teams in **FP7** projects and activities. If the trends demonstrated in 2008 and 2009, when this financing totalled EUR 15.19 million, continue, an additional **EUR 37.98 million** may be available for R&D in the planning period.

The potential impact of the changes, i.e. the effects brought about by the integration of the Serbian R&D into the ERA, can be derived from a cost-benefit analysis. In quantitative terms, the total cost of convergence has been estimated to be **EUR 2 493.05 million, while the total benefit** is expected to amount to **EUR 2 531.03 million**. The difference between these two items shows that the **net profit** from integration will be **EUR 37.98 million**. This calculation should be considered in view of the fact that the R&D sector will practically receive the total amount of the estimated benefit of **EUR 2 531.03 million**, while the government expenditure will involve the repayment of the investment loan (**EUR 300 million**) and the regular R&D expenditure on the national level. These benefits for the R&D sector will **stem directly from the integration** of the Serbian R&D into the ERA. Against the backdrop of the state of the national economy, the global economic crisis and the underestimated position of science in the Serbian industry and society, the Lisbon Strategy and the Barcelona Objective (as EU standards for research, development and innovation) will be the instruments of change in attitudes of the Serbian government and decision-makers toward R&D funding. The Serbian R&D community will benefit directly from the shift in attitudes through considerably higher funding, both in absolute and relative terms. The sum total of budget appropriations of the Ministry of Science and Technological Development for R&D in the period from 2010 through 2014 will be more than 15 times higher than the budget planned for the Ministry of Science and Technological Development in 2009. The qualitative costs of EU convergence involve the efforts of individuals, organisations and institutions of the Serbian R&D sector related to integration and implementation of the R&D activities that will foster the development of the economy and society. The qualitative benefits of the integration will be reflected in the number of domestic researchers building their careers in the ERA and the number of international researchers conducting a part of their project work and possibly a part of their research careers in Serbia. Additionally, Serbian scientists will become acquainted with the cultural heritage of the EU member states, while Serbian culture may become closer to the citizens of the united Europe. There will be other effects that cannot be pinpointed exactly at this moment, but will certainly emerge as the benefits of integration of Serbian science into the ERA.

The integration of Serbian R&D into the ERA is necessary, imminent and desired by the majority of researchers in Serbia. This study has demonstrated why it will be beneficial to render the most creative sector of Serbia a part of the European Research Area, contributing both to the

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

development of the national economy and society and implementation of the Lisbon Strategy and Barcelona Objective of the united European R&D community. This positive spirit and stimulus coming from the national science may serve as the driver of a swift integration of other sectors and the entire country into the European Union.

IMPACT OF SERBIA'S EU ACCESSION ON EDUCATION – EXECUTIVE SUMMARY

In 1999, European economic space became reinforced by another vital element of economic development. By signing the Bologna Declaration, European countries committed to create a European space for higher education and a single European research space. In a parallel move, the signing of the Copenhagen Declaration on Vocational Education and Training (VET) in 2002 rendered the system of the common higher education space complete. Europe has ensured that all member states, the acceding countries and even potential candidates should make the greatest efforts to advance their education systems and make them converge. This exercise has been implemented through programmes like *TEMPUS*, *CARDS*, etc. The scale of the efforts is underpinned by the fact that about EUR 45 million has been invested into development of education Serbia in Montenegro in 2003 and 2004 only through *TEMPUS* programme¹⁷, while almost EUR 5.13 billion¹⁸ was channelled into *CARDS* between 2000 and 2006. In the period from 2004 to 2007, 98 students from Serbia received *Erasmus Mundus* scholarships to continue their studies in various fields.

The Copenhagen Process and the Bologna Process have directly influenced the development of education in Serbia. The greatest challenges of education reform faced by the countries on the road to the European Union include a) decentralisation, b) education for all, c) equality, g) autonomy of schools, and d) promotion of innovation. The problem most countries in Central and Eastern Europe need to tackle is the social dialogue, which is still in its infancy and the attempts to include social partners have been flawed, while new approaches and models are still being sought. A lot of effort has been invested into establishment and develop-

¹⁷ Bojan Komnenović, *Evropski prostor nauke, istraživanja i visokog obrazovanja*, AOM, Beograd, 2005, 10.

¹⁸ European Commission website E:\European Commission - *Enlargement The Programme Cards.htm*

ment of a system of quality assurance. However, the major difficulty all the countries in the region need to overcome is the position of teachers, and their pre-service training and professional development.

These are also the challenges Serbia has encountered on its way to the EU. The Copenhagen Process (which started in 2001) has affected reforms in VET and largely directed their course. A major part of reform of VET took place in the field of development, design and implementation of new pilot profiles and pilot curricula. Nonetheless, a mechanism to transform the best solutions and practice from pilot programmes into the regular education system has not been put in place.

By signing the Bologna Declaration, Serbia joined the group of the European countries that pledged to coordinate their policies in the sphere of higher education in order to establish European Higher Education Area by 2010, with full respect for specific cultural, linguistic and national characteristics of each country. This meant that a new law would have to be designed so as to align the system of higher education in Serbia with the principles of the Bologna Process. The new Law on Higher Education, adopted in 2005 (and amended in 2008), directly introduced recommendations of the Bologna Process into the educational practice in Serbia. The overall process of European integration requires of Serbia to address the immense challenges of education reform and to identify the principles on which the reform process needs to be based.

The Serbian Ministry of Education has defined three main lines of action for development of education in Serbia:

1. Equality,
2. Quality and competitiveness within the European education framework,
3. Education system efficiency.

In terms of adoption of European standards in education, the European Commission stated in its annual report on Serbia's progress within the EU Stabilisation and Association Process (SAP) for 2008¹⁹ that sustainable efforts need to be made to ensure quality, mobility and **link with the labour market**. Links between university, VET and other education sectors are still weak. Mechanism that would ensure inter-sector mobility has not been put in place. The development and adoption of a **national qualification framework** has not advanced. **VET system needs to be reorganised and adult training developed in order to ensure a broader range of profiles and**

¹⁹ *Serbia 2008 Progress Report*, Brussels, 05.11.2008, SEC(2008) 2698 final.

better adaptability to economic needs. Limited administrative capacities and lack of coordination between responsible institutions remain issues of concern. **Financing** for the education sector is still **inadequate**. It represents 3.7% of GDP and is affected by rigid allocation mechanisms, insufficient funding from local authorities and a lack of involvement of the business sector. Public expenditure for human resources in 2007 amounted to 18% of GDP in 2007, while it was 19.7% the year before.

The process of alignment with **Education and Training 2010 work programme** calls for additional legislative reforms concerning education, particularly in the area of financing, **education of children with special needs**, VET, accreditation and certification of vocational education and training programmes and quality assurance in general. The existing legislative solutions relating to education have envisaged equitable access to education for children with special needs and minority children. The inclusion of children with special needs in the education process must be based on the recommendations set forth in the Poverty Reduction Strategy and National Action Plan for Children, and on the results of the pilot programmes. With regard to education of minorities, there are good legislative solutions and existing regulations guarantee equal access to education for members of all national minorities, training of teachers to be able to teach in the minority languages and publication of textbooks in the minority languages. What this area needs is elaboration of bylaws, particularly with regard to in-service and pre-service teacher training, financing and standards. From the perspective of equality, **education of Roma** is one of the most complex challenges for the education system in Serbia. Roma need to be included in the education system, the continuity of their education needs to be safeguarded, they need to receive quality education, tolerance and respect for differences need to be promoted in schools and Roma cultural identity preserved.

Efficiency of the Serbian education system

An analysis of the efficiency of the Serbian education system²⁰ has shown that the total investment in education in Serbia is below the EU average (3.5-4.5% of GDP, compared with 5% of GDP in the EU).

²⁰Aleksandar Baucal, Dragica Pavlović-Babić: *Kvalitet i pravednost obrazovanja u Srbiji: obrazovne šanse siromašnih Analiza podataka, PISA 2003 i 2006*, Beograd, 2009.

On the other hand, the ratio of average teacher salary at 90% of GDP per capita and the student/teacher ratio in primary schools are on par with the EU average. The fact that the Serbian education is underperforming can be interpreted as a signal that the entire system has been **demoralised**. The lack of motivation can partly be attributed to events occurring in the past 20 years, but also to the fact that education has not been among the priorities on the political agenda. What is more, education becomes the main topic only in the wake of a negative and dramatic event in schools, while a clear **course** for development of education has not been established yet (resulting in a lack of purpose and challenges). Furthermore, the comprehensive education reform that started in 2001 was suspended in 2004 for no clear reason and without any agreed alternative, and so on and so forth. In these circumstances, one of the priorities for action should be mobilisation of the system and reaching consensus on a vision and future direction of Serbian education.

The findings of the study²¹ led to a conclusion that investment into education should be increased, particularly with the aim of boosting teacher motivation and improving the quality and equality of the education system in Serbia. Bigger investments into education must be accompanied by design of solid mechanisms that would ensure better disbursement efficiency and transparency. Without such mechanisms, any additional spending will not necessarily result in higher quality and equality of education.

Starting from the 2006/2007 school year, mandatory and free preparatory preschool programme (PPP) for children aged between 5.5 and 6.5 was introduced. The children enter the programme for a period of at least six months in the year preceding their first grade. The official data show that at the beginning of the 2007/2008 school year, 99.6% of children were encompassed by this programme, though there are indications that a considerable number of children, particularly from the vulnerable groups, are not covered by the official statistics. When overall parameters of the PPP quality are summarised, it may be assumed that some of the basic **prerequisites for quality of the PPP work** have been established²²:

²¹Ibid.

²²Ana Pešikan; Ivan Ivić, *Obrazovanjem protiv siromaštva: analiza uticaja uvođenja pripremnog predškolskog programa u Srbiji*, Beograd, 2009.

- Institutional, financial, and personnel requirements necessary to implement PPP as a mandatory activity for all children aged between 5.5 and 6.5 have been put in place.
- Major share of PPP is organised by kindergartens, which is an important precondition for the quality of the work done.
- Pre-school teachers mostly implement the programme, which is another plus, because they are better prepared and trained for work with children of this age.
- In most learning groups, the four-hour programme lasts an entire school year.

The results of the primary education development in the period between 2002 and 2009 have included:

1. **Ongoing advancement of primary education programmes;**
2. **National Education Council adopted Standards for Assessment of Primary Education Outcomes. The Standards define skills and competences a student is expected to have at the end of primary (eight-year) education in ten subjects²³. Academics, experts and teachers developed the Standards.²⁴**
3. **The new Law on Fundamentals of Education and Upbringing introduces mechanisms that may underpin the increase in the quality of:**

The role of schools in socialisation:

- Prohibition of discrimination
- Prohibition of violence (by and against anyone), abuse and neglect
- Established mechanisms of:
 - Early detection
 - Comprehensive reaction (including the family, local community etc.)
 - Known punitive action.

Teachers:

- Strengthened education (30 credits)

²³ Serbian, mathematics, history, biology, geography, chemistry, physics, art, music and physical education; while standards set out by the Common European Framework of Reference for Languages apply to foreign languages.

²⁴ Standards for assessment of primary education outcomes have been prepared within a component of the Education Improvement Project implemented by the World Bank.

- Strengthened professional development
 - Centres for in-service teacher training
 - Possibility of suspension of licenses
- Improved induction
 - Trial period
 - Introduction of teacher trainees, who do not teach independently

Quality of Management:

- Director training and examination
- Enhanced procedures for appointment of directors
- Defined role of the Parents Council
- Student participation in decision-making

Supervision:

- Explained and better regulated procedures
- Counsellors/consultants
- Outlined and simplified complaint mechanisms
- Appreciation of parents' and teachers' opinions
- Quality assurance and self-evaluation of schools
- Cooperation among counsellors and the Institute for Development of Education in assessing the quality of a school's work.

The new Law on Textbooks and other Teaching Materials is promoting the quality and diversity of textbooks and teaching materials through market competition, established procedures and observance of required standards.

The process of modernisation and advancing VET in Serbia, which started in 2001, has drawn on European principles and contained the main guidelines for quality improvement, management and financing transformation, and inclusion of stakeholders and social partners. Its aim has been to provide an efficient transfer of knowledge, as well as acquisition of skills by all participants in the education process, with full appreciation of ethnic, cultural and linguistic diversity. In 2006, the Government of Serbia adopted the *Strategy for Development of Vocational Education and Training*. Its implementation will ensure a) VET that will provide access to employment, b) horizontal and vertical mobility in education, which will enable continuous alignment of the vocational training with development needs on the national and local levels and with labour market demand, c) defining of European VET standards, which will contribute to workforce

mobility, including employment in Serbian subsidiaries of foreign companies.²⁵

In 2006, the Government of Serbia also adopted the *Strategy for Adult Education Development*, which was largely aligned with the concept of life-long learning in the EU. The Strategy deals with persons outside the scope of the formal schooling system who have not acquired primary or vocational education that would give them access to employment. It envisages various and flexible forms of education: regular primary education, part time primary education, initial VET, labour market programmes, and continuous education programmes. It must be underlined that both strategies were developed with EU support, through *CARDS* programme.

The largest part of reforms in the secondary VET has encompassed the **development, introduction and implementation of pilot educational profiles and pilot curricula**. The overall reform activity has adhered to traditional values of the Serbian education system, but also has promoted the main principles of the Copenhagen Process. The pilot profiles and curricula have been developed at the initiative of social partners and association of VET secondary schools. They have been based on:

- Objectives and outcomes;
- Modules and topics;

Compulsory and elective components of the programme. Several programmes and projects have been implemented since 2001 and they have contributed directly to VET reform, particularly the programmes financed by the European Union and German Agency for Technical Cooperation *GTZ*. Their key effects include:

- Exam commissions for final and graduation exams for pilot profiles. Due to practice-oriented lessons, the interest and motivation of students have increased considerably and their average grades have risen consequently. The number of absences has declined significantly, which indicates that classes in the pilot curricula are much more interesting to students, not only because of their modern and applicable content, but also because of the methodology used. Teachers have applied new didactic methods they learned at in-service teacher trainings.
- Social partnership has been established and stakeholders' roles in VET development have been defined, particularly with regard

²⁵The second Serbian Poverty Reduction Strategy implementation report, August 2007.

to identifying demand for occupations, defining occupation profiles (i.e. identifying the required skills and competences to meet the needs and demands of the industry), and participating in exam commissions.

- Students who attended the pilot curricula complete their education by taking a final exam. The final exam programme in pilot profiles has been prepared through consultations and by respecting demands of the social partners – Serbian Chamber of Commerce, Employers' Union, relevant business associations and with active participation of VET secondary schools where the pilot curricula have been organised.
- External members of final exam commissions are representatives of the business sector and delegated by the Serbian Chamber of Commerce.

Drawing on the strategic documents on VET development and principles and priorities defined in Serbia's EU accession programmes, the six key priorities for future VET development in Serbia may be:

1. Establishing pluralism of institutions, programmes and organisations involved in VET and linking formal and informal vocational training, which should facilitate further development of VET and ensure flexible horizontal and vertical mobility of students and participants;
2. Development of a system of standards in VET. This envelopes elaboration of both occupational standards and standards in education. It includes also tasks that concern a change in status, content, and functioning of the practical training. The following measures are proposed:
 - Modernisation and development of practical work and practical training, both in VET schools and educational institutions, as well as in firms;
 - Redefining the form, method and content of practical training in firms, on the basis of a partnership and cooperation agreement between schools and socio-economic partners;
 - Further modernisation – of the content, organisation and method of teaching, teachers' work and schools in general, which entails further advancement and innovation of modular curricula based on learning outcomes. Within this priority, special missions have been defined for development and im-

provement of curricula in minority languages and for children with special needs;

1. Establishment and advancement of a quality assurance system in VET. This includes development of a system of accreditation and certification in VET and adult education, improvement of the examination system in VET, evaluation of pilot curricula implementation in a number of activity areas up to date and their transposition into the regular VET;
2. Rationalisation and enhancement of VET secondary schools network, which encompasses alignment of the VET school network with the labour market and demands of the business sector;
3. Linking VET schools and institutions with local communities, the labour market, regional chambers of commerce, employers' union, small and medium-sized enterprises and labour unions. A special aspect of this is formation of local councils on VET.

The process of higher education reform in Serbia started in 2001 and was officially outlined in the Higher Education Reform Strategy in 2002. The new Law on Higher Education (2005, and changes 2008) envisaged a number of solutions aiming at alignment with the principles of the Bologna Declaration. This involved, in particular, introduction of two study cycles, Bachelor's and Master's degrees, Diploma Supplement, European Credit Transfer System (ECTS), definition of learning outcomes etc. The Law set forth that higher education was to take place via academic and professional studies, through approved, i.e. accredited, higher education programmes. Academic studies offer an academic programme that trains students for development and application of scientific, professional and artistic achievements. Professional studies comprise a programme that prepares students to apply the skills and competences required for direct entry into the labour market. The Bologna Follow-up Group gave Serbia a **3.8 score (on a scale from 1 to 5) for the Bologna Process implementation**.²⁶ Pivotal progress has been made in application of the three-cycle system of accreditation. The Bologna Process has encompassed all the public and private institutions of higher education. The National Council for Higher Education, Serbian Dean Conference, Conference of Universi-

²⁶Ministry of Education of the Republic of Serbia: *Education policy priorities*, October 2008.

ties of Professional Studies and the National Team of Higher Education Experts have constantly monitored implementation of the Bologna Process. A major part of the work ahead will involve development and recognition of a framework of qualifications.

Mobility of Serbian students is realised within the framework of *Erasmus Mundus*, *Basileus*, *Tempus* and *CEEPUS* programmes, while students at all study levels are supported with national scholarships. Universities of Belgrade, Niš, Novi Sad and Kragujevac have adopted bylaws on student mobility and transfer of credits, which facilitate recognition of periods of study, exams passed and credits achieved upon return to their original university, i.e. faculty. Info-days for promotion of various scholarship options pertaining to student and academic staff mobility are held regularly. Serbia has successfully implemented the *Tempus* programme for participation in the Bologna Process and there are currently seven projects whose beneficiaries are Serbian universities that have established cooperation with other universities in Europe.

According to the assessment of the European Training Foundation (*ETF*), just like all the other Western Balkan states, **Serbia still has no answer to the challenges stemming from the changes on the labour market**. A lot more has to be done to strengthen the social partnership, with mutual appreciation of interests. A major progress has been made with design of strategic documents concerning employment, but not much of that has been put into practice. The strategies can be implemented efficiently and effectively only through institutional cooperation on all levels. Action plans for employment should support local economic development, and social partnership on the local level also should be strengthened for that purpose.²⁷

The process of Serbia's EU accession does not require, but has significantly boosted, the necessary education reform. The reform efforts strive to advance the teaching quality, transform the management and financing in education, include stakeholders and social partners in order to ensure an effective transfer of knowledge and acquisition of skills for all participants in the education process and improve the labour market efficiency, with full respect for ethnic, cultural and linguistic differences.

²⁷Anastasia Fetsi, Arjen Deij, Jean-Raymond Masson, Meri Lorencic, Henrik Huitfeldt, Ekaterina Selezneva, William Bartlett and Ray Phillips, *Labour markets in the Western Balkans: Challenges for the future*, ETF publication, 2007.

IMPACT OF SERBIA'S EU ACCESSION ON THE LABOUR MARKET – EXECUTIVE SUMMARY

The EU accession process implies an economic convergence and harmonisation with European legislation and norms. The nature of the process depends on the size and specific character of the gap between, in our case, the labour market in Serbia, an EU aspirant, and the given norms and objectives of the European Union. Serbia embarked on the process of reforms and alignment with the EU in the area of labour market, as in many others, in 2001. This entailed reform **of the labour legislation, payroll tax reform and adoption of a new employment strategy**. This study shall review the results of the reforms and their sustainability in light of the global economic crisis. It highlights the need to increase the employment rate and quality of employment as priorities in strengthening the labour market. There are concerns that the rather gloomy picture of employment in this decade of transition may persevere even in the next period, if the decision makers (the competent government officials) fail to take full responsibility for serious reforms, including building capacities for efficient use of all the advantages of EU integration.

The first part of the analysis of the effects of EU accession on the labour market in Serbia covers the main characteristics of the Serbian labour market, distinguished by a **high unemployment rate caused by the transition and other structural and long-term underlying reasons**. The impact of the global economic crisis has been included in the analysis. The crisis started in late 2007 and was in full swing by autumn 2008, at the time when the reform process was not yet completed. It is believed that the long-term impact of the crisis worldwide will be felt the most on the labour market, which is traditionally the last to recover after the employers regain confidence in the stability of the business climate. This poses further challenges for macroeconomic decision makers.

The fact that the unemployment has been recognised by the Serbian public as a larger problem than the two key political issues, Kosovo and cooperation with the International Criminal Tribunal for the Former

Yugoslavia²⁸, speaks volumes about the relevance of the current state of the Serbian labour market. In contrast to the inflation rate, the balance of payments deficit and unemployment rate were left out of reach of the economic policy-makers in Serbia and they continue to point out the flaws, the lack of reforms and scarcity of structural coordination in Serbian economy. Internationally comparable unemployment rate in Serbia was 18.8% in 2007 and was extremely high relative to the 7% in the European Union or 10% in Poland and Slovakia, the two recent EU entrants with the highest unemployment figures. The global economic crisis has slightly narrowed the disparity, as it hit heavily some EU labour markets like Spain, Hungary and Latvia. However, should the crisis continue, the risk of Serbian economy landing hard in 2010 will increase. The three most probable ways to amortise an extended crisis would be diminishing of real income through high inflation, mass delays in the payment of wages and other liabilities and, finally, mass layoffs. Before the global economic crisis, unemployment rates in the Western Balkans spanned between 9.1% in Croatia and 34.9% in Macedonia. In the meantime, the unemployment numbers rose due to the crisis. According to some estimates, **the unemployment rate in Serbia is expected to hit 21% by the end of 2009.**²⁹

Demographic trends, primarily ageing and declining population, but also the brain drain, reflected negatively on the Serbian labour market. The number of working-age population will decline by almost 150 000 – from 5 030 000 in 2002 to 4 885 000 in 2012, due to a net population loss of around 350 000 over a ten-year period. **Average annual decline in working-age population between 2006 and 2012 is expected to total some 15 000.**³⁰ On top of that, UNHCR listed Serbia last year among the five countries in the world with a long-term refugee crisis whose solution required concerted action. Serbia is currently hosting 97 000 refugees from Croatia and Bosnia and Herzegovina and some 200 000 internally displaced persons from Kosovo and Metohia. The proportions of the prob-

²⁸Research conducted by the International Republican Institute, March 2009, *Politika*, 9 April 2009.

²⁹UniCredit Group's estimate, <http://www.naslovi.net/2009-05-04/24sata/stopa-nezaposlenosti-raste-na-21-odsto-u-2009/1139627>.

³⁰Mihail Arandarenko: Prioriteti definisani Nacionalnom strategijom zapošljavanja i drugim strateškim dokumentima, Projekcija osnovnih kontingenata na tržištu rada (RZS i ARS) 2006-2012 – kretanje zaposlenosti, demografski indikatori ponude rada, kretanje stope participacije, stope zaposlenosti i stope nezaposlenosti, Preporuke za politiku zapošljavanja i aktivne programe tržišta rada, unpublished document.

lem are much wider, as many refugees assumed Serbian citizenship, while their situation and the related problems have not been resolved.³¹

With **950 000** persons employed in the private sector in Serbia, a country whose working-age population totals over 5 million, the platform for growth is exceptionally narrow. On the other hand, some **550 000** workers employed in the Serbian public sector **weigh heavily on the economic development**. The global economic crisis and completion of privatisation will eliminate redundant workers in enterprises that have not been privatised or restructured to date. The public sector is goaded by the crisis and the expert public to implement reforms leading to fiscal adjustments and workplace rationalisation. However, the crisis may prolong the existence of considerable "last resort employment" (virtually undesirable employment as the only chance to have a job), primarily among farmers and self-employed persons. Agricultural productivity in Serbia is very low. It is believed that a half of the persons currently employed in the farming sector would suffice to attain the current share of agriculture in Serbian GDP.³²

Systemic efforts of the state are reflected in the National Employment Strategy (NES) for Serbia, which was adopted in April 2005 and which represents the main strategic document for promotion of employment. It draws on the European Union's Lisbon Strategy and covers the period between 2005 and 2010. The Strategy emphasizes the need to take a **regional approach to the labour market** in order to make jobs closer to the workers, instead of being the other way round. This would promote balanced economic development, as one of the pillars of a high and sustainable economic growth. The basic units of observation in the strategy are three regions (Belgrade, Vojvodina and Central Serbia), with 25 districts. The Strategy moves on to an analysis of payroll tax reform. Unlike most EU countries, which apply a progressive tax system, Serbia has *de facto* introduced a **regressive tax system**, which imposes additional burden on low-income persons and discourages cheap job creation. A recapitulation of trends in key indicators of the Serbian labour market brings us to the proposed measures for economic policy creators in this area. With necessary structural changes, such as a **pension system reform**, the suggested measures that are pivotal to employment growth include **further payroll tax reform, implementation of the recently adopted Law on Employ-**

³¹UNHCR, <http://www.unhcr.org/publ/PUBL/455443b011.pdf>
<http://www.refugees.org/countryreports.aspx?id=2168>

³²For more, see the chapter on the Impact of Serbia's EU integration on agriculture.

ment and Unemployment Insurance, as well as a more efficient application of active labour market measures (trainings, support to job creation in the private sector).

In its response to the economic crisis, Serbia has been unable to use measures of an expansive monetary and fiscal policy, because reserves generated by several large-scale privatisations have been used up, mainly through government consumption. Frequent electoral cycles stimulated several governments to allow spending beyond real capacities. Also, there is no money in public coffers for any major public works or investments. Therefore, the monetary policy has been left on its own for the most part, because interventions of the National Bank of Serbia were not accompanied by fiscal policy measures. This is yet another reason why positive effects of the EU accession are of crucial importance for the Serbian economy and the labour market.

To solve the problem of unemployment, we need structural reforms and the most important among them is the pension system reform mentioned above. The pension reform represents an unfinished business in Serbia. In 2008, three pension funds were merged (for the employed, the self-employed and farmers) into an integrated system. Pensions are the heaviest burden for the Serbian economy, exacting some EUR 3.5 billion a year. At the same time, there are only five workers for every four pensioners. **Employee and employer contributions cover only two-thirds of total expenses, while the rest is financed from the state budget.**³³ The ratio is expected to worsen further this year. The problems of an ageing population, fiscal and foreign trade deficits, rising social expenditures and repayment of the external debt existed prior to the global economic crisis. In a time of global economic downturn, we may now say with certainty that pension system reform is of critical importance to Serbia. Pension reform mostly focuses on introduction of mandatory private pension insurance and supplementary voluntary pension schemes. Serbia is lagging behind other countries in the region when it comes to pension overhaul, but it gives the country a chance to use the experiences and models applied elsewhere. Even Serbia's first arrangement with the International Monetary Fund at the beginning of the global economic crisis in 2008 encompassed a pension system reform. The existing model of pension financing is unsustainable. The urgency of the reform from the perspective of the national economy is supported by the fact that the state backed the

³³ILO, http://www.ilo.org/public/english/region/eurpro/budapest/download/socsec/pension_workshop_serb.pdf

Pension and Disability Insurance Fund with some RSD 565 billion in the period between 2003 and 2008, which exceeded Serbia's total privatisation revenue in the same period (around RSD 502 billion).³⁴

The influence of the EU becomes obvious already in the first part of this chapter, for instance, on **shaping of the National Employment Service**. The second part deals directly with effects of EU integration on the labour market in Serbia and the **implications and benefits for Serbia**. European integration eliminates administrative barriers to free movement of people, goods and capital. It ensures political stability and favourable legal and economic climate for investment, consequently increasing a country's investment and credit ratings. The EU convergence sends a signal to investors that their assets will be safe and supports their confidence in a country's economic development. Nonetheless, each country is a specific case and the EU is an ever-changing entity. Therefore, the influence of integration on the labour market always hinges on specific character of a would-be EU member state or an EU candidate country and general circumstances, i.e. the timing of the accession. The European Union needs a capable partner to draw financing from the EU funds and attract suitable levels of private foreign direct investment.

Upon obtaining the status of an EU candidate country, a highly positive scenario can be conceived for the labour market in Serbia, which would rely on one central and two ancillary components presented below. **The calculations suggest that the invigorated business sector may help increase employment by 250 000 in the next five years and cut unemployment by around 200 000. Should the country receive a candidate status in 2010, the unemployment rate would decline to some 12% by 2014.³⁵ Employment rate, which ought to be the main parameter of labour market performance for economic policy makers, would rise from the current 51% to 58% and the gap between the EU and Serbia would consequently narrow to some 10 percentage points. Boosting employment in the private sector above all should be the central objective of the economic policy of Serbia, standing in the waiting room of the European Union.**

The main platform for attainment of this objective by 2013 is a stable and high foreign direct investment inflow of an average 3 billion euros

³⁴Statement by the Governor of the National Bank of Serbia Radovan Jelašić, <http://www.naslovi.net/2008-11-20/blic/neophodna-reforma-penzionog-sistema/920370>

³⁵Михаил Арандаренко: „Тржиште рада у Србији и интеграција у Европску унију“. Short version of the text published in the daily *Politika* on May 3, 2008.

per year even after the privatisation has been completed. The annual FDI inflow of EUR 3 billion is widely accepted as *sine qua non* for accomplishment of the national macroeconomic objectives. A lower foreign direct investment inflow would prolong the far from optimal macroeconomic performances and hamper attainment of the macroeconomic goals. This component is indirectly, but tightly, linked to European integration. The two ancillary components of employment growth are immediate benefits of European integration: **access to EU funding, once the EU candidate status is obtained, and the removal of barriers to free movement of people**. It should be noted that the European Union is very interested in optimisation of the labour market indicators in Serbia, because it would facilitate Serbia's integration into the economic system of the EU and moderate migratory aspirations, illegal emigration in particular.

Despite the specific nature of labour markets in each candidate country or potential candidate, it may be very useful to explore the effects of EU integration on the labour market by making analogies with countries in the region that have advanced most on their way to the EU. We have relied here on the examples of Romania, which became an EU member state in 2007, and Croatia. For the purpose of a comparative analysis, two studies analyzing benefits and downsides of the EU accession for the labour market have been used. The Romanian study³⁶ focuses on overall macro costs and benefits for the labour market stemming from the EU accession, while the Croatian study³⁷ atomises the costs. Both studies also deal with the movement of labour force and forecast a limited labour mobility in the first stage of EU membership. They also inquire into the brain drain issue, especially concerning the youth and IT experts. The studies emphasize that migration is a two-way street and probe into the issue of admission and treatment of workers from other EU states in Romania and Croatia, respectively. They also bring up the issue of the temporal divide between costs and benefits and discuss who should pay for the costs.

The study of the European Institute of Romania concludes that, overall, the EU accession scenario would be preferred over the scenario of isolation from the perspective of the Romanian labour market as well. The average real wage growth was substantially higher in the integration scenario relative to the isolationist model (a 0.4% rise in average annual

³⁶European Institute of Romania, Pre-accession Impact Studies II, Study no. 12 A Cost-Benefit Assessment of Romania's Accession to European Union

³⁷Pristupanje Europskoj Uniji: Očekivani ekonomski učinci, Ekonomski institut, Zagreb 2007.

wage in the isolationist scenario and a 1.89% increase in the integration model). The Croatian study by the Zagreb-based Institute for Economics deals in particular with the time gap between costs and benefits, because the costs become evident already in the period of pre-accession, while the benefits are expected to come later. Making a comparison between a situation on the labour market if reforms are implemented for the EU accession and the isolationist scenario, the study establishes a link between an expected increase in employment rate with differential (additional) GDP rate growth in the two potential scenarios. The calculations in the study suggest that differential GDP increase would be 1% in the period between 2006 and 2010 for the integration scenario over the isolationist model.

Though the two studies monitor different indicators (trends in average wage and GDP), they share the same opinion regarding the positive trends. A similar situation and the positive influence of the EU integration on key macroeconomic indicators may be replicated in Serbia, just like in its neighbours to the East and West. With regard to the impact of opening of the European labour market on Serbian workers, migrations are usually in the centre of the attention, as one of the major effects. Beside the economic growth, migrations have also helped countries like Poland, but also Romania, which had high unemployment rates, to face **labour shortage in some areas** today.³⁸ The experiences indicate that migration should be expected primarily among the young and educated population. However, while there is an abundant literature on the impact of migration on host countries, very little attention has been paid to the impact of migration on the sending countries.³⁹ It can be expected that, analogous to Serbian neighbours, migration will help ease the pressures on the labour market, increase the inflow of remittances and the transfer of know-how, but also bring about **labour shortage in some sectors**, as highlighted in the Skills Gap Analysis in Four Sectors of Serbian economy, which was published by the USAID Serbia Competitiveness Project.⁴⁰ Further studies, as well as concrete measures to establish stronger relationships between

³⁸Михаил Арандаренко: „Гаранције за странце“, *Политика*, 3. мај 2008..

³⁹András Inotai, *Effects of Accession on the New Member Countries: The Economic Dimension*, Institute for World Economics of the Hungarian Academy of Science, Budapest. The author presented the paper at the FEFA annual conference held on 9 May 2009 and at a conference organized by TEPSA and the Institute for World Economics in October 2008.

⁴⁰Skills Gap Analysis in Four Sectors of Serbian Economy, 2008, www.compete.rs

education and business, are needed to make more precise projections of the proportions and effects of the migration processes on Serbia.⁴¹

Serbia already has a business environment that is not essentially different from those in the new member states and especially in the EU candidates. The high impact, quality and the best-paid jobs are in the private sector. **In the lack of domestic capital, creation of these jobs is most directly linked with the level of foreign direct investment. Again, we must emphasize the importance of political stability as the key precondition for attracting foreign investors. The only way to achieve that is by accelerating the European integration process.** If the progress toward the EU should be stopped, even with apparent internal political stability, the FDI inflow would decline. In the long-term perspective, only private sector employment and salaries have prospects of growth. The EU candidate status is a strong signal, because it instils trust in investors with regard to future economic growth rates and the safety of their assets. A country on the way to the EU is recognised as a country with stable market institutions, rule of law and full access to the largest market in the world. This should be the foremost priority for Serbia.

⁴¹ For more, *see* the chapter on the Impact of Serbia's EU integration on education.

IMPACT OF SERBIA'S EU ACCESSION ON THE JUDICIARY – EXECUTIVE SUMMARY

The official relationship between the European Union and Serbian judiciary and its reform is formalised through conditions set out in the European Partnership, as a unilateral act, and through European Commission Progress Reports for Serbia in the Stabilisation and Association Process (SAP). The approach in both documents takes two directions and is comprehensive with regard to the judiciary, as it covers the requirements guaranteeing both judicial independence and judicial capacities, i.e. the expertise. For instance, the European Partnership insists on developing a system of education and training of judges through transformation of the Judicial Centre into a National Judicial Academy, advancement of both the technical and normative system of judicial management in courts, and reinforcement of the focal points within the judiciary responsible for international legal assistance in criminal matters and extradition requests. The document also calls for final establishment of a network of courts in line with the Constitution, further development of alternative dispute resolution mechanisms, such as mediation, and establishment of adequate administrative capacity of the High Court Council as the supreme judicial body. Furthermore, the European Partnership insists on building the administrative capacity of public prosecutors and of the special offices for prosecution of war crimes and organised crime.

On the other hand, the 2008 Progress Report for Serbia in SAP underscored the fact that appellate courts and Administrative Court have not yet been established, which has in turn delayed transformation of the Supreme Court into the Supreme Court of Cassation. **The inexistence of an efficient network of courts, despite the constitutional provisions, creates delays in rulings and backlog for the courts, and results in excessive length of proceedings.**

With regard to requirements guaranteeing independence of the judiciary, the European Partnership and European Commission reports rely entirely on assessments expressed by the Council of Europe, in particular

the Compliance with obligation and commitments of the post-accession programme (the so-called monitoring programme) and opinions and assessments of the Venice Commission regarding the position of judges and prosecutors. On 13 June 2009, at the request of the Parliamentary Assembly of the Council of Europe, the Venice Commission adopted the Opinion on the Draft Criteria and Standards for Election of Judges and Court Presidents of Serbia, as well as on the Criteria and Standards for the Evaluation of the Qualification, Competence and Worthiness of Public Prosecutors. The documents expressed great concern with regard to general election of judges in Serbia, which is sometimes called re-election. The Government of Serbia and the Ministry of Justice defend the general election on the grounds of the problem with corruption and incompetence in courts, which stems from the appointment of politically suitable judges during the previous regime. The lawmakers believe that mere application of sanctions or individual removal of a judge from office would do more harm than good, as it may exacerbate the current atmosphere of public distrust of the judiciary in Serbia. On the other hand, the Venice Commission suggested it might be better to take an individual approach to instances of corruption and incompetence in courts, so as not to jeopardise the principle of independence of the courts and avoid unlawful pressure by the executive. Both the general and the individual approach entail political consequences and it may be difficult to strike a balance in that regard. Nonetheless, in light of the steady decline in public confidence in the legal system and the negative statistics presented in the full version of this study, the arguments in favour of general measures that encompass the entire judiciary increase in importance. However, the procedure of the general election must be based on objective and transparent criteria and should not leave space for any inappropriate pressure by the executive. **The greatest concern was expressed with regard to the criteria for general election of the judges and the first appointment of judges for a three-year mandate**, as the criteria concerning professionalism and related efficiency of judges are not fully objective.

The judicial system in Serbia has not operated in conformity with European standards and needs of the Serbian citizens for quite some time, despite many legal changes that have taken place since 2000. The need for regulatory reform has been made more urgent by many complaints filed by citizens objecting to excessive delays in court proceedings, lack of enforcement of rulings and corruption. The Serbian court system is weak in many aspects: the system of courts is inordinately complex and wide; the standards for appointment, removal, evaluation and promotion of judges

are unclear; there are no capacities for integrated planning, budgeting and performance measurement; the functioning of judicial administration is obsolete; there is no continued training of judges and other judicial officials. Furthermore, the fact that **judges declare exceptionally mild sentences for serious crimes** is deeply preoccupying for the public.

Article 9 of the Serbian Constitution recognises the judicial system as an autonomous and independent branch of government. Nevertheless, it cannot be asserted that the judiciary unambiguously derives its full equality with other branches of government from the Constitution and laws. In fact, as we will explain later, the National Parliament appoints court presidents and judges selected for the first time. Before the High Judicial Council Law was passed, the Ministry of Justice, a body of the executive, had significant discretion in election of judges. The establishment of the High Court Council has moderated the inferiority of the judicial power relative to other branches of the government, but this problem has not been rectified entirely, in light of the composition of the High Court Council. **In reality, the political branches of government – legislature and administration – largely influence the judiciary, the courts and judges.**

The institution of the High Judicial Council was introduced in Serbian legislation in 2001. Legal professionals were divided on whether this satisfied, in terms of both the institutional and the personnel solution, the need for an autonomous judicial body that would contribute to independence of the judiciary. The rules regarding competences of this body have been modified on several occasions, through both amendments and changes to the High Judicial Council Law and frequent amendments of the Judges Law. Furthermore, the previous constitutional provisions imposed shared competence – the High Judicial Council decided on selection and promotion of judges, while the Grand Personnel Panel, a body of the Supreme Court of Serbia, decided on removal of judges from office and fulfilment of retirement criteria. Only with passing of the new Serbian Constitution in 2006 did the High Court Council become a constitutional category. Both legal theorists and the practitioners (particularly judges) have hailed this solution, as it is expected to strengthen the role and independence not only of the High Court Council, but also of the judiciary in general. It is particularly noteworthy that the Constitution also provides for integration of all competences enjoyed by similar institutions in comparative law, in line with relevant European standards. It is interesting that the provisions of the new Constitution separate competences regarding selection, promotion and removal from office of judges and prosecu-

tors. For this reason, the State Panel of Prosecutors has been introduced into the Serbian legal system, beside the High Court Council. It appears that the key new competences of the body concern the permanent election of judges, deciding on the number of judges and lay judges for each court, evaluation of work of judges and court presidents, deciding on removal of a judge from office and proposing the amount and structure of budget allocations required for operation of the courts. The scope of these powers, and especially the fact that the High Court Council will decide on permanent election of judges and on removal of judges from office, demonstrate the aspiration to strengthen the independence of the judiciary from the executive and legislative branches, though the composition of the body does not reflect this idea fully.

Still, it is clear that these powers necessitate streamlining the organisation of the High Court Council (HCC) as well as novelties in judicial management – such as introduction of disciplinary bodies that would decide in original jurisdiction on disciplinary responsibility of judges. Furthermore, in view of the wide scope of competences and tasks of the HCC, the Law sets out that members of the Council that are selected from the judges shall be relieved of their duty during their mandate with the HCC. This ensures, in theory at least, that a HCC session may take place anytime – because six members are needed for the quorum (while HCC has seven judges, one of whom is the President of the Serbian Supreme Court of Cassation, is not a selected member and necessarily continues to hold his office).

In line with the new Law, the election of judges will take place by 1 December 2009 at the latest, except for the judges of the Supreme Court of Cassation, who will be selected within 90 days from the establishment of the High Court Council. The judges elected in conformity with this Law will take their office on 1 January 2010 (Article 100, paragraphs 1 and 2). The High Court Council decides on the number of judges and lay judges, according to the Law, within 30 days from selection of the first composition of the High Court Council, with prior approval of the justice minister (Article 100.1). The first election of a judge is considered to be the appointment of a judge pursuant to previous laws. However, appointment of a misdemeanour judge is not understood to be the first election (Article 100.4).

Serbian Ministry of Justice has prepared Draft Criteria and Standards for Election of Judges and Court Presidents in line with Article 45.6 and Article 69 of the Judges Law, which was subsequently adopted by the High Court Council (Decision published in the Official Gazette of the

Republic of Serbia No. 49/2009). The criteria and standards concern evaluation of qualifications, competence and worthiness of judges and court presidents. The document starts with legal definitions of "qualification", "competence" and "worthiness", and goes on to specify details of each of the three criteria that are applied to (1) the first election of a judge for a three-year mandate, (2) the election to permanent functions of judges who were previously appointed, (3) the election to permanent functions of judges whose three-year mandates have elapsed, (4) the promotion of judges from one court into the next highest court and (5) the election of court presidents.

The main problem with the criteria is that they are unattainable for our judges, since they are too complicated to be applied in practice and encompass mostly quantitative indicators that may compromise the quality of the work of judges. For instance, the criteria for election to permanent functions of the already appointed judges involve the percentage of performance measure achieved; the number, type and complexity of cases; the number of cases concluded; the number of confirmed or overruled decisions; the amount of time taken to reach a ruling etc. This problem was perceived also by the Venice Commission who stated in its opinion that "the mere counting of workloads should not be used in such a way as to put pressure on a judge to make decisions without proper consideration. For instance, there may be a higher number of cases in a given region due to the fact that this region has an overzealous lawyer who systematically appeals when his or her clients have lost a case – which could skew the scales with respect to the caseload in favour of that region. However, it seems reasonable that these criteria should be used as a means of identifying possible problems, provided that proper evaluation is then carried out and not simply be treated as a numbers exercise." It is also unclear how specific competences set out in the draft can be measured – for instance, the capacity for analytical and synthetic opinion, self-control and cultured behaviour (the Venice Commission also highlighted this issue).

It is very important to cite other remarks offered by the Venice Commission in its Opinion of 12-13 June 2009, which analysed the criteria in great detail and pointed to the potential problems in their application. The Commission expressed its apprehension that the already appointed judges, who have not been guilty of any misconduct, may not be reappointed to their office. This concern is partly alleviated by Article 13 of the Decision on criteria, which states that the already appointed judges applying for the function in the court of same type or of the same instance shall be assumed to have fulfilled the criteria and standards specified in the

draft criteria on judges. The Commission concluded that the draft criteria are in line with European standards (recommendations of the Council of Europe and good practices of member states) and forward-looking, as they define a precise framework for skills required of the various categories of judges. However, the Commission was apprehensive about the method for evaluating and balancing different skills against one another. Finally, the Venice Commission criticised justly the shortness of the timeframe for implementation of this comprehensive reappointment of judges and presidents of courts in Serbia, which is to take place by 1 December 2009. With regard to the deadlines and the method of selection, further potential problems need to be accentuated. Upon prior consent of the Ministry of Justice, the High Court Council determined that only 1 838 judges are needed, while there are 2 400 currently appointed judges and 1 000 misdemeanour judges who will participate in the public competition as well. The question is whether the High Court Council, which has not been fully constituted, will be able to conduct a detailed evaluation of the applicants, in light of the highly ambitious criteria set out in the draft. The preparedness to hold an objective selection procedure is also questionable, as the stated need of 1 838 judges would mean that some 600 judges would not be appointed to offices, not to mention the misdemeanour judges.

Finally, we must keep in mind that a working group of the Serbian Ministry of Justice has prepared the draft criteria, though they ought to be defined by the High Court Council, hence the competence of the Ministry of Justice to adopt this document may be reasonably questioned. One of the major changes involves disciplinary responsibility of judges, introduced by the new Judges Law. It defines disciplinary offence as unconscientious performance of a judge's office or conduct unworthy of a judge, as set out in the Law. It also lists different categories of disciplinary offence, which aim to safeguard efficiency and independence of a judge's function. The Law stipulates disciplinary sanctions that may entail public warning, fifty-percent reduction in salary for up to one year and suspension of advancement that may last for up to three years. According to the new Courts Law, the court system in Serbia comprises courts of general and courts of specialised jurisdiction. Courts of general jurisdiction are basic courts, high courts, appellate courts and the Supreme Court of Cassation. The commercial courts, Commercial Appellate Court, misdemeanour courts, High Misdemeanour Court and the Administrative Court are courts of specialised jurisdiction. The Law on Seats and Territories of Courts and Public Prosecutors defines the seats and territories of their jurisdiction, as well as departments of High Misdemeanour Court and Administrative Court

and the territories of their respective jurisdictions. **The major problem is implementation of the laws. Although their enactment has been postponed until 1 January 2010, the question remains whether there are the organisational and technical capacities to establish the new judicial network.** Furthermore, a similar organisational structure was designed in previous amendments of judicial regulations, but the application, as a rule, was postponed to a later date.

IMPACT OF SERBIA'S EU ACCESSION ON COMPETITION POLICY – EXECUTIVE SUMMARY

Competition law in Serbia: a European perspective

Competition policy is a complex legal and economic category whose coverage encompasses market structure, business conditions and behaviour of business entities. It presupposes four defining elements: subjects, an object, location and goal of the market game. The rules on competition and state aid control have been the vital principles in the creation of the European Union's internal market. Effective safeguarding of competition, which entails alignment of laws and bylaws with the EU legislation and their efficient implementation, is one of the key criteria for the assessment of Serbia's preparedness to join the European Union. Competition has a direct and major influence on overall economic development, investment opportunities and advanced quality of goods and services. Similarly, it helps reduce prices, generates other consumer benefits, and provides for eventual establishment of a modern market economy, capable of joining the EU single market and other international developments.

The purpose of the Stabilisation and Association Agreement (SAA) between the European Communities and their member states and the Republic of Serbia (signed in 2008), as well as of the Interim Agreement on Trade and Trade-related matters between the European Community and the Republic of Serbia, is to create a free trade area between Serbia and the European Union. By signing this document, Serbia assumed the obligation to align its legislation with *acquis communautaire* (the body of EU legislation) gradually and within a specific timeframe, in conformity with the third Copenhagen criterion for EU membership.⁴² The harmonisation of rules must first focus on the area of competition and state aid laws, as

⁴²Chapter VI of the SAA, Articles 72-79, regulates this obligation.

well as on protection of intellectual property rights, standardisation of technical regulations, public procurement and consumer protection. In its wider sense, the alignment refers not only to regulatory harmonisation, but also to establishment of an adequate institutional framework for effective implementation of the laws.

Convergence of laws with EU legislation is necessary in order to secure proper functioning of the free trade area between Serbia and the EU. Besides, the second membership criterion defined in Copenhagen in 1993 sets out that a country aspiring to become an EU member must have a functioning market economy, with the capacity to cope with competitive pressures within the internal market. This requirement can be met only by aligning Serbian legislation with that of the EU. Its goal would be to have the Serbian economy operate in conformity with domestic regulations, previously harmonised with the *acquis*. Only in that case, the day of EU accession would not be perceived as a fundamental change and shock for the domestic economy, because compatible legal arrangements would apply on both sides. With that in mind, the Agreement sets out clearly the obligations for Serbia concerning deadlines and *acquis* areas with which it needs to comply.

Modality of the harmonisation, the related timeframe and any exceptions from the obligation to align with remaining areas of the *acquis* are subject to negotiation on EU membership, which Serbia will conduct in the last stage of its EU accession. It is important to note that alignment does not only include legislative activities, i.e. the passing of laws and by-laws, but also the efficient application of regulations, which requires prior building of relevant administrative and judicial capacities. For a country's legal system to be compatible with EU legislation, it must have the practice (administrative and judicial) to prove that the harmonised regulations have been implemented effectively.⁴³

Article 73 of the Stabilisation and Association Agreement rules out the following practices as incompatible with the proper functioning of the SAA, insofar as they may affect trade between the Community and Serbia: agreements among undertakings, decisions by association of undertak-

⁴³The European Commission stated in the 2008 Progress Report for Serbia (Commission of the European Communities/2008.2008 Progress Report for Serbia, Brussels, p. 40-41) that Serbia has achieved certain progress in implementation of antitrust laws and that the Competition Commission's efficiency has improved. The Report presented the following assessments: the existing antitrust laws are not fully aligned with requirements of the Stabilisation and Association Agreement and the Interim Agreement, merger control procedures are not yet adequate, the executive capacities of the Competition Commission are still not satisfactory, the enforcement capacity of the judiciary is weak, operational independence of the competition authority needs to be secured.

ings and concerted practice between undertakings whose objective or consequence is prevention, restriction or distortion of competition, and abuse by one or more undertakings of a dominant position on the entire or substantial part of the territory of the Communities or Serbia. This article directly introduces in implementation of the SAA the prohibition of restrictive agreements set out in Article 81 of the Treaty Establishing the EC and the ban of abuse of a dominant position stipulated by the Article 82 of the EC Treaty. According to the Article 73 of the SAA, such behaviour is prohibited if it affects the trade between the Community and Serbia. In the light of the size of Serbian economy, it may be expected that all restrictive agreements targeted by domestic lawmakers and each instance of abuse of a dominant position would have an impact on cross border trade and thus be in contravention with this article. In practice, this means that Serbia's antitrust activities will no longer be only an obligation of the state toward its citizens, but also Serbia's international obligation toward the European Union. Article 74 of the SAA states that upon expiration of the three-year period from the day when the Interim Agreement comes into effect (i.e. as of 1 January 2012), the competition rules will apply also to public undertakings and firms with special rights in line with the rules of European Communities set out in Article 86 of the EC Treaty. This essentially means that from that date onward, competition rules will encompass public enterprises, but to an extent that would not jeopardise the mission of those undertakings. From the perspective of substantive law, these two articles bring no new obligations for Serbia with regard to competition, as the same solutions are already contained in the effective regulations.⁴⁴ A distinctive novelty brought by the Agreement, in view of the fact that once the SAA comes into effect, the application of competition rules will become an international obligation for Serbia, is that the implementation of the laws will henceforth also be monitored by the European Commission, as part of its surveillance of the entire SAA implementation. The Stabilisation and Association Committee will also review their application once the European Council approves the Interim Agreement (IA).

Serbia cannot join the European Union without prior adoption and implementation of competition rules. Consequently, the European integration process becomes a guarantee that Serbia will establish a recognisable and effective competition policy, which will be monitored by the EU institutions once Serbia becomes a full-fledged member.

⁴⁴Articles 4, 7 and 9 of the Competition Act (Official Gazette of the Republic of Serbia, 79/2005)

Regulatory framework

The Constitution of the Republic of Serbia⁴⁵ stipulates equality of all market participants and prohibits any conduct that limits free competition in contravention with laws, by forming of monopolies or abuse of a dominant position. The passing of the Competition Law in 2005⁴⁶ was the first step in the development of competition law and protection in Serbia. This Law established the Commission for the Protection of Competition, an autonomous and independent body accountable to the National Parliament of the Republic of Serbia. After three years of implementation of the currently effective Competition Law, it became evident that its text was imprecise and contained many loopholes. Synchronously, numerous organisational and procedural problems in the work of the Commission were noted. As the loopholes of the previous law could not be covered by its modifications and amendments, the Government of the Republic of Serbia agreed on the proposal of the new Competition Law in March 2009 and it was adopted by the Parliament in July 2009. The adopted amendments and new legislative solutions aim to transpose comprehensively and correctly the European legislation in this area, to advance the concept of the institutional solution, as well as to create other legal and organisational conditions for efficient protection of competition on the Serbian market. The crucial changes include the area of control of mergers by defining the procedures for the Commission for the Protection of Competition (CPC) to follow and designing solutions to avoid reference to the Law on General Administrative Proceedings, unless when necessary.

Institutional framework: Competition Commission and judicial protection

With Article 73.3 of the Stabilisation and Association Agreement, Serbia undertook the obligation to set up an operationally independent authority that will have the powers to effectively protect competition on the Serbian market. The Commission for the Protection of Competition was established in April 2006, with the powers to initiate and conduct investigation into disruption of competition on the Serbian market. The Commission is composed of the Commission Council and the Commission Support Service. The main task of the Competition Commission is to ensure a free market game and prevent any restrictions that, in absence of

⁴⁵Article 84, paragraphs 1 and 2 of the Serbian Constitution.

⁴⁶Official Gazette of the Republic of Serbia, No. 79/2005

the Commission's activities, may harm the consumers, overall economic efficiency and development of the economy.

Although it is competent to decide on rights and obligations of market participants in line with the existing rules on protection of competition, the procedure for deciding in these legal matters and the procedural powers of the Commission are considerably limited. This primarily concerns the powers to have access to and demand relevant data, documents and other evidence that are important for proper ruling in a specific case. A major part of the Commission's practice relates to exemption of individual restrictive agreements and clearance of mergers, while fewer resources are used to review and proceed upon requests directed against abuse of dominant position or acting upon the Commission's own initiative. A particular problem is the relatively low threshold for mergers, which has considerably slowed down business activities and caused a backlog of cases before the Commission.

If it finds that rules of competition have been breached, the Commission is not competent to issue a sanction and can only act as an applicant before a competent misdemeanour court, while a number of obstacles emerge in the proceedings, which prevents a successful completion of the case and results in absence of an effective sanction. A Commission's decision that the Competition Law has been violated can be challenged before the Supreme Court in administrative proceedings. During 2008, the Commission was active in all three areas of its competence, as defined by the Law. It investigated into breach of competition rules caused by agreements that prevent, limit or disrupt competition (cartel agreements), inquired into abuse of a dominant market position, and prevented creation or maintenance of market structures that restrict or hamper a free market game (merger control).⁴⁷

Year	2007	2008
Number of cases	151	159
Mergers	128	137
Restrictive agreements and abuse of dominant position	23	22
Mergers' ratio	85%	86%

⁴⁷Data taken from the 2007 and 2008 Reports of the Commission for the Protection of Competition.

In 2008, the Competition Commission investigated into the existence of prohibited agreements and reviewed claims that particular agreements did not fall under the category of prohibited collusions in 20 cases. It completed 12 proceedings, while eight are still underway. The Commission received ten requests to exempt agreements from prohibition, eight of which were processed in 2008, while two cases are still underway. In the eight completed proceedings that were conducted upon request to exempt an agreement from prohibition, the Commission decided to grant approval in seven cases, while one request for exemption was denied.

The new Competition Act establishes a qualitatively new form of judicial protection of competition. It envisages that the Administrative Court reviews the Competition Commission's rulings (Article 71), once it is in place, while the High Commercial Court (Article 77) will decide in legal cases against the Commission in the meantime. The judges of the High Commercial Court must be trained to follow the cases regarding protection of competition. The optimal solution would be to select a number of judges of the High Commercial Court to specialise in this matter, so that all the training funds can be channelled toward them, while they may continue to preside over competition cases as judges of the Administrative Court, upon its establishment. This would ensure uniform application of competition rules and cut the training costs. Three panels with nine judges are expected to prosecute in this matter.

With regard to judicial procedure, a legal review of Commission's decision is conducted before Administrative Court (High Commercial Court) upon a complaint of a party to that procedure and in line with general rules governing administrative dispute. Generally, the appeal does not postpone execution of the decision, but if the party involved files a special request, the Commission Council may postpone the execution until the court reaches a final decision in the case. Any damages resulting from breach of competition rules may be claimed before a competent court in a litigation procedure. In that event, the Commission's decision with regard to either the grounds or the amount of damage done does not bind the court. There are special legal provisions concerning the court procedure as to the grounds for reviewing the amount of fine issued in a particular administrative measure and the judicial ruling if the challenged Commission's decision is found to be illegal only in that part. The law also envisages special, short deadlines for proceeding and deciding on the appeal.

Impact of competition policy

Implementation of the competition policy aims to enable competition on the market for the purpose of providing a wider and better choice for the consumer. Strong competition ensures the necessary efficiency and effectiveness of the economy and its steady development. Hence, competition in market economies is a matter of general interests that is guarded carefully, while the system for its protection does not come free of charge. Governments and economies pay for the costs of institutions and mechanisms safeguarding competition by budget appropriations or payment of fees and fines. The question is whether the positive effects of this policy (the benefits) are worth the investment (the costs), or what the trade-off in implementation of this policy is.

Though there is much dissent among experts concerning the real influence of competition policy on economic growth and development, the situation in developing countries is simpler as there is almost general agreement on a strong and positive link between effective implementation of competition policy and a rise in number of smaller and more efficient private enterprises. Besides savings for the consumer, application of competition policy has an impact on basic macroeconomic indicators such as economic growth, employment and productivity. Consumers benefit from competition through lower prices and higher quality, as well through a wider range of products and services, but also in the bigger picture, through better quality of life due to economic development. Can this be achieved by a competition policy and do the benefits exceed the costs? The answer lies in efficiency of institutions safeguarding competition, primarily the Commission for the Protection of Competition and the judicial system. The European Union recognised the importance of competition a long time ago and built the foundations for the policy in its founding treaty. Competition is exceptionally relevant for Serbia today, as the country wishes to preserve and promote a free and supportive business environment, to make the market attractive for new investment and to protect the interest of the consumer. These are all the goals of the Serbian competition policy, which is one of the most solid bridges linking the national legislation with the EU.

AN OVERVIEW OF THE NORMATIVE FRAMEWORK FOR CONSUMER PROTECTION IN THE PROCESS OF SERBIA'S EU ACCESSION – EXECUTIVE SUMMARY

The immediate effect of Serbia's EU integration on consumer rights would be felt through expansion of both the market and consumer choice, as well as through the higher legal and physical guarantee of every individual contract, which would help consumers in Serbia reach a **higher level of consumer surplus**. The benefits for consumers have become evident with the eradication of deceptive commercial practices (in both the so-called legal and the grey economy), elimination of products that do not comply with quality standards, and with dwindling number of problems that occur when consumers are uninformed. This gives consumers a chance to obtain good value of goods and services for the money they bring on the market. The indirect effects of an efficient system of consumer protection are reflected in changes to product selection – in the production stage that precedes the act of consumer choice. Diverse instruments of consumer rights protection press producers and retailers to change their business behaviour and abandon the practices they developed within their poor and undeveloped local markets. The change in their attitude toward domestic consumers simultaneously qualifies them for entry into the European market, where they will face not only far more exacting buyers, but also institutional limitations they have not encountered before. However, without that change, they definitely would stand no chance of expanding their business.

The mechanism for adjustment of national legal systems to EU standards is contained in the EU directives, which define only the minimum requirements for consumer protection and obligate the national legislation to adapt to them. The number of these directives or secondary legislation of the European Union (EU) is **close to a hundred**. Every state

is free to decide how it will transpose directives into its legal system, because they do not have immediate effect. However, with development of the single market and emergence of some high risks, the EU legal instruments with direct effect, regulations, may become more frequently used. There are currently two of them governing this area: **Regulation establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights**⁴⁸ and **Regulation on cooperation between national authorities responsible for the enforcement of consumer protection laws** (the Regulation on Consumer Protection Cooperation)⁴⁹, both adopted in 2004. Unlike directives, whose objective is to safeguard standards for functioning of the market, regulations serve for oversight and control of an already harmonised and integrated market. Therefore, these regulations have only informational purpose for Serbia at this point.

The obligation of **minimum harmonisation** set out in directives does not preclude the possibility of member states imposing higher standards in their national consumer protection legislation relative to the harmonised criteria that are essential to functioning of the single market. It is self-explanatory that products or services originating in a country with higher standards enjoy a better reputation and the outcome of the directives may be viewed from that perspective – not as a constraint, but as a benefit. Though directives differ with regard to their subject matter and may seem specialised, they often overlap as they regulate different aspects of similar relations. The lawmakers need to be careful when transposing directives into national legislation so as to avoid having one law, inspired by one directive, regulate the market game in a different way from a law drawing on some other directive. To prevent that, the **principle of accumulation of mechanisms** for consumer protection should be observed in transposition of directives in order to avert both horizontal and vertical collision of different legislation (for blanket legislation to leave enough room for the more particular pieces of legislation, and for the latter not to collide with the former).

Consumer protection has many dimensions and starts much before a retailer and a consumer meet on the market. In that context, there is a set of rules that encompass technical norms or standards defining

⁴⁸Regulation No 261/2004/EC of the European Parliament and the Council.

⁴⁹Regulation No 2006/2004/EC of the European Parliament and the Council of 27 October 2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws (the Regulation on Consumer Protection Cooperation), OJEC 364, 09/12/2004, p. 01-11.

product safety, the producer's and retailer's liability regarding the design, selection of components, parts or additives, storage, display or placing products on the market. Still, it is customary to begin an analysis of the real level of protection by inquiring into the quality of buyers' position concerning their bargaining power. It focuses on whether consumers can influence the contents of contracts, whether they have the right and possibility of choice, that is, whether the mechanisms of the public law have empowered consumers to overcome their weaker position relative to retailers, public utilities, service providers, banks, health institutions and any other supplier. The main principle applied in regulation of this area is to **tip the scales to favour of the consumer** by modifying the principles of civil law and law of obligations that presuppose real equality of parties to transactions. The most commonly cited points where consumer protection law diverges from the general legal rules that apply to contracts in which one of the parties is not the consumer include⁵⁰:

- **placing the burden of proof** on the retailer, and not on the consumer,
- establishing **legitimacy** of the specific nature of the contract, which means that the Law of Contracts and Torts should contain the provisions allowing for departure from the general contract rules with regard to the consumer,
- **advanced procedural rules safeguarding the consumer** by making provisions for longer time frames, particularly compared with transactions involving two retailers,
- **thwarting information asymmetry** by obligating the retailer to provide prior information as well,
- mandatory form and substance of the contract confirmation to better protect the consumer from misunderstandings,
- **unfair contract terms cannot be binding** *ex lege*,
- ***dubio pro proferentem*** principle - if a contractual provision can be interpreted in different ways, it must be interpreted in the way that is most favourable for the consumer,
- **cheap, clear, unambiguous and accessible** system for activating the public law mechanism of consumer protection,
- ***locus standi*** for *actio popularis* by consumer NGOs, and
- free **legal assistance** to consumers provided by their local community.

⁵⁰J. Cucai, op. cit. p3

The process of assertion of consumer rights in Serbia with regard to the Consumer Protection Law may develop in two stages. The first one would entail fulfilment of all the criteria implied by the Stabilisation and Association Agreement (SAA), because now the public attention is focused almost exclusively on trade liberalisation and the free movement of goods and people. However, it is clear that enlargement of the single market, which is the ultimate effect of the SAA, must involve a number of institutional changes to equal the status of Serbian consumers with that of the EU consumer, at least with regard to the protection of consumer rights. It can be reasonably argued that they are much less protected than even consumers in the region, that is, in the CEFTA countries. However, the far more reaching SAA effect is the one that will affect manufacture and retail – the sectors in the supply chain. It concerns primarily the attainment of European standards of quality and safety of goods and services, which would facilitate the possibility of exchange. These essential requirements aim simply to make trade happen, as opposed to full adoption of the *acquis communautaire*, which would be a condition of membership. The incorporation of the entire *acquis* does not even seem necessary at this point, as not all its elements have the identical significance for either consumers or business in Serbia. When setting the priorities, attention should be paid to the real circumstances on the domestic market and consumers should be empowered with the (missing) rights they actually need, those from which various disputes or abuse of power of retailers arise, and not with every single right, including those that currently have no bearing on Serbian citizens.

One of the vital issues that the effective law has not resolved in a satisfactory manner (legally speaking, the relevant directive has not been implemented adequately) concerns the **mechanisms of out of court settlement of consumer disputes**. Though the law mentions this option in principle, the tone used is so lapidary and non-binding that any effort to create the relevant bodies has been left wanting. Voluntary arbitration in consumer disputes must be set in place by establishing an independent, correct and efficient system of legal protection of the consumer, in line with relevant EU standards. Namely, the classical approach to consumer protection based on the principles of civil law, a lawsuit seeking damage compensation, is too expensive, slow and complicated, and entirely inappropriate for consumers (who need to fight large trans-national corporations). **Consumer organisations/associations** are an inevitable factor in the process of defining and safeguarding consumer rights and have various responsibilities and roles: starting from oversight of market trends and

AN OVERVIEW OF THE NORMATIVE FRAMEWORK FOR CONSUMER PROTECTION

quality controls, through defending consumers in lawsuits, making initiatives for advancement of regulation and systematic efforts on informing and educating the consumer. These unavoidable developments emanate from the logic of the entire system and cannot be viewed as an expression of fragmentary demands of a group of market participants. Without these qualified and well-staffed organisations, it will be impossible to have a sustainable concept of consumer protection in Serbia, because in the absence of consumer associations, the state would be the only guardian of consumer rights. The concept of civil society clearly requires that affairs of public interest should not be handled by state agencies alone, because it would hypertrophy and stifle the very essence of market economy.

STATE AID CONTROL IN THE EU AND ITS APPLICABILITY IN SERBIA – EXECUTIVE SUMMARY

State aid is currently one of the most dynamic legal fields in the European Union, primarily because several large cases have perturbed the economy and because the state aid policy reform started in 2005 with the aim of improving its efficiency and redirecting the money from the traditional sectors toward research and development. It might be said that, in a strange way, the same issues, for completely different reasons and motives, preoccupy the attention of both European and Serbian civil servants.

The fundamental objective of the European Union is to create a space without internal borders (Article 2 of the Treaty Establishing the European Community). Provisions of the same Article further stipulate that the Community shall establish a common market and for that purpose develop a system preventing distortion of competition (article 3(g) of TEC). The Chapter on Competition (articles 81-89) of the EC Treaty, beside the provisions concerning practices of undertakings (cartels, monopolies and mergers), includes the rules regarding government intervention and granting of subsidies. Drawing on the TEC articles referred to above, the European Union has developed a sophisticated system of control of any form of state aid to firms. Article 87.1 declares any state aid that may distort competition and affect trade between EU member states incompatible with the common market, that is, in contravention of the Treaty on European Community that establishes the common market. The second paragraph of the same article rules out particular categories of state aid as incompatible with the TEC, while the next paragraph defines what forms of state aid may be acceptable. It is up to the European Commission to verify compatibility (legality) of the latter. Article 88 defines the procedure for notifying the European Commission about any new state aid (individual or an aid scheme) or alteration of the existing state aid scheme

before it is granted or becomes effective. This procedure was elaborated in detail in the Council Regulation No 659/99.

In order to understand the tenet of incompatibility, in principle, of state aid in the EU when it affects or threatens to distort free competition and intra-community trade⁵¹, we will first define the concept of state aid. We will then inspect whether there are provisions allowing for granting of state aid and, if so, under what conditions. As the TEC provides no formal definition of the concept, its meaning has been derived from interpretation of the Article 87 of TEC by the European courts and the European Commission. In short and departing from the provisions of the article, state aid may be defined as any economic advantage granted to particular undertakings or a group of undertakings (whether they be public, state or private) directly by the state or indirectly through state resources.

Article 87.3 defines five situations (categories) in which aid may be compatible with the common market. The use of the tentative form "may" suggests that only the European Commission is competent to review a particular measure and verify its compatibility with the TEC. In other words, the Commission decides on acceptability of aid. For this reason, the European Commission must be informed of any state aid plans. National judicial and executive bodies of EU member states cannot assess whether some aid is allowed or not. This is the reason why we say that the exclusive competence in the area of state aid rests with the European Community. The Commission may decide to authorise the aid it has been notified of, to request that the proposed measure be modified or to reject the proposal entirely. In accordance with Article 88 of TEC, even when a member state disagrees with a Commission's decision, it may not disregard it and grant the proposed aid. It can only attempt to challenge the decision before the European Court of Justice. We can see that the control by the Commission is not an exclusively negative task. Control does not mean ban, as prohibition is based only on a Commission's particular decision on incompatibility. Apart from its detrimental qualities, state aid may play a positive role in financing services of general interest, narrowing regional differences, easing social tensions, promoting environmental protection, boosting employment etc. These and similar cases are envisaged by Article 87.3 of TEC.

Provisions of Article 83.3 (a) served as a basis for a set of Commission guidelines specifying the criteria for award of regional state aid, while the criteria for granting of sectoral (automobile industry, steel in-

⁵¹Trade among EU member states.

dustry etc.) and horizontal state aid (job creation, restructuring of enterprises, training etc.) were defined in accordance with subparagraph (c) of the same Article. **The Commission guidelines take many forms⁵² and concrete pieces of legislation need to be examined carefully in order to meet particular state aid requirements.** Beside massive legislation, to understand the evolution of the concept of state aid and the way the Commission applies it in practice, the case law of the **European Court of Justice and the Court of First Instance** would also need to be scrutinised (but we shall not do it in this text). We must stress, however, that the European Commission Regulation 1998/2006⁵³ sets out that aid up to EUR 200 000 to one enterprise over a period of three years does not constitute state aid in the meaning of article 87 (1)⁵⁴, that is, it may be granted without prior notification of the Commission. **In the early stages of the subsidy control system in Serbia, even the slightest aid must be reported, because these European criteria cannot be applied directly due to the small size and low economic power of the Serbian market. Of course, from the perspective of trade with the EU, such minor subsidies are irrelevant and cannot be subject to an objection by the EU, but their impact on the internal competition on the Serbian market needs to be investigated.**

In line with Article 38.4 of the Interim Agreement on Trade and Trade-related matters, Serbia is required to set up within one year an operationally independent state aid authority that would be competent to authorise state aid schemes and individual aid, but also to order that unlawfully awarded aid be recovered. This, together with other provisions contained in the same Article of the Interim Agreement, obligates Serbia to establish this body within the stipulated time frame, which essentially means that Serbia has to pass the Law on State Aid Control, complete all the preparatory activities and start with its implementation before the required deadline.

The first steps in establishing a system of state aid control in Serbia started on 1 August 2005, when the Law on Amendments and Changes to the Law on Budget System (Official Gazette of the Republic of Serbia No 66/05) established the Treasury Administration, an administrative authority within the Ministry of Finance. On top of the tasks assigned by this

⁵²Notices, communications, regulations, guidelines, frameworks, letters to member states

⁵³The so-called *de minimis* regulation.

⁵⁴Does not contravene this article, because it is deemed not to affect competition.

law to the Treasury Administration, this agency was also made responsible for state aid registration and monitoring. These efforts are organised within the framework of the Department of State Aid Control, in the Sector for Public Enterprises and State Aid. The Department is still an organisational part of the Treasury Administration, while the work related with state aid has been taking place in the Sector for Economy and Public Enterprises of the Ministry of Finance since 1 November 2007.

This organisational mesh has hamstrung any actual work on establishing a system of state aid control in Serbia. The Department of State Aid should be situated in the Sector for Public Enterprises and State Aid of the Ministry of Finance, and not in the Treasury Administration. It also needs to be equipped with adequate staff and receive any support it may need. The building of administrative capacities is also a precondition for significant EU grants through IPA funds and Twinning programmes.

LEGISLATIVE AND OTHER ACTIVITIES

The Law on State Aid Control was passed on 8 July 2009 and will come into force on 1 January 2010. The Law itself is just a framework and contains basic provisions, which are further elaborated in bylaws. Two bylaws under authority of the Government and one bylaw for which the Ministry of Finance is responsible have been planned. Rules of procedure for the State Aid Control Commission, which will be formed by the Government in line with the Law, also need to be defined.

It would be desirable if, for the sake of both competency and higher operational independence, the competent ministries delegated experts to the Commission, instead of choosing their own employees. It will be interesting to see the relationship between the Commission and the Government, as it is difficult to imagine that an aid grantor (usually a public entity or the Government) would initiate proceedings against its Commission. Maybe the practice will show that the Commission should adopt recommendations and instructions, instead of final administrative decisions, though the relevant SAA article is quite rigid on this point. Similarly, the Commission may be established by the Law, instead of being yet another classical governmental commission.

One of the Government bylaws mentioned above will include detailed rules and criteria concerning award of state aid, which will simulta-

neously be the parameters for assessing the compliance of the notified and granted state aid with the Law and, consequently, with European legislation. This practically ensures alignment with *acquis communautaire* in the area of state aid. The comprehensive and complex rules established at the level of the European Union need to be transposed precisely by also making sure that the new regulations do not collide with the existing national legislation. The Law on State Aid and the related bylaws are just a reflection of the European legislation. The second bylaw by the Government will be much narrower and stipulate the procedure for informing the Commission about any state aid. Four annual reports on state aid granted in Serbia have been prepared: for 2003 and 2004 (a single report), 2005, 2006 and 2007. All the reports were approved by the Government, translated into English and published on the website of the Ministry of Finance.

IMPACT OF SERBIA'S EU ACCESSION ON INFORMATION SOCIETY AND MEDIA – EXECUTIVE SUMMARY

The subject of this study is an overview of economic effects of Serbia's EU convergence in the area of information society and media, which comprises telecommunications, information technologies and information society, audiovisual sector and film industry.

Telecommunications, Information Technologies and Information Society

According to the data provided by *Cullen International*⁵⁵, Serbia's electronic communications market was worth EUR 1.4274 billion and had a 4.33% share in Gross Domestic Product (GDP in 2007 was EUR 31.4 billion). According to RATEL (Serbia's Republic Telecommunications Agency), the total income in the electronic communications sector has been constantly on the rise: EUR 0.93 billion in 2005, EUR 1.3 billion in 2006, EUR 1.47 billion in 2007 and EUR 1.61 billion at the end of 2008. In 2008, the electronic communications sector had a 4.87% share in GDP. Mobile communications accounted for the largest share of the income earned by this sector in the past four years, and it soared after Mobtel was sold and the third mobile network operator entered the market.

As regards fixed line telecommunications, the licence to provide voice services is held by one operator only – Telekom Serbia. More than 95% of the network was digitalised by January 2009, which was a 2% increase relative to January 2008. The number of party lines in the network has remained high (more than 177 000) and major investments in the

⁵⁵ *Cullen International* provides monitoring of developments in the electronic communications markets in Albania, Bosnia-Herzegovina, Montenegro, Serbia, Croatia, Macedonia and Turkey for the European Commission. The semi-annual reports record the development of the market and fulfilment of conditions stemming from the EU association process.

future will be required to solve this problem. The first step in promoting competition in the fixed line network was the issuance of two licences for the broadband wireless access in 2009. Investments into the fixed telephony have demonstrated the following trends: EUR 83.9 billion in 2005, EUR 62.5 billion in 2006, EUR 165.9 billion in 2007, EUR 64.7 million in 2008. The investments peaked in 2007, as Telekom Serbia acquired 65% of Telekom Srpske in Bosnia-Herzegovina and purchased the licence for the fixed wireless access and mobile telephony in Montenegro.

The further liberalisation of the mobile communications market by allowing entrance of the third operator has given results. All mobile operators were granted the licence for the third generation of mobile telephony. There are more than 9 million of mobile subscribers, whose number has grown at about seventeen-percent rate (mobile penetration in January 2008 was 112.7%, while the figure was even higher in January 2009 – 128.3%). Investments into the mobile telephony sector totalled EUR 0.445 billion in 2005, EUR 103.9 million in 2006, EUR 210.0 million in 2007 and EUR 240.27 million in 2008. These figures indicate that the market liberalisation has promoted investment. Telenor purchased Mobtel and the new operator VIP (member of the Mobilkom Austria Group) arrived. The highest growth has been recorded in the Internet segment. There were 1 619 711⁵⁶ Internet users at the end of 2008, while the number of Internet service providers rose to 197. The broadband Internet access, the cornerstone of the information society, has also posted an increase and its current penetration stands at 6.3%. However, the dynamics of broadband uptake is insufficient to narrow the gap with the EU 27, where broadband penetration is 22.9%. If mobile broadband in Serbia is included in the statistics on development of the broadband Internet access, the total penetration reaches 18%. The number of cable TV subscribers currently stands at 861 000. The investment into the cable systems in the past four years averaged EUR 450 million: EUR 350 million in 2005, EUR 190 million in 2006, EUR 899 million in 2007 and EUR 362 million in 2008.

The research conducted within this study has revealed two possible options for further development of telecommunications and information society:

Option 1 – Do nothing or act randomly

In this scenario, any further alignment of regulations with the EU would be abandoned or the harmonisation would take place in some ar-

⁵⁶RATEL's presentation at the conference "Infoarena 2009, Belgrade", June 2009

eas only, depending on the hot topic of the day. Postponing the enactment of harmonised regulations is a risk that may lead to:

- delays that would impede market liberalisation;
- fewer foreign direct investments;
- fewer investments in the fixed line telecommunications and their current provider, the state-owned Telekom Serbia;
- slower introduction of modern services on which the total economy should operate;
- unadjusted prices, particularly of new services, which will be a burden for residential subscribers, and especially for the economy (income earned from business and residential subscribers).

Option 2 – Total harmonisation with the *acquis*

By signing the EU Stabilisation and Association Agreement (SAA) and adopting a development policy, the Government of Serbia has expressed its commitment to EU accession, thus acknowledging its obligations relating to transposition of the EU legislation. Telecommunications and information society is the leading sector in the process of integration into the EU and the broader globalisation process.

This option has the advantages of:

- increased investments;
- faster introduction of new services;
- market entry of new operators and job creation; and
- lower prices of particular services.

It also carries its risks, and the key ones include:

- possibility that Telekom Serbia might fail to adapt to the liberalised market and by this lose not only the market, but also its value and be forced to reduce significantly the number of its employees;
- inconsistent application of the EU legislation in practice, while the Telecommunications Agency may lose control over market regulation;
- lack of the necessary coordination between the state authorities responsible for this sector (examples: introduction of fees, impeded construction due to the inability to obtain construction permits).

The options presented above may produce the following economic effects:

Economic effects of Option 1

The preservation of the current state of affairs would lead to the further decrease in investments into the fixed line network. If the downward trend keeps the same pace (a decline from EUR 165 million in 2007 to EUR 64 million in 2008) in the next three years, these investments will not exceed EUR 50 million. This will not be sufficient to satisfy demands for the solution of the "universal service" issue, nor the problem of party lines. The motivation of mobile operators to introduce new services will weaken because they will not be driven by market competition.

Economic effects of Option 2

The option of total harmonisation with the *acquis* creates the possibility of market entry by several operators and service providers and of strategic partnerships with the EU operators. The arrival of new operators should bring 200 000 new subscribers. Investments into the implementation of this scenario will reach about EUR 200 million (the average investment needed is about EUR 1 000 per subscriber). Due to the pressure caused by the competition, investments into the broadband wireless access may be some 30% higher relative to those stipulated in the licence and reach EUR 120 million, instead of the expected EUR 90 million. The only provider of the fixed line telecommunications will retain the current level of investments of about EUR 60 million per year. Mobile operators will be motivated by competitive pressures in the fixed line network, the convergence and the combined package with the broadband access to speed up the building of the 3G network, which requires about EUR 50-80 million a year per operator. The total economic effects of Option 2 may be summed up as higher investments and a 0.65% GDP growth.

Audiovisual Sector

In accordance with the EU Stabilisation and Association Agreement and the European Partnership for Serbia adopted in 2008, the short-term priorities planned for the audiovisual sector are to step up the process of alignment of all media laws with the EU standards and the *ac-*

quis, and to implement the Broadcasting Development Strategy by 2013. The enactment of new laws in the field of public information, inter alia, is aimed at strengthening the independence, transparency and liability of the Republic Broadcasting Agency by introducing clearer procedures and criteria for granting broadcasting licenses, especially for cable and satellite operators. The objective of the new laws is to regulate also the issue of programme content of the cross-border radio and TV broadcasts, by introducing an obligation for broadcasters to reserve time for European programmes (broadcasting quotas) and other measures to improve the free movement of cross-border TV programmes in Europe.

To complete the privatisation of electronic media, the lawmakers must correct the discrepancy between the Law on Public Information and the Law on Broadcasting, on the one hand, and the Law on Local Self-Government and the Law on the Metropolitan City, on the other.⁵⁷

The short-term priorities of the Ministry of Culture include adoption of two documents:

- Law on Ratification of the European Convention on Cross-border Television, which was adopted in May 2009 (Official Gazette of the Republic of Serbia – International Agreements, No 42/2009);
- UNESCO Convention on the Protection and Promotion of the Diversity of Cultural Expressions.

The workgroup for drafting legislation, established by the Ministry of Culture, has begun to draft amendments to the Law on Broadcasting, with the purpose of harmonizing it with the EU Audiovisual Media Services Directive (AVMSD). However, as the Directive entails fundamental changes concerning the media, and in view of the current level of broadcasting services in Serbia, the duration of the drafting process cannot be predicted with certainty at this point. The goal is to harmonise the current rules with the AVMSD by the end of 2010, but its attainment will depend on other factors as well, such as amendments to the legislation concern-

⁵⁷ The Law on Public Information and the Law on Broadcasting prescribe that founders of public media cannot be, directly or indirectly, the state or the territorial autonomy, while provision of Article 8.2.5 of the Law on the Metropolitan City sets out that the City of Belgrade, which has the jurisdiction of both the municipality and the city, may establish TV and radio stations, newspapers and other public media. Furthermore, Article 20.1.34 of the Law on Local Self-Government stipulates that a municipality may establish TV and radio stations for the purpose of reporting in the minority languages that are officially used in the municipality, or for reporting in a minority language that is not officially used, when such reporting presents the attained level of minority rights.

ing electronic communications. The process of European integration in this area will result in:

Qualitative effects:

- creation of the legal framework that will ensure the implementation of the effective single broadcasting market;
- opening the audiovisual market to competition;
- protecting minors from having access to harmful audiovisual contents;
- protection of the European cultural interest in the context of the WTO;
- fight against piracy;
- strengthening the independence of the media and journalists;
- ensuring loyal competition on the market;
- legislative reform and the adoption of European standards;
- transformation of the state media and improvement of the public services.

Quantitative effects:

Though the TV and radio media recorded a steep rise relative to the majority of the EU countries, with more than 1 200 broadcasting organisations (about 900 radio and some 300 TV stations) in 2002, the advertising revenue was low in both absolute and relative terms in comparison to the international standards. However, after the final competition, only 467 broadcast licences will be granted for all areas of the country, which will significantly increase the advertising revenue of broadcasters. The advertising market has grown from EUR 30 million in 2001 to EUR 206 million today. The relative share of television in the mass media market is declining, while the share of radio broadcasters has been stable since 2003.

Film industry

The integration process in the area of film opens up new possibilities for solving the two main problems of Serbian film industry – the structural problems concerning financing of the film industry and the in-

effective combat against film and video piracy, which both affect directly the economic sustainability and further development of this area. The structural problems in financing are reflected in the limited number of sources of finance for filmmaking (which is predominantly funded from state coffers), high costs of film production and non-existence of special film production funds that would be filled from other sources (e.g. CDS and Internet providers, fixed line and mobile telephony operators, etc.), and lack of special tax incentives for investing into the film industry. The average production cost per film in Serbia ranges from EUR 0.5 million to EUR 1.2 million. The film *Zona Zamfirova* is cited as an example of how unprofitable the domestic films are in the light of the local circumstances: it attracted 1 300 000 spectators (the absolute record for the Serbian market) and earned EUR 2 million, but it lacked another 200 000 viewers in order to achieve a net profit.⁵⁸

From 2005 through 2008, 36 films were made in Serbia: 5 in 2005, 7 in 2006, 16 in 2007 and 8 in 2008. Serbian film industry is financed from three sources: budgetary resources, foreign funds and domestic and foreign sponsors. The most important channels disbursing financing from the public coffers are the Film Centre Serbia (under the auspices of the Ministry of Culture), the Secretariat of Culture of the Autonomous Province of Vojvodina and the funds for promotion of film industry of local self-governments. The Law on Broadcasting (Article 83.6) prescribes that the state broadcaster RTS should transfer a 1.5% share of the total collected subscription fees to the budget account of the Republic of Serbia for the development of the national film industry. The Law on Establishing Particular Competences of the Autonomous Province of Vojvodina (Article 6.2) prescribes that the fees and payments collected in accordance with the regulations governing film industry are attributed to the budget of the autonomous province. This applies to users whose seat is on the territory of the autonomous province, when the point of video rental, public broadcasting or sale, i.e. the place of broadcasting or the starting point of the means of transport in which the broadcasting is performed, is on the territory of the autonomous province. The revenue from issuance of the sticker, pursuant to the law, belongs to the issuing agent.⁵⁹

⁵⁸Sanja Ćirić, 'Državne subvencije za fabriku snova', *Ekonomist*, 13 August 2007, page 27

⁵⁹Law on Establishing Particular Competences of the Autonomous Province of Vojvodina, Official Gazette of the Republic of Serbia, No 6/2002, 101/2007 - other law and 51/2009 - other law

According to the report issued by the Anti-Piracy Association of Serbia, it has been estimated that the state loses EUR 32.7 million in uncollected taxes due to piracy every year. The structure of the loss is as follows⁶⁰:

- VHS/DVD sale to rental clubs – EUR 9.6 million
- VHS to let – EUR 3.6 million
- DVD to let – EUR 3.6 million
- retail sale – EUR 7.2 million
- cinemas – EUR 5.1 million
- TV rights – EUR 3.6 million
- total – EUR 32.7 million.

The declining number of cinemas and cinema attendance best illustrates the losses incurred due to piracy. From 2002 to 2007, the number of registered cinemas dropped from 156 to 104, but increased slightly to 117 in 2008.⁶¹ According to the Anti-Piracy Association of Serbia, cinema attendance has dwindled because of the piracy by up to 90%. In the period between 2002 and 2007, the number of cinemagoers decreased by 2 735 000. If the average cinema ticket price is two euros, the direct loss has amounted to EUR 5.47 million.⁶²

The National Programme for Integration into the European Union has defined short-term and long-term priorities for Serbia concerning, among other things, the advancement of legislation and institutions in the field of film industry.⁶³ The short-term priorities include: a) adoption of the new Law on Film Industry; b) adoption of the new Law on Culture; c) adoption of the strategic plan for development of the film industry; and g) defining the cultural institutions in this field. Our study has pointed to two possible options of the further development of film industry:⁶⁴

Option 1 – Do nothing or act randomly

This scenario involves no further activities aimed at the improvement of legislation, primarily with respect to increasing the funding for the

⁶⁰For a detailed assessment see the Report of the Anti-Piracy Association.

⁶¹Data of the Film Centre Serbia on the number of cinemas in 2008.

⁶²According to the Film Centre of Serbia, the cinema ticket price in the period from 2005 to 2009 ranged between 140 and 270 dinars.

⁶³National Programme for Integration into the European Union, October 2008, p. 318.

⁶⁴To learn more about the development potential of the Serbian film industry, see the Internet presentation of the Serbian Film Association at: <http://www.filminserbia.com>.

film industry, or the legislative reform may cover only the areas of current interest. Postponing the changes in legislation would maintain the current level of financing and the current pace of film industry development.

Option 2 – Full harmonisation with the *acquis* and joining the MEDIA 2007 programme of the EU would involve:

- passing of the new Law on Film Industry and amendments to other relevant laws that would create the preconditions for the increase in funding for film production;
- harmonisation of legislation in other areas relating to film industry;
- more efficient implementation of anti-piracy measures:
 1. establishment of specialised teams within the Serbian Ministry of the Interior that would combat piracy;
 2. continual training of the staff employed in the police force, inspection services, the Customs, Prosecutor's Office and courts;
 3. frequent campaigns aimed at raising public awareness of detrimental effects of piracy;
- implementation of the Law on Combating High Tech Crime;
- joining the MEDIA 2007 programme and the European Audio Visual Observatory.

IMPACT OF SERBIA'S EU ACCESSION ON SME SECTOR – EXECUTIVE SUMMARY⁶⁵

Business-enabling environment

In the first years of reforms, after the political watershed in 2000, the SME sector received less attention from the Serbian executive and legislative authorities than the large foreign investors, partly due to a lack of solid organization and a legitimate representative of the SME sector in Serbia. Notably, the small and medium-sized enterprises account for almost 99.8% of all companies in Serbia, and they are heavily concentrated in Belgrade and South Bačka District, where 40 percent of the registered small and medium-sized enterprises operate. Future focus should be on strengthening the less developed regions, because the SME sector in Serbia currently creates 67% of employment, 55% of GDP and almost 50% of exports.⁶⁶

Of 181 countries ranked by the World Bank's Doing Business Report, Serbia was 94th in 2008, falling by 26 notches compared to 2006. In the World Economic Forum rankings, Serbia was 85th of 134 countries. Notwithstanding a small progress year on year (when it was ranked 91st), Serbia was still merely at the level of Western Balkan average (average ranking of these countries was 86), while the gap relative to the countries of Central and Eastern Europe (whose average position was 56) was immense.⁶⁷ In comparison to other countries in Europe and the region,

⁶⁵The author, Ana S. Trbovich, PhD (Faculty of Economics, Finance and Administration – FEFA), wishes to express her thanks to Jovanka Jovanović (Serbian Ministry of Economy and Regional Development), Dejan Trifunović (Serbian Chamber of Commerce) and Natalija Sandić (FEFA student) for their contribution to this study. The study relies partly on CEVES report *International Competitiveness and Economic Growth of Serbia*, November 2008. In terms of methodology, the present analysis follows the guidelines of the European Charter for Small Enterprises.

⁶⁶See <http://www.merr.gov.rs/>, "Sektor MSP jedan od ključnih stubova ekonomskog razvoja", Belgrade, 19 May 2009.

⁶⁷Belgrade Centre for Advanced Economic Studies (CEVES)/USAID Serbia Competitiveness Project, *International Competitiveness and Economic Growth of Serbia*, No-

Serbia is lagging behind in creating environment conducive to small and medium-sized enterprises, despite some progress produced last year.⁶⁸ After it changed its Rules of Procedure in 2009, the National Parliament of the Republic of Serbia adopted a set of reform laws within a short time period. Now efforts should be directed at implementation of the laws in order to improve the business environment and, by the same token, Serbia's rankings in international reports.

In the 2008 poll conducted by the World Economic Forum, just like in the previous year, Serbian firms cited political instability as a major hindrance to doing business. Corruption was second, followed by the red tape. Two years in a row, these three factors were cited as the most problematic, which highlights the lack of any major progress in enhancing the business climate with regard to the services the state provides to companies. The order has changed, however. While the red tape was seen as the prime problem in 2007, it was pushed back by political instability in 2008, in the aftermath of several extraordinary elections held in Serbia over the last two years. This suggests that, despite certain advancements, the public administration will have to do a great deal more to create a favourable business environment.⁶⁹

According to the European Bank for Reconstruction and Development (*EBRD*), Serbia is only halfway through its transition, in the middle of the process of switching to an effective market economy. The growing unemployment underpins this statement, while the key assumption for a successful completion of transition is job creation. According to *EBRD* indicators, this goal is much more distant for Serbia than it is for the majority of the neighbouring countries, and particularly for those that already joined the EU.⁷⁰ Over the past nine years, Serbia has failed to eliminate the lingering problems, such as relative political instability, impaired implementation of laws (no rule of law), the overall land issue (property rights and construction permits), the country's tainted image, bureaucracy and corruption. Serbia's competitiveness is still held back by lack of understanding or application of technical standards, quality control, rules of origin, consumer protection and accreditation process.

vember 2008.

⁶⁸See *SME Policy Index 2009*, <http://www.investmentcompact.org/dataoecd/7/25/43084042.pdf>.

⁶⁹European Bank for Reconstruction and Development, *Transition Report 2008*.

⁷⁰*Ibid.*

Entrepreneurship in Serbia – Strategic and institutional framework

In 2003, Serbia joined the European Charter for Small Enterprises, which provides guidelines for entrepreneurship development.⁷¹ The Government of the Republic of Serbia has adopted not one, but several strategic documents on development of small and medium-sized enterprises (SME). The quality of the latest document, the Strategy for Development of Competitive and Innovative Small and Medium-Sized Enterprises 2008-2013, is that it links for the first time specific objectives with budget appropriations through an annual action plan. However, annual budget planning in practice has still failed to fully observe the strategic guidelines of this or any other Serbian strategy.⁷² The Strategy aims at “developing an enterprising, knowledge- and innovation-based economy, which will foster a strong, competitive and export-oriented SME sector, and also contribute significantly to an increase in the standard of living in Serbia”. Implementation of the Strategy in the near future should ensure creation of a more efficient regulatory environment for the small and medium-sized enterprises, a balanced regional distribution of SMEs and faster development of the sector. The Strategy has been aligned with the *Small Business Act*, a document adopted by the European Commission in June 2008.

In August 2006, the Council on Small and Medium-Sized Enterprise was established. Its objective is to coordinate the Serbian government SME policy. The composition of the Council was changed in November 2007 and now five out of the 12 Council members are entrepreneurs, while other members come from the public sector. Business representatives take part in a different, wider advisory body, the Forum for Small and Medium-Sized Enterprises,⁷³ which was set up in February 2008. There is still no consensus as to which entrepreneurs should take part in the work of this body, as there are no recognized SME business associations yet.⁷⁴ A fledgling SME body is the Committee for Small and Medium-Sized Enterprises of the Serbian Chamber of Commerce, which counts 26 members.

⁷¹*SME Policy Index 2009*, <http://www.investmentcompact.org/dataoecd/7/25/43084042.pdf>.

⁷²Other, related strategies have been adopted, such as the Strategy of Economic Development, Strategy for Foreign Investment Promotion and Development, EU Association Strategy and Strategy for Increasing Serbian Exports 2008-2011.

⁷³See <http://www.pks.rs/forum>.

⁷⁴There are trade/related/sectoral associations, but not a single body that would represent the entire SME sector.

For a long time, it was unclear who in the Serbian government was responsible for promoting competitiveness and entrepreneurship. The Ministry of Economy and the Ministry of Science and Environmental Protection shared the competence in practice from 2001 through 2008. As of July 2008, the jurisdiction was granted to the Ministry of Economy and Regional Development, i.e. to its Department for Small and Medium-Sized Enterprises. Another entrepreneurship fostering institution, which is particularly important for the SME sector, is the Serbian National Competitiveness Council (SNCC). First established in 2003 and then re-launched in 2008, the SNCC deals with the issues that affect SME business. It is symbolic and appropriate that the vice-chair of the SNCC is Serbia's coordinator for the European Charter for Small Enterprises and the Assistant Minister of Economy in charge of the SME sector.

Entrepreneurship in Serbia – Access to finance

The main obstacle to development of small businesses in Serbia is the scarcity of finance options to start or grow one's business. The commercial banks have become more efficient, but high interest rates and rigid lending conditions became even tighter at the beginning of 2009 due to the Global financial crisis. Access to finance is still the key problem for small and medium-sized enterprises, and resolving this issue should become the priority for SME development in Serbia. Serbian government did intervene in an attempt to provide more favourable loans, with support of the European Investment Bank, Italian government's credit line worth around EUR30 million, and budgetary appropriation of EUR200 million. There are also plans to increase the number and size of financial instruments available.⁷⁵ Progress has been made in providing subsidies (mostly implemented by the Agency for Small and Medium-Sized Enterprises) and guarantees, but financing of micro-loans is still limited, while venture capital is still undeveloped.

Credit guarantees are extended by the Guarantee Fund of the Republic of Serbia, Vojvodina Guarantee Fund and by some smaller, mostly donor-based funds. Export Credit and Insurance Agency (AOFI) also disburses loans to small businesses. To facilitate access to finance for small business, AOFI has reduced the requirement concerning the minimum

⁷⁵See <http://www.merr.gov.rs>, Srbija ima trend rasta i razvoja malih i srednjih preduzeća, 7 May 2009.

value of exports of firms applying for loans from EUR1 million to EUR300 000⁷⁶. Serbian Development Fund provides financing and micro loans for new companies. Foreign donors also engage in micro financing. The National Investment Plan has also envisaged subsidies for young firms. Since 2006, Serbian government has replaced foreign donors in financing export promotion by means of trainings or support for attending trade fairs or product marketing. There are still only few investment funds in Serbia, which may be instrumental in SME development.

Entrepreneurship in Serbia – tax policy, inspection, business councils and training

Although the tax policy in Serbia considerably improved, while fiscal decentralization and payroll tax cuts in particular have provided incentives for small and medium-sized enterprises and facilitated their business, there is still room for reforms. The tax system currently does not allow for a simplified filing of tax returns for small businesses, while their tax burden is still relatively high. Moreover, entrepreneurs are ignorant about computing their tax liabilities. The tax system should definitely adjust further to the SME constraints by establishing a simpler procedure for small businesses and providing tax-related advice to SMEs. A breakthrough has been made in the form of taxpayers' trainings, which the Tax Administration initiated in 2009.

Inspection service reform is one of the priorities for advancement of the general business environment in Serbia. The cost of inspection imposes a heavy burden on small and medium-sized enterprises, as it consumes the time they would otherwise be dedicating to business. Furthermore, SMEs are inadequately acquainted with competences of the inspections and their own obligations, which may become a source of corruption or bribe solicitation.

There is a large variety of trainings available to SMEs in Serbia, but of inconsistent quality. The existing SME training centres need to be evaluated and a system of quality control established, which could be additionally promoted by means of a system of vouchers that would allow the users to choose between different trainings offered by the state. Additional efforts are required in terms of adequate business counselling of SMEs. Euro Info Centre, whose objective was to provide advice to SMEs

⁷⁶See <http://www.aofi.rs>.

doing business with the European Union, closed in 2004, after only three years of operation in Serbia,⁷⁷ and was finally reopened as the Enterprise Europe Network (EEN) within the Serbian Agency for Small and Medium-Sized Enterprises.⁷⁸ SME business centres should be developed at the municipal level also (many municipalities did open their Offices for Local Economic Development), while the SME Agency should continuously evolve the quality of the services it offers to firms. This area has attracted attention of donors and several foreign projects, including an EU project implemented by the European Bank for Reconstruction and Development that subsidises small and medium-sized enterprises using professional consulting services (*BAS/Business Advisory Services*).

Entrepreneurship in Serbia – education, business incubators and industrial parks

Serbia has not made sufficient progress in use of technology in business, especially with regard to small and medium-sized enterprises. To overcome this issue, in addition to changes of the legal framework, obstacles such as the lack of know-how and financial constraints of small businesses need to be removed. The additional problem is that the brain drain, triggered by the wars and economic hardships of the nineties, has persisted. Many highly educated people still leave Serbia in search of employment abroad, which underpins the importance of programmes like the Young Talents Fund. The current capacities for applied, commercial research of Serbian universities and research institutes are unknown and their results and potentials would need to be assessed. Commercial research should be supported, inter alia, through development of adequate infrastructure, particularly for telecommunications. Technology parks are one of the ways to promote commercial research. The technology park in Novi Sad is closest to implementation of this concept in Serbia at this moment, because firms that use advanced technologies (telecommunications, computer programmes, biotechnology) are established within the university centre there. The announced implementation of scientific de-

⁷⁷Serbian Chamber of Commerce has set up a new portal on doing business with the EU, which now includes a special section for small and medium-sized enterprises (see <http://pks.komora.net/>). The Ministry of Economy and Regional Development and some government agencies, Business Registration Agency, for instance, have special SME portals.

⁷⁸ See <http://www.een-srbija.rs>.

velopment strategy will start in autumn 2009, with the aim of changing this situation.⁷⁹

Due to the strong expert and financial support from the European Union and other international partners, Serbia has made pivotal advancements in the development of vocational secondary education and promotion of entrepreneurship through vocational education.⁸⁰ However, not enough consideration has been given to entrepreneurship promotion through other forms of learning, where higher education can play an important role.⁸¹ Employee training or continuous professional development is crucial for raising competitiveness and attracting new investments, but Serbia, according to the World Economic Forum's rankings, occupies only the 121st position out of 131 countries ranked in terms of staff training. Business incubators are in the early stages in several Serbian towns.

Entrepreneurship in Serbia – simplify legislation

The Serbian Government adopted the Regulatory Reform Strategy 2009-2011⁸², which envisages a Comprehensive Regulatory Reform (CRR), aimed at cutting administrative burden for businesses by at least 25% by 2011. Nonetheless, the first stage of the reform involves compiling all the regulations, which will take about a year, while businesspeople have already identified legislation that impose the biggest obstacles through a campaign of a non-governmental organisation, the National Alliance for Local Economic Development (NALED). It would be advisable, for the sake of improvement of the business environment, to couple the CRR campaign with implementation of the reforms suggested in NALED's *Grey Book*,⁸³ which takes on a special importance in the light of the Global financial crisis.

⁷⁹See the draft Serbian Science and Technological Development Strategy 2009-2014, <http://www.nauka.gov.rs>. For more information, see the chapter on science and research of the FEFA study *Impact of Serbia's EU Accession* (the executive summary presented in the present, eponymous, book).

⁸⁰Further details are available in the chapter on education in the FEFA study *Impact of Serbia's EU Accession* (the executive summary presented in this book of the same name).

⁸¹See <http://www.inovacija.org>, and USAID Competitiveness Project, *Skills Gap Analysis in Four Sectors of Serbian Economy*, 2008, <http://www.compete.rs>.

⁸²See <http://www.srp.gov.rs>.

⁸³For more information, see <http://www.naled-serbia.org>.

Conclusion – reform priorities from the perspective of small and medium-sized enterprises

Association of European chambers of commerce – *Eurochambres*, in cooperation with the Serbian Chamber of Commerce, has laid out a plan for putting into action the Eurochambres' proposal for follow-up of the Law on Small Enterprises by the end of 2009. There are three priorities. The top one is to improve access to finance for SMEs. To attain that goal, the measures to promote delayed repayment, encourage banks not to restrict access to finance for SMEs and improve investment programmes have been proposed. The next priority is to have regulations that respond to SME needs. To develop and advance the SME sector in that regard, the regulators will need to apply the Think Small First principle⁸⁴, step up the efforts to cut 25% of administrative costs for firms by 2012, reduce start-up time to 3 days and promote the idea of a "second chance" for entrepreneurs. Strengthening SME access to market is the third priority, which involves timely implementation of the EU Services Directive, designing solutions to provide SME access to e-services of other EU member states and application of the European Code of Best Practices, which facilitates SME access to public procurement contracts. In a nutshell, European integration is a synonym for an improved way of doing business for small and medium-sized enterprises. Any alternative would delay development of the business environment and of the international competitiveness of small and medium-sized enterprises in Serbia.

⁸⁴*Think Small First* is the programme that was introduced in the United Kingdom in 2000 as a framework for support to small and medium-sized enterprises.

IMPACT OF SERBIA'S EU ACCESSION ON REGIONAL DEVELOPMENT – EXECUTIVE SUMMARY

The primary reason for the European regional policy is economic in character: the European Union can efficiently influence the socio-economic differences between its member states only through a regional policy. A single European market without an efficient regional policy would not be able to narrow the regional gaps in the EU. European orientation is vitally important for all the countries in South East Europe, because it provides a chance for their regional and overall socio-economic development.

With regard to regional development, the main task of national authorities involves, above all, institutional adjustments to the EU standards. The haphazard and unstructured action in SEE countries has led to ever-widening regional differences. The impact of the global economic crisis and the incomplete process of transition have only made the situation worse. It will take several years to mitigate the effects of the crisis, while the economic and regional map of Europe will change. The entire SEE region will feel the long-term consequences of the downturn, which will have a profoundly regional dimension in all the SEE countries, including Serbia. That is why it is extremely important to step up the EU accession process, because European regional policy is a major opportunity for Serbia's development, while the unfinished transition can only emphasize the internal regional differences. Otherwise, development will focus more strongly in the Danube and Sava rivers belt, while the gap with the rest of Serbia, if the association process continues in the same manner, will expand in developmental, economic and demographic terms, which entails large political risks in turn.

Research has shown that in terms of regional development, the potential integrative effects of Serbia's EU accession are multiple, substantial and confirmed, both direct and indirect, regionally unbalanced and that they have an economic, demographic, social, infrastructural and human dimension.

This has been confirmed not only by the experiences of all the transitional economies that are EU member states now, but also by our regional experiences with EU projects during the past period of transition (2001-2008). The differences between EU states have narrowed, but the reach of positive effects depends, primarily, on the countries themselves and on their coordination of a number of factors: the dynamics of the entire economic and education reforms, the level of decentralisation etc. It is simply impossible to make a comparison between regional effects of an EU integrated economy and a model of a country left outside European integration or integrating slowly in the EU. In the light of the fact that Serbia's regional model is highly centralised, institutionally undeveloped, with immense repercussions involved, the effects of EU accession acquire a particularly positive dimension.

The conclusion regarding internal regional differences entails a temporal dimension and a starting development position. Potential effects may take either of the two directions: economically stronger regions may become more competitive and better prepared for the market game, while underdeveloped, backward, peripheral, and mountain and hillside regions may initially (over the first 10 years) lag behind the core regions, but develop much faster and seek their chance for progress in strengthening the principles of solidarity and compensations. **In order to reverse the decades-long negative trend of regional imbalances, the indirect effects of European integration on Serbia's regional development will be of conclusive importance. This primarily applies to building of a regional institutional infrastructure, which is a very long and laborious process.** A comparative research of the significance and effects of EU cohesion policy on its member states has produced the following conclusions:

- **EU regional policy has developed into one of the key EU policies.** It has grown in importance over time, which has resulted in the development of instruments and mechanisms designed to solve the specific problems of new member-states and their regional disparities. The development path of the regional policy has been turbulent and often loaded with conflicting interests of different groups of countries, due to large inconsistencies in their levels of development and reasons of the regional imbalances. At some points, this has held back the process of integration.
- **The regional policy instruments have helped considerably the transitioning countries in their economic restructuring and European integration.** The system of the regional policy is built on the principle of a two-way road – no assistance or ac-

tivity can take place without active participation of the country benefiting from the regional development funds. Beside the goal concerning economic and social integration of the member states, the policy has also been applied to promote democracy and the feeling of unity at the EU level and in individual member states.

Upon entry of new member states, European regional policy has encountered more complex challenges, due to the numerous and disparate regional problems and the imbalances the countries brought into the EU. Regional polarisation at the level of the EU has been similar to regional inequalities displayed within national borders, as the integrated European space has split along two axes: north-south and core-periphery.

Country	Most developed regions	Least developed regions	GDP p.c. 1995	GDP p.c. 2005	Change in GDP p.c. 1995-2005
Poland	Mazowieckie	Lubelskie	1.64	2.21	+35%
Hungary	Kozep-Magyarország	Eszak-Alföld	2.02	2.40	+19%
Czech Republic	Prague	Stredni Morava	2.36	2.69	+14%
Slovakia	Bratislava	Vychodne Slovensko	2.51	2.76	+10%
Ireland	Border, Midland and Western	South-East	1.44	1.51	+5%
Italy	Trentino-Alto Adige	Calabria	2.25	2.19	-3%
Germany	Hamburg	Dessau	2.88	2.83	-2%

Measured in GDP per capita in 2004, the ratio between 10 most developed and 10 least developed regions of the EU was 12:1, which was a substantial increase from the 4.7:1⁸⁵ recorded in the early nineties. Apparently, the gap in GDP/p.c. (*PPC*) between the richest and the poorest regions of Central and Eastern Europe is wider than in Italy (a country with extensive intraregional disparities), including Germany, with its eastern and western parts. Further centralisation of economic activity in the most advanced areas of EU-15 has stopped. The main reason for that has been

⁸⁵Differences in GDP per capita among selected new and old EU member states, EUROSTAT – DG REGIO, 2006.

precisely the well-thought out policy of balanced regional development, supported by the structural funds of the EU. Hence, it is to be expected that in the future this trend will probably also cease in the group of new member states. This supports the claim presented above that the rise in regional inequalities in Central and Eastern Europe has been primarily an aftermath of the transition and integration into the EU framework.

- **EU cohesion policy promotes a more efficient regional development of the member states.** The cohesion policy has also provided an opportunity for the member states to apply their own regional policy models in the most efficient and effective manner.
- **Without EU cohesion policy, it would have been much more difficult to attain the positive effects of the regional policy in the member states.** Promotion of regional development is a long-term goal, comprehensive and expensive, but also a necessary process. Without assistance from the EU funds, European institutions and know-how, member states would hardly be able to achieve solid results.
- **The level of success or failure of a specific regional policy depends on, above all, the ingenuity of the member state.** A strategically designed and financially supported Serbian regional development policy will be crucial to attaining positive effects. Serbia's regional policy can only succeed if it is guided by expertise, and not by daily politics.

It is impossible to separate the assessment of effects of European integration on the regional development from the overall (general) effects of economic growth and convergence, that is, it would be difficult to define what level of development a country would have reached without the intervention of regional policy instruments. The effect on overall economic growth is clear and measurable. According to the latest European Commission report on cohesion in 2008, **the regions that benefited from the structural funds within Objective 1 of the cohesion policy (convergence) between 2000 and 2005 registered 50% higher growth of GDP per capita relative to the rest of the EU. At the same time, their unemployment rate declined by 3 percentage points.** The strongest effects were recorded in the change in composition of regional economies from traditional to more productive and competitive sectors. The report also noted that the financial and business services, trade, transport and communication, and high technology sectors in regions that have been beneficiaries of structural funds within the first two objectives of cohesion policy demon-

strated high growth potential in the medium-term period. High-tech sector has been designated as one of the sectors in which the EU has a competitive advantage. It includes manufacture of electrical and optical equipment, aircraft and spacecraft equipment, pharmaceuticals and medical and precision instruments. Because of the wide economic gap between the EU and the United States, the EC Report underlined the need to direct more investment into innovation, education and training. In fact, in the most developed regions, the share of R&D expenditure in GDP is three times higher than in poorer EU regions, but also 15% lower relative to the US. The investment in higher education is much lower in the EU as well: 1.2%, compared with the 2.9% of GDP in the US. The research of effects on Serbian regional development induced by the EU structural funds can be summed up as follows:

- **Developmental effect**

As the unfinished infrastructure on the Corridor X matches the most underdeveloped area in Serbia (South Serbia), construction of this vital pan-European corridor with support from the EU funds will put an end to negative developmental trends and revitalise the undeveloped region of South Serbia. There are 360 000 unemployed persons registered in the area around the Corridor X, while the construction of the corridor is expected to employ 120 000 of them. A major positive effect will be related with the construction industry, as a 10% increase in construction accounts for 1% GDP growth directly, and indirectly for five times more, through development of other economic sectors.

- **Investment effect**

A European Commission research for the 2000-2006 financial framework showed that on every euro spent through the community cohesion policy in regions benefiting from the funds within the Objective 1, an average of 0.9 euro more was invested from other sources. Furthermore, in regions using the funds within Objective 2 (Regional Competitiveness and Employment), every euro earmarked through the European cohesion policy was backed by **additional investment of three euros**, on average. Implementation of large infrastructural projects in Serbia will not be possible without incorporation in the EU regional policy.

- **Additional financial effect**

By use of EU structural funds, the **regional public sector capacity** for cooperation with international financial institutions and the banking sector is enhanced, which in turn secures future sources of investment.

- **Faster development of cross-border regions**

The experience of all transition economies that are EU members today indicates that cross-border cooperation is paramount for development of cross-border regions. The majority of cross-border cooperation projects have been related to the building of infrastructure for environmental protection and promotion of economic cooperation. Beside the direct impact this has had on the local level, it has also generated indirect and multiplying effects in other areas. Cross-border programmes will considerably advance the administrative capacities of all the participants and by this serve as a good exercise for use of EU structural funds, once Serbia becomes an EU member state.

- **Strengthening of public-private partnership**

Use of structural funds paves the way for establishing a long-term collaboration between the private and the public sector in the form of a public-private partnership. This will be a lasting source of financing for other developmental projects in the region.

- **Promotion of strategic regional planning**

The most powerful manifestation of the direct influence of EU structural funds is the strengthening of the concept of regional strategic planning, and design of developmental policies and investment programmes at both the national and the regional level. Accordingly, it will be necessary to introduce **mandatory strategic planning and project management within local authorities** (special units).

- **Selection of development priorities**

Public investment needs to be carefully considered and planned at all governmental levels, from the central to the local. Cohesion policy has played a key role throughout EU regions in the strategic planning of priorities and their synergism with priorities at the national and the EU levels. The EU cohesion policy has also been pivotal to promotion of areas that were not the centrepiece of regional and national policies. Numerous pilot projects financed from the structural funds have engendered national and regional policies concerning research and development of new technologies, innovation and entrepreneurship, active employment policies and social inclusion. In this way, the cohesion policy has impelled the regional and national authorities to apply the concept of comprehensive long-term strategic planning of economic development, including multi-year budgeting.

- **Public administration reform**

One of the indirect effects of EU cohesion policy has been the enhancement of governance capacity of the administration, due to introduc-

tion of structural funds. The EU structural funds have helped advance the capacity to create public policies, build long-term partnerships, intensify the use of policy and programme effect evaluation, and enhance transparency in decision-making and best practice exchange. In this way, introduction and application of the cohesion policy has supported public administration reform in other areas, while **governance at all levels has been upgraded**. In that respect, establishment of new bodies, such as regional development agencies, has played a key role in evolution of many EU regions. In line with the Law on Regional Development, which was adopted on 8 July 2009, Serbia will also endeavour to reinforce development agencies and regional administrative capacities.

- **Training of local authority employees on EU project preparation and implementation**

When drafting the budget of a local authority, an allocation in the local budget must be made for co-financing of EU projects. The key recommendation regarding cross-border cooperation programmes is to select priority projects in cooperation with municipalities in the neighbouring country and start designing the preparatory documents early on, in order to most efficiently use the potential of the cross-border cooperation programmes.

The model of Serbia's regional development by 2020 will be contingent on the dynamic of the EU accession process (see table below). We need to highlight the risk factors, which have been rendered more acute by the economic crisis:

- deadlines and requirements for Serbia's EU association are still undefined, despite the clear European orientation of the government and the public support;
- the downplaying and slow application of EU standards in some key areas (public sector reform, competition policy, infrastructural reforms);
- mild institutional support to regional integrations and cooperation with the neighbouring states;
- the principle of partnership and cooperation with the civil sector is important from the aspect of regional development, but the results in practice indicate this principle has been only declarative;
- the rising social costs of transition, while the enthusiasm for reforms has plummeted and even requires government incentives in some areas;
- tardiness of institutional and legal transition toward a modern state.

Matrix of effects of Serbia's European integration on the regional development

Areas	Performance of underdeveloped regions and states	Performance of developed regions and states
1. Overall effects		
Access to EU instruments and funds	++	+
Access to EU institutions and policies	++	+
Access to institutionalised exchange of knowledge and experiences within the EU	++	+
2. Specific effects		
2.1 Macroeconomic effects		
GDP growth	++	+
Employment growth	+/-	+
Productivity growth	+	++
Foreign direct investment inflow	++	+
2.2 Cohesion effects		
Lower regional differences (convergence)	--	+
Higher competitiveness	--	++
Promotion of cross-border, trans-national and intraregional cooperation	++	++
2.3 Effects on infrastructure, human resources and innovation development		
Development of infrastructure	++	+
Development of human capital and social capital	+	-
- Education	-	++
- People	--	-
- Innovation and creativity development	-	++
2.4 Indirect effects		
Economic concentration	--	--
Institutional capacity	++	+/0

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

Urban development	0	0
Rural development	0	0

Legend: ++ very positive result, + generally positive result, 0 no effect, - negative result, -- highly negative result

Note: Effect is here projected as a result, not as an outcome (which frequently has not been caused by the cohesion policy)

Alternative scenarios for Serbia's regional development by 2020

	Scenario 1: Disintegrated regional spatial system (-, -)	Scenario 2: Integrated and partly regulated regional spatial system (-, +)
-	<p>Disintegrated, unregulated regional spatial system; Space unconnected to the EU; Marginal importance of regional planning; Highly centralised system, downward trend in regional cohesion; Accelerated metropolisation and regional agglomeration in 20 cities; Strong demographic recession; Devastated, non-standardised economic system; Resource-led growth, uncompetitive export structure; Vital infrastructural corridors undeveloped; Institutionally undeveloped system; Rising trend in social exclusion; Extremely high environmental risks; Economic decisions considerably swayed by politics.</p>	<p>Partly regulated regional spatial system; Space connected to the EU; Increased importance of regional planning; Partly centralised system, mildly upward trend in regional cohesion; Metropolisation and urban agglomeration Unrelenting trend of demographic decay; Restructured, standardised economic system; Resource-led growth, mildly increased competitiveness of export structure; Vital infrastructural corridors incomplete; System institutionally compatible with the EU; Rising trend in social exclusion; Environmental risks under control; Economic decisions swayed by politics to a lower extent.</p>

IMPACT OF SERBIA'S EU ACCESSION ON SME SECTOR

Economic growth*	Scenario 3: Non-integrated partially regulated regional spatial system (+,-)	Scenario 4: Integrated regional spatial system (+,+)	
+	Partial, selectively regulated regional system; Space unconnected to the EU Upward trend in importance of regional development planning; Centralised system, downward trend in regional cohesion; Higher level of metropolisation and urban agglomeration; Partial demographic revitalisation; Restructured, selectively standardised economic system; Investment- and innovation-led growth, rising competitiveness of export structure; Vital infrastructural corridors developed; Institutional system incomplete; Upward trend in social inclusion; High environmental risks; Economic decisions considerably swayed by politics.	Regulated regional spatial system; Space territorially connected to the EU; Efficient and rational regional development planning; Decentralised system, upward trend in regional cohesion; Strengthening of internal territorial cohesion, promotion of competitiveness of cities, regions and areas, reinforcement of advantages; Gradual demographic revitalisation; Sustainable economic growth, knowledge-based development; Competitive, standardised economic system; Vital infrastructural corridors developed; Institutional system completed; Socially balanced society, low risk of poverty, high social inclusion; Environmental risks under control; Economic decisions out of reach of politics.	
	-	EU	+

* Economic growth analyzed in two variables: average growth by 2020 below 3% of GDP (-), or 5-7% of GDP (+)

ARTICLES

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ROLE OF THE JUDICIARY IN THE PROCESS OF EUROPEAN INTEGRATION

Aleksandra Čavoški, Ph.D.¹ and Ana Knežević Bojović, LL.M²

1. Role of the national courts in the process of European integration

Although two of the four EU membership criteria relate to judiciary, the countries embarking on the road to Europe often neglect the role and importance of the judicial system, and in particular that of the national courts. National governments are focused on creating a depoliticised and professional state administration, capable of serving their citizens. This approach is somewhat understandable, as the role of public administration in harmonising the national legislation with *acquis communautaire* and designing the national rules for the purpose of this exercise is far more important in the early stages of European integration.

Nevertheless, national courts do play a vital part in this process, though their significance increases after the country has joined the EU. First, proper application of *acquis* is dependent on the work of the national courts. It is frequently forgotten that the judicial system of the European Union comprises not only the European Court of Justice, Court of First Instance and, since recently, Civil Service Tribunal, but also national courts, without which the European justice system would be incomplete. The variety of legal sources in the European Union poses a very complex task for national courts; therefore, national judges need to undergo training on the legal nature of Community legislation.

In fact, they are pivotal to development and consistent application of EU law. In this endeavour, through the preliminary ruling procedure,

¹Faculty of Law, Union University, Belgrade.

²Institute of Comparative Law, Belgrade.

national courts establish a partnership relationship with the European Court of Justice and contribute to uniform application of Community law on the territory of the European Union. What is more, this procedure contributes to universal acceptance of *acquis communautaire* and of the European Court of Justice as the guarantor of its proper interpretation, as well as to the "procedure whereby Community law becomes part and parcel of the legal culture of Member States, a veritable component of the Law of the Land"³. Finally, national courts guarantee appropriate legal recourse for individuals and legal entities if a government agency infringes Community law. "The ability of litigants to enforce Community law in national courts is an essential feature of the integrated legal system set up by the Community"⁴. In this process, national courts are required to provide the same legal means and under the same conditions that are available to litigants in cases of violation of domestic laws⁵. This role of national courts has emanated from the case law of the European Court of Justice, which has developed the basic principles of community law: direct effect, supremacy of European law over that of member states and state liability.

2. Criteria for the national judiciary

The importance of national judiciary in the process of European integration stems from the fact that it is responsible for attainment of two out of the four Copenhagen criteria. The first, the so-called political criterion, requires stability of institutions guaranteeing democracy, rule of law, human rights and respect for and protection of minorities⁶. On the other hand, the fourth criterion, defined by the Madrid European Council, requires the capacity of the state to implement *acquis communautaire* through efficient administrative and judicial structures (judicial and administrative capacity)⁷.

In the first stages of European integration, candidate countries and potential candidates face difficulties in attainment of the first criterion, be-

³J.P. Jacque, J.H.H. Weiler, 'On the Road to European Union – A New Judicial Architecture: An Agenda for the Intergovernmental Conference', *Common Market Law Review*, 27, (1990), pp. 185-207.

⁴Deards, E & Hargreaves S, *European Union Law*, Oxford University Press, 2004, p. 77.

⁵Ibid, 100.

⁶http://ec.europa.eu/enlargement/enlargement_process/accesion_process/criteria/index_en.htm

⁷Op.cit.

cause establishment of the rule of law as a precondition for functioning of a state governed by laws presupposes well-organised and independent judicial bodies and strict observance of the separation of powers. This criterion requires that judicial institutions be built on some generally accepted, fundamental principles. However, emphasis is placed on judicial independence, which encompasses the work of the entire judiciary, particularly court practice and the principle of “fair trial and access to justice”.

The fight against organised crime and corruption reveals why it is important that these requirements be fulfilled. Independent judicial, and particularly court authority, is a precondition for combating organised crime. The field of judiciary in the Stabilisation and Association Process is especially interesting. It is also unique because, in contrast to the agriculture, fisheries, energy, environment and other areas, there is no specific list of European rules that domestic legislation needs to conform with. There are some conventions that regulate the equality of parties to criminal proceedings and others that govern the work of some judicial and police institutions. This is the reason why harmonisation of laws in this sphere starts with the harmonisation of domestic legislation with standards of the Council of Europe.

Serbia, like all countries of Central and Eastern Europe that have been admitted to the Council of Europe, is struggling the most with the first political requirement, because of the legacy of authoritarian rule. Even after the previous regime was overthrown, “Serbian laws that were passed in the last decade of the twentieth century, as well as federal laws, were not adjusted to standards of modern jurisprudence or comparative law, and especially not to the legal system created within the Council of Europe and the EU. The legislation dating from this period is faulty, as a rule, because many legal situations were not regulated, which created ample space for arbitrary and inadequate interpretation of laws by the executive. The judicial system was not perceived as an independent branch of government, equal with the legislature and the executive. Besides, legal provisions concerning the judiciary frequently contradicted the Constitution.⁸ New laws on the court system were adopted for the first time in November 2001. The last set of laws on the judiciary was passed in December 2008. It comprised the Judges Law, Law on the High Court Council, Law on Public Prosecutors, Law on the State Panel of Pros-

⁸ ‘Judicial System Monitoring’, an unpublished study prepared by research associates of the Institute of Comparative Law and representatives of the Judges Association within a project of the Fund for an Open Society.

ecutors, Law on the Court Organisation, Law on Seats and Territories of Courts and Public Prosecutors and the Law on Amendments and Changes to the Misdemeanour Law.

One of the core issues contained in the political requirement that was to be resolved by these laws is election of judges and their work, which are supposed to uphold the independence of the national judiciary. The authors of this paper have decided to delve into these issues in order to ascertain whether the laws guarantee attainment of the political requirement concerning independent judiciary. The centrepiece of this exercise is introduction of an independent body responsible for election, dismissal, promotion and disciplinary liability of judges – the High Court Council.

3. Independence of judicial office

3.1. Selection of judges and court presidents

Selection of judges has always been an especially important issue, as the method of the election is highly indicative of the real independence of the judiciary from other branches of government. Though the Constitution has always recognised the judiciary as an independent branch of government, the selection of judges has unequivocally jeopardised the equality of the judiciary in the system of separation of powers. For a long time, the National Parliament selected or dismissed judges, at the proposal of the minister of justice; hence, the issue of the influence of the executive on the selection of judges and judicial office was justly raised. In 2001, after adoption of new judiciary laws, which were written in light of comparative solutions in other countries, this competence was divided between the National Parliament and the High Judicial Council, as the Council nominated to the National Parliament the prospective court presidents, judges, public prosecutors and deputy public prosecutors. In December 2008, the latest package of judiciary laws was adopted, which changed once again the procedure for selection of judges and court presidents.

3.1.1 Selection of judges

Articles 146 and 147 of the Constitution of the Republic of Serbia define the manner of selection of judges and duration of judicial office. The

Constitution guarantees permanency of judicial office, except for the first election, when judges are appointed for a probationary three-year period. The Constitution and Judges Law envisage different methods of selection for judges elected for office for the first time and for any ensuing selection. The new Judges Law⁹ has made considerable progress relative to previous legislative solutions, as it has substantially expanded jurisdiction of the High Court Council. It appears that the key new competences of the body concern the permanent election of judges, deciding on the number of judges and lay judges for each court, evaluation of work of judges and court presidents, deciding on removal of a judge from office and proposing the amount and structure of budget allocations required for operation of the courts. The scope of these powers, and especially the fact that the High Court Council will decide on permanent election of judges and on removal of judges from office, demonstrate the aspiration to strengthen the independence of the judiciary from the executive and legislative branches, though the composition of the body does not reflect this idea fully.

The election starts with public competition announced by the High Court Council. The call is published in the *Official Gazette of the Republic of Serbia* and another public media with nationwide coverage. The applications are submitted to the High Court Council within 15 days from the announcement in the *Official Gazette of the Republic of Serbia*. Evidence of compliance with the selection requirements are submitted along with the application.

The High Court Council collects information and opinions on qualifications, capacities and worthiness of the candidates. These are obtained from the bodies and organisations that the candidates have worked with during their legal career. For candidates who have worked in courts, the Council obtains the opinion from the bench of the candidate's court and opinion from the bench of the next higher court. The candidate has the right to see these opinions before the selection takes place.

In nomination of the candidates for first election to a judicial office, beside qualifications, capacity and worthiness, the High Court Council particularly values the type of work the candidate has done after passing the bar examination. The Council is obligated to procure a review of work of candidates who have been judicial assistants. Before making the nomination, the High Court Council may interview the applicants. The High Court Council nominates to the National Parliament one or several candidates for one judicial office. The High Court Council's nomination

⁹*Official Gazette of the Republic of Serbia* No 116/08.

must be reasoned. At the proposal of the High Court Council, the National Parliament appoints judges elected for the first time.

In conformity with the law, the High Court Council is also responsible for election of judges to permanent posts in the same or another court. A judge elected for the first time who has received evaluation that he or she has "performed the judicial duty exceptionally well" must be appointed to a permanent office. A judge whose work during the initial three-year mandate has been described as "unsatisfactory" cannot be permanently appointed. The High Court Council decides also on reassignment of permanently appointed judges to another or higher court.

The High Court Council defines the number of judges and lay judges for each court. The number of judges in misdemeanour courts, High Misdemeanour Court and Administrative Court is specified also for each division located outside the court seat. The High Court Council reviews the required number of judges and lay judges in all courts every five years. The High Court Council may re-examine the number of judges and lay judges even earlier, upon its own initiative or at the proposal of a court president, president of the next higher court, president of the Supreme Court of Cassation or the justice minister, taking into account the annual caseload.

3.1.2. Selection of court presidents

As regards appointment of court presidents, the solution defined in the previous law has been retained and court presidents continue to be selected by the National Parliament at the proposal of the High Court Council. Before deciding on the nomination, the High Court Council obtains the opinion on the applicants from the bench of the court whose president is to be selected. The candidate has to possess outstanding capacity for court management and organisation, in line with the criteria set out by the High Court Council.

The function of court president is terminated with termination of judicial office, appointment to another court, at personal request, in the event of abolishment of the court, expiration of the mandate and dismissal from the function of court president. The National Parliament passes the decision on termination of a court president's office. After a court president's mandate has expired, the High Court Council is required to nominate promptly candidates for the position.

This solution may be subject to criticism for two reasons. First, the question is why the procedure for election of court presidents is different from the one for judges and why the primacy here is given to the National Parliament, which represents the legislative branch. This jeopardises the independence of the office. The second problem is definitely the composition of the High Court Council, which brings us again to the issue of independence of the nominee.

3.1.3. Criteria for selection of judges and court presidents

One of the main problems that may compromise proper selection of judges is the criteria for selection of judges and court presidents¹⁰, which have been designed by the Serbian Ministry of Justice in line with Article 45.6 and Article 69 of the Judges Law¹¹. The criteria and standards concern evaluation of qualifications, competence and worthiness of judges and court presidents. The document starts with legal definitions of “qualification”, “competence” and “worthiness”, and goes on to specify details of each of the three criteria that are applied to (1) the first election of a judge for a three-year mandate, (2) the election to permanent functions of judges who were previously appointed, (3) the election to permanent functions of judges whose three-year mandates have elapsed, (4) the promotion of judges from one court into the next highest court and (5) the election of court presidents.

The main problem with the draft is that the required criteria are unattainable for our judges, since they are too complicated to be applied in practice and encompass mostly quantitative indicators that may compromise the quality of the work of judges. For instance, the criteria for election to permanent functions of the already appointed judges involve the percentage of performance measure achieved; the number, type and complexity of cases; the number of cases concluded; the number of confirmed or overruled decisions; the amount of time taken to reach a ruling etc. This problem was perceived also by the Venice Commission who stated in its opinion that “the mere counting of workloads should not be used in such a way as to put pressure on a judge to make decisions without proper consideration.

¹⁰ Decision on the Selection Criteria and Standards for the Evaluation of Qualification, Competence and Merit of Judges and Court Presidents (*Official Gazette* No 49/2009).

¹¹ [http://www.venice.coe.int/docs/2009/CDL\(2009\)091-e.asp](http://www.venice.coe.int/docs/2009/CDL(2009)091-e.asp)

For instance, there may be a higher number of cases in a given region due to the fact that this region has an overzealous lawyer who systematically appeals when his or her clients have lost a case – which could skew the scales with respect to the caseload in favour of that region. However, it seems reasonable that these criteria should be used as a means of identifying possible problems, provided that proper evaluation is then carried out and not simply be treated as a numbers exercise.”¹² It is also unclear how specific competences set out in the draft can be measured – for instance, the capacity for analytical and synthetic opinion, self-control and cultured behaviour (the Venice Commission also highlighted this issue¹³).

It is very important to cite other remarks offered by the Venice Commission in its Opinion of 12-13 June 2009, which analysed the criteria in great detail and pointed to the potential problems in their application. The Commission expressed its apprehension that the already appointed judges, who have not been guilty of any misconduct, may not be reappointed to their function. This concern is partly alleviated by Article 13 of the Decision on Criteria, which presents the assumption that the already appointed judges applying for the function in the court of same type or of the same instance shall be assumed to have fulfilled the criteria and standards specified in the draft criteria on judges. The Commission concluded that the draft criteria were in line with European standards (recommendations of the Council of Europe and good practices of member states) and forward-looking, as they defined a precise framework for skills required of the various categories of judges. However, the Commission was apprehensive about the method for evaluating and balancing different skills against one another. Finally, the Venice Commission criticised justly the shortness of the timeframe for implementation of this comprehensive reappointment of judges and presidents of courts in Serbia, which is to take place by 1 December 2009.

With regard to the deadlines and the method of selection, further potential problems need to be accentuated. Upon prior consent of the Ministry of Justice, the High Court Council determined that only 1 838 judges are needed, while there are 2 400 currently appointed judges and 1 000 misdemeanour judges who will participate in the public competition as well. The question is whether the High Court Council, which has not been fully constituted, will be able to conduct a detailed evaluation of the applicants, in the light of the highly ambitious criteria set out in the

¹²http://www.sudije.org.yu/list_news

¹³Op. cit.

draft. The preparedness to hold an objective election procedure is also questionable, as the stated need of 1 838 judges would mean that some 600 judges would not be appointed to offices, not to mention the misdemeanour judges.

Finally, we must keep in mind that a working group of the Serbian Ministry of Justice prepared the draft criteria that were subsequently adopted, though they should have been defined by the High Court Council; hence the competence of the Ministry of Justice to adopt this document may be reasonably questioned. In fact, this again raises the question of the discretion that the executive has over the judiciary.

3.1.5. Constitutionality of the new selection procedure

Judges appointed in line with the Judges Law (*Official Gazette of the Republic of Serbia*, No 63/01, 42/02, 17/03, 27/03, 29/04, 35/04, 44/04, 61/05, 101/05 and 46/06) and the Law on Courts, *Official Gazette of the Republic of Serbia*, No 46/91, 60/91 - correction, 18/92 - correction, 71/92, 63/01, 42/02, 27/03 and 29/04) "continue to hold their office in the courts to which they were appointed until the judges selected in line with the new Law assume their office" (**Article 99.1**). "Judges referred to in article 99.1 and 99.2 of the Judges Law, who have not been selected pursuant to this Law, shall be dismissed from their office on the day when judges elected in line with this Law assume their posts" (**Article 101.1**).

According to the new law, the selection of judges will take place by 1 December 2009 at the latest, except for the judges of the Supreme Court of Cassation, who will be selected within 90 days from the establishment of the High Court Council. The judges selected in conformity with this law will take their office on 1 January 2010 (**Article 100, paragraphs 1 and 2**). The High Court Council decides on the number of judges and lay judges, according to the Law, within 30 days from selection of the first configuration of the High Court Council, with prior approval of the justice minister (**Article 100.1**). The first election of a judge is considered to be the appointment of a judge pursuant to previous laws. However, appointment of a misdemeanour judge is not understood to be the first election (**Article 100.4**).

Judges' Association of Serbia (JAS) has initiated the procedure to review the constitutionality of the transitional provisions of the Law (particularly the provisions contained in **Article 99.1, Article 101.1 and Article 100.4**). The principal argument of JAS representatives has been that

these provisions have effectively abolished permanency of judicial office, which was guaranteed both by Article 100.1 of the previous Constitution, which was in force at the time of appointment of judges, and by Article 146.1 of the current Constitution. JAS also “highlight(ed) the legal and constitutional continuity between the current and the previous constitution, and consequently the continuity regarding permanency of judicial office. What is more, continuity of judicial office is “recognised” by Article 100.4 of the Judges Law, which sets out that the first election of a judge is deemed to be appointment of a judge in line with the previous laws. Continuity of judicial office is “recognised” also by Article 56 of the Law on High Court Council, which stipulates that upon termination of the first term of office of the Council, the judges elected as members of the High Court Council continue to hold their office”.¹⁴ In their rationale, the judges also highlighted that these provisions have a retroactive effect and encroach on the acquired rights of judges elected in conformity with earlier laws. This is explicitly banned by Article 197.1 of the Constitution, which safeguards the principle of legal security as one of the tenets of the rule of law, set out in Article 3 of the Constitution. “There can be no retroactive effect of laws, unless it is necessitated by the public interest defined with adoption of the law, as Article 197.2 of the Constitution states explicitly. Judges have acquired their permanent function in line with the Constitution and regulations that were effective at the time of their appointment. Therefore, their permanent office has been legally obtained, but the law we are challenging retroactively cancels this permanency, which jeopardises the citizens’ right to a fair trial before an independent and impartial court”¹⁵.

The dilemmas concerning this issue have been resolved in principle by a decision of the Serbian Constitutional Court¹⁶ that rejected the initiatives for review of the constitutionality of the disputed provisions of the Judges Law or determination whether they conflict with ratified international agreements. Nevertheless, dissatisfied with such ruling of the Constitutional Court, the Judges’ Association of Serbia has announced it would file a complaint with the European Court for Human Rights and called on its members to boycott the competition. Though the challenged transitional and final provision of the Judges Law were not found to be unconstitutional, it is clear that the antagonism between the executive and a part of the judicial power in Serbia continues to exist. If a large number

¹⁴http://www.sudije.org.yu/list_news

¹⁵*Op. cit*

¹⁶Decision adopted at a session held on 9 July 2009, case number IX-43/09.

of judges refuse to apply for offices, the election of judges in line with the new law can easily be questioned on the grounds of legitimacy. In addition, it seems that dissatisfaction of judges with the way some reforms in the judicial system have been implemented may jeopardise the aspects of the reform that the Ministry of Justice and judges have already agreed on.

3.2. High Court Council

As an important step in winning independence for the judicial authorities from other branches of government, the institution of the High Judicial Council was introduced in Serbian legislation in 2001, but it became a constitutional category called the High Court Council only with passing of the new Serbian Constitution in 2006¹⁷. This solution has been hailed by both legal theorists and the practitioners, particularly judges, as it is expected to strengthen the role and independence not only of the High Court Council, but also of the judiciary in general. It is particularly noteworthy that the Constitution also provided for integration of all competences enjoyed by similar institutions in comparative law¹⁸, which used to be divided between three bodies – the High Judicial Council, Grand Personnel Panel and the Monitoring Board. It is interesting that the provisions of the new Constitution separate competences regarding election, promotion and removal from office of judges and prosecutors. For this reason, the State Panel of Prosecutors has been introduced into the Serbian legal system, beside the High Court Council.

However, the way this body is organised may be criticised. What is particularly striking is the fact that a special position in the Council is given to holders of political offices – the justice minister and the chair of the competent committee of the National Parliament – simply by virtue of their offices. The tendency to organise the Council hierarchically may account for the standing position of the Minister of Justice and the chair of the relevant parliamentary committee with full voting rights – and this rule may be disputed on the grounds of principle. In comparative law, especially in transition countries, representatives of the executive either

¹⁷*Official Gazette* No 98/06.

¹⁸For more information on judicial councils in comparative law, see *Pravosudni saveti*, grupa autora, Institut za uporedno pravo, 2003, EU (II) 142. European standards include, in particular, the Recommendation No (R (94) 12 of the Committee of Ministers of the Council of Europe on Independence, Efficiency and Role of Judges, and European Charter on the Statute for Judges (DAJ/DOC (98) 23).

may not be members of a judicial council or, if they are, they do not have the right to vote.¹⁹ Therefore this solution somewhat undermines the idea of strengthening judicial independence.

On the other hand, it seems that the combination of constitutional and legal provisions concerning selection of the elected members of the High Court Council has been a considerable step forward. Namely, according to the Law on the High Court Council²⁰, the judges are elected to the Council by votes of all the judges in Serbia. The judges are chosen in direct elections and by secret ballot, pursuant to provisions of the Constitution and law, with the aim of ensuring balanced geographical representation of courts and representation of courts of all instances²¹, which is in line with relevant European standards. Then the High Court Council, as authorised nominating authority, proposes to the National Parliament the candidates – one that has won the highest number of votes or several, if they have won almost equally high number of votes.²² This solution means that, in the future, judges will have a much more prominent and immediate role in election of majority members of the body competent to decide on election of judges, their promotion, disciplinary liability or removal from office. The potentially contentious issue that has remained unresolved is the possibility that the National Parliament may decide not to elect one or several members of the High Court Council nominated by the Council. The legal provisions may lead us to conclude that in that case, as well as in the expressly regulated situation in which a member fails to assume the duty²³, the High Court Council would organise new elections and propose new nominees. This solution has the potential to lead to repeated elections and political obstruction of the work of the High Court Council – a practice that is, unfortunately, familiar to the political and legal

¹⁹Vesna Rakić-Vodinić et al, *Pravosudni saveti*, Institut za uporedno pravo, Beograd, 2003.

²⁰*Official Gazette* No 116/2008.

²¹According to Article 22 of the Law on the High Court Council, the Council comprises judges selected from the following courts:

- one judge of the Supreme Court of Cassation, Commercial Appellate Court and Administrative Court;
- one judge of appellate courts;
- one judge of high and commercial courts;
- one judge of basic courts;
- one judge of misdemeanour courts and the High Misdemeanour Court;
- one judge from the territory of autonomous provinces.

²²Article 35 of the Law on the High Court Council.

²³Article 38 of the Law on the High Court Council.

atmosphere in Serbia (remember that work of the Constitutional Court was blocked as the judges could not be elected). Furthermore, the Venice Commission has criticised the fact that the National Parliament elects the members of the High Court Council through a simple, instead of qualified, majority²⁴. Though a qualified majority voting would certainly be a more solid guarantee of the Council's independence and symbolise a political consensus on the choice of the candidates, it seems that the practice of the Serbian National Parliament has shown it would only facilitate obstruction of the Council's work and any subsequent election of judges.

The law sets out that the Bar Association (for the lawyer selected as the Council member) and a session of deans of all the faculties of law (for the professor of law selected to the Council) may be the authorised nominating authorities of members of the High Court Council that are not judges. A special problem with appointment of the first configuration of the new High Court Council is the transitional and final provisions of the Law on the High Court Council. They stipulate a different method for election of the first configuration of the Council, as the judges are not directly elected to the Council. The candidates are nominated instead to the High Judicial Council (as the authorised nominating authority) by the bench of one or several courts, depending on their category and instance, and from the territory of the autonomous provinces. Already when the draft law was presented to the public, the Judges' Association of Serbia expressed its dissatisfaction with the fact that the concept of direct election of candidates was abandoned.

The criticism regarding the selection of, primarily, the first configuration of the High Court Council has proven not to be completely unjustified. The candidates representing law professors and lawyers have not been elected to the Council yet, as the National Parliament has failed to select a single candidate proposed by the session of deans of all faculties of laws or those nominated by lawyers.

Despite the fact that not all members of the Council have been elected, the Council was constituted and it adopted its Rules of Procedure²⁵, in line with legal provisions that obligate the Council to adopt its Rules of Procedure within 90 days from its establishment.²⁶ It appears, however,

²⁴Opinion 464/2007 on the Draft Law on the High Court Council.

²⁵Rules of Procedure of the High Court Council, *Official Gazette of the Republic of Serbia* No 43/2009.

²⁶Article 35 of the Law on the High Court Council. Article 18.1 sets forth that the Council adopts a rulebook that regulates the work and decision-making of the Council.

that the legality of the Council's constitution may be reasonably questioned, as Article 54 of the Law stipulates that constitutive session of the Council will take place within 7 days from the appointment of the elected members – and some of them have not been selected yet. In principle, the fact that judges have been appointed to the Council is a safeguard that the authority nominating prospective judges is a body mostly composed of judges (6 elected members and the president of the Supreme Court of Serbia – 7 out of 11 members). Nonetheless, the fact that this body has started work though it is incomplete compromises the legitimacy of its decisions, particularly in the light of the approaching selection of judges.

The new Constitution and the Law on the High Court Council have expanded powers of the Council. The solution presented in the new Constitution has given this body the competences it usually has in comparative law, but which used to be divided among three bodies in the Serbian legal system – the High Judicial Council, Grand Personnel Panel and the Monitoring Board. It is clear that these powers necessitate streamlining the organisation of the High Court Council (HCC) as well as novelties in judicial administration – such as introduction of disciplinary bodies that would decide in original jurisdiction on disciplinary liability of judges. Article 15 of the Law on the High Court Council sets out that the Council also comprises standing bodies – the Commission for Evaluation of Work of Judges and Court Presidents, Selection Commission and disciplinary bodies. The potential problem that has been encountered in practice and has not been tackled is the lack of space, and of technical and human capacities for proper discharge of the Council's duties. Some progress may have been made with the new Law and the Rules of Procedure, but the practice has shown that implementation of judiciary legislation has been largely constrained by the budget; therefore similar problems in the work of the HCC may be expected.

Furthermore, in view of the wide scope of competences and tasks of the HCC, the law sets out that judges elected to the Council are to be relieved of their duty during their mandate with the HCC. This ensures, in theory at least, that a HCC session may take place anytime – because six members are needed for the quorum (while the Council has seven judges, one of whom is the President of the Serbian Supreme Court of Cassation, is not a selected member and necessarily continues to hold his office). It also means that even an incomplete HCC may adopt decisions, because decision-making requires support from majority of the total number of members of the Council – that is, six votes.

3.3 Permanency of judicial office

Article 146 of the Serbian Constitution guarantees permanency of judicial office, except in the case of first election. In contrast to the earlier solution (which did not include probationary work, or possibility of selection or appointment of temporary judges), the new Law does not envisage that the mandate of judges may become permanent already with the first election.

The Judges Law sets forth that a judge serves as a permanent judge in the court to which he was appointed. He may be assigned by a decision of the High Court Council to another post or transferred to another court, other state body, institution or international judicial organisation only upon his prior written consent. A judge may be assigned to another post if there is an urgent need to fill in a vacant position that cannot be substituted through selection or temporary assignment of a judge, with prior approval obtained from presidents of both courts. A judge may be transferred to another court whose functioning is hampered or retarded by lack, unavailability and disqualification of judges or by other reasons. Transfer of a judge from one court to another is not prescribed as a disciplinary action. Judicial duty lasts continuously from the day of appointment to permanent office until a judge reaches retirement age. Working life of a judge ends at age 65 or after 40 years of service. Judicial duty may cease earlier only under conditions set out in the Law.

Reassignment and transfer of a judge to another court have not posed problems in practice. However, the question is whether this provision may be abused and competences of some courts reduced once the new organisational structure outlined in the Law on the Organisation of Courts²⁷ is established (implementation of the Law will start as of 1 January 2010). As this issue falls under jurisdiction of the High Court Council, it would be recommendable to define some criteria to be applied in this case.

3.4. Activities

3.4.1. Advancement

This Law has introduced a system of advancement of judges, which is a major change relative to previous legislative solutions. The provisions of the Law include regular review of work of all judges and court

²⁷*Official Gazette* No 116/08.

presidents. The review covers all aspects of judicial office and work of court presidents and is the grounds for election, mandatory training and removal of judges.

The power to assess a judge's work is given to councils formed in courts of the next higher level, as councils in the next higher courts assess the judges in immediately lower courts. A council comprises three judges who are elected for a four-year term by secret ballot of all the judges. One council is formed for every 100 judges whose work is evaluated.

A Commission of the High Court Council assesses court presidents. The composition and the work of the Commission are regulated by an act of the High Court Council. The work of permanently appointed judges and court presidents is evaluated regularly every three years, while those elected for the first time are assessed each year. In exceptional cases and if the High Court Council decides so, a judge may be evaluated extraordinarily.

The assessment is in the form of opinion. The opinions regarding assessment of judges may be expressed as "exceptionally successful performance of judicial duty", "successful performance of judicial duty" and "unsatisfactory". The assessments of court presidents may read "highly successful performance of court president's duty", "successful performance of court president's duty" or "unsatisfactory performance of court president's duty". The assessment is entered into personal record of a judge or court president. Judges and court presidents have the right to object to the expressed opinion.

Assessment of judges takes on a new significance in the process of election of a judge to a permanent post. The Judges Law obligates the High Court Council to appoint a judge selected for the first time who has been evaluated during his three-year mandate as "exceptionally successful in performance of judicial office". On the other hand, a first-time judge whose assessment during the three-year term was "unsatisfactory" cannot be selected to a permanent function, which simultaneously becomes a reason for removal of a judge elected for the first time. Problems concerning assessment may emerge due to the lack of standards for election of judges and court presidents mentioned above.

3.4.2 Professional development

The new Judges Law also contains provisions regarding professional development of judges. A judge is entitled to professional development and training at the expense of the Republic of Serbia. However, sometimes

the right to professional development becomes an obligation for judges in accordance with the Law or a decision of the High Court Council. These situations involve a change in specialisation, major amendments to regulations, introduction of new work techniques and elimination of anomalies in actions of a judge that have been detected in the course of a review.

In view of Serbia's commitment to EU accession, it is justified to wonder whether the country has the capacities to conduct relevant training for judges and prosecutors in the field of European legislation. Experts from scientific and educational institutions will need to be engaged on intensive training of judicial office holders.

3.4.3. Termination of judicial office

Judicial office may be terminated at personal request of a judge, in the event of occurrence of conditions set out in the Law or removal of judge from office in line with the Law, or if the judge is not selected for permanent appointment. The High Court Council passes the decision on termination of judicial duty. A judge may challenge this decision before the Constitutional Court. Submission of such appeal precludes the right to file a constitutional complaint. Judicial office does not cease if the number of judges in the respective court is reduced. The Law regulates the procedure, the grounds and the reasons for termination of judicial office, as well as reasons for dismissal of a court president.

Provisions of the Judges Law prescribe the reasons for removal of a judge from office in cases when a judge has been pronounced, for committing a criminal offence, a mandatory prison sentence of minimum six months or has been found guilty of a punishable offence that makes him unworthy of the office of a judge, if a judge has been incompetent or has seriously breached discipline. Assessment describing a judge's work as "unsatisfactory" is considered a sign of incompetence, according to the Judges Law, which adds to the importance of the evaluation of judges. As this Law has introduced disciplinary liability of judges, unconscientious discharge of judicial duty or conduct unworthy of a judge are classified as disciplinary offences.

The initiative for removal of a judge from duty may be made by anyone. The procedure for removal is initiated by a proposal of court president, president of the directly superior court, president of the Supreme Court of Cassation, justice minister, bodies responsible for review of judges or Disciplinary Commission, while the grounds are determined

by the High Court Council. The High Court Council determines the facts and decides in a procedure that is closed for public. The Council is obligated to conduct the procedure and reach a ruling within 45 days from submission of the document initiating the procedure. The decision of the High Court Council must be reasoned.

A novelty in the Serbian legal system is a constitutional and legislative solution by virtue of which the decisions of the High Court Council may be appealed, while the Judges Law²⁸ sets forth that judges may complain to the Constitutional Court against the decision not to elect a judge or to terminate a judicial office. This constitutional provision gives an important leverage over the work of the High Court Council, especially with regard to the vital issues concerning election of a judge to permanent office or removal from office. The previous solution that placed the power of appointment and dismissal of judges in the hands of the National Parliament left little or no room for a legal remedy against the Parliament's decisions. For a short time, the Law contained the right to challenge a decision on removal of judge from office before the Constitutional Court, but this provision was later abrogated. Hence the view of the legal theorists that judges must have the right to a legal remedy before the Constitutional Court, within the framework of protection of their right to be elected²⁹.

It is clear that considerable progress has been made relative to earlier legislative solutions with the expressed prescription of legal remedy concerning the decision on removal of a judge from office and situations when it is deemed that a judge has not even been elected. Nevertheless, there is a legal loophole concerning the right to appeal the selection of judges that has contravened the Constitution and the law, and the Constitutional Court, if presented with such a case, is expected to take a clear stance with regard to its potential jurisdiction.

3.5. Accountability of judges

The general principle that regulates civil liability of judges in the Serbian legal system is contained in the Article 6 of the Judges Law: "Republic of Serbia shall be held accountable for damage caused by unlaw-

²⁸*Official Gazette* No 116/2008

²⁹Bosa Nenadić, 'Pravo razrešenog sudije na delotvorno pravno sredstvo u pravnom sistemu Republike Srbije', *Pravni informator* 1/2005.

ful or improper conduct of a judge". If a final ruling by the Constitutional Court, effective judicial decision or settlement in court or before other competent authority should find that the damage was done on purpose or by gross negligence, the Republic of Serbia may demand of the judge to compensate for the damages the state paid.

Should the European Court of Human Rights or other international tribunal or organisation to which Serbia is a party establish in their ruling that human rights and fundamental freedoms were violated during proceedings and that a ruling was based on such violation or that a court failed to reach a ruling because the right to trial within reasonable time was breached, the Republic of Serbia may demand of the judge reimbursement of the damages paid, if the miscarriage of justice was done on purpose or through gross negligence.

At the request of the minister of justice, the High Court Council decides whether compensation may be claimed from a judge. The Law sets out that the state is held liable for damages made by a judge (so-called *vicarious liability*³⁰), but the Law envisages that a state may initiate the relevant procedure and require a judge to cover for the damages paid, providing that a court ruling or settlement established the judge's guilt of intention or gross negligence. This law has introduced an important novelty related with situations where liability of a judge has been determined through a ruling of an international court, which was an obligation Serbia undertook with membership in some international organisations.

The state may be held liable for harm done by a judge in two situations concerning:

- unlawful action of a judge – this concept needs no further explanations
- misconduct of a judge – this idea should be elaborated, which the legislator, unfortunately, did not do. An indication of what may be considered misconduct of a judge may be found in the provisions regulating removal of judge from office due to incompetence, which entail insufficiently effective discharge of judicial duty, if a judge's work has been assessed as "unsatisfactory" by the criteria and standards for the evaluation of judges.

The High Court Council recently adopted a Decision on the Selection Criteria and Standards for the Evaluation of the Qualification, Compe-

³⁰ 'Judicial System Monitoring', an unpublished study prepared by research associates of the Institute of Comparative Law and representatives of the Judges Association within a project of the Fund for an Open Society.

tence and Worthiness of Judges and Court Presidents. We must underline that the Decision contains no specific provisions concerning the criteria, standards or the procedure for assessment of judges elected to permanent office, and the precise scope of the notion of competence of judges elected to permanent office cannot be determined. Furthermore, it is unclear how the assessment of a judge's competence and worthiness affect the overall evaluation of a judge's work. The formulation "unconscientious discharge of judicial duty" adds to the confusion. Together with "conduct unworthy of a judge", it is the basis for launching a disciplinary action against a judge. The Judges Law³¹ catalogues different categories of disciplinary offences and appropriate sanctions, and also specifies what is considered a serious disciplinary offence that may trigger a procedure for removal of a judge from office. The relationship between improper action of a judge, incompetence, unconscientiousness and unworthiness is unclear; in fact, this terminological diversity seems to be a consequence of unaligned terminology taken over from the previous laws, rather than a clear intention of the legislator. The idea of "misconduct" may be assumed to include incompetence and unconscientious discharge of judicial duty, which will probably overlap in some parts. Judicial practice can be expected to provide answers to these questions.

The state may ask a judge to recompense for the damages only if he has been found guilty of intention or gross negligence. This means that the state, like any other legal entity, bears the risk of negligent conduct of a person appointed to a judicial office.

The Judges Law distinguishes two categories of judicial immunity:

- material immunity, as judges cannot be held accountable for opinion or vote given in the course of their work, unless a judge has breached the law³²,
- procedural immunity, which protects a judge from being placed in remand, without approval of the High Court Council, during criminal proceedings for a crime committed in the course of judicial office.³³

This virtually means that criminal proceedings against a judge may be initiated at any moment, regardless of whether the crime was commit-

³¹Article 90.

³²Article 151 of Serbian Constitution, Article 5 of the Judges Law.

³³Article 151 of Serbian Constitution, Article 5.2 of the Judges Law.

ted in the course of his work or outside court, but an authorisation of the High Court Council is needed to place a judge in remand.

The way the immunity of judges is regulated may be justly criticised, because procedural immunity of judges conceived in this way is narrower than the immunity enjoyed by members of the parliament. The previous Constitution contained the same solution and legal experts³⁴ contested that it obviated the principle of separation of powers, while it may also be asserted that it jeopardises the proclaimed independence of the three branches of government. Furthermore, the Law on the High Court Council also sets out that its members enjoy immunity as judges³⁵ – though a much better solution would be if the immunity of the Council members were brought into line with that of members of the parliament. This would enhance the independence of the body and the Council's role in establishing and preserving independence of judicial power in general.

3.6.1. Disciplinary liability of judges

One of the key changes introduced by the new Judges Law has been the introduction of disciplinary liability of judges. Disciplinary offence has been defined as unconscientious performance of judicial duty or conduct unworthy of a judge. The Law lists different categories of disciplinary offence, both minor and serious ones, which aim to safeguard efficiency and independence of a judge's function. The Law also stipulates disciplinary sanctions that may entail public warning, fifty-percent reduction in salary for up to one year and suspension of advancement that may last for up to three years.

The High Court Council sets up the disciplinary bodies: the Disciplinary Commission, Disciplinary Prosecutor and his deputies, selected from the judges. At the proposal of the Disciplinary Prosecutor, the Disciplinary Commission initiates the procedure for removal of a judge from office if the judge has been found guilty of a serious disciplinary offence. In view of the reasons for initiation of this procedure, the Law envisages urgent proceedings closed for the public, unless the judge proceeded against demands that the proceedings be public. A judge has the right to

³⁴Z. Ivošević, 'Sudstvo u Srbiji', cited by Miodrag Radivojevic in 'Položaj i uloga sudske vlasti', published in collection of papers *Kriza i reforma pravosuđa*, CUPS, 2001, Beograd.

³⁵Article 9 of the Law on the High Court Council.

be informed promptly about the proposal of the Disciplinary Prosecutor, to be acquainted with the case and the related documents and to provide explanation and evidence supporting his claims by himself or via an attorney. A judge has the right to present his claims in a direct hearing before the Disciplinary Commission.

Disciplinary Prosecutor and the judge proceeded against may challenge a decision of the Disciplinary Commission by filing a complaint with the High Court Council within eight days from the delivery of the decision. Deciding on the complaint, the High Court Council may affirm the finding of the Disciplinary Commission or modify it. The High Court Council is obligated to decide on the appeal within 30 days from the filing of the appeal. The decision of the High Court Council is final. An effective legal decision on disciplinary sanction is entered in the personal record of the judge.

4. Conclusion

The role of the judiciary, national courts in particular, is pivotal to European integration, though it is often forgotten. The very fact that two of the four criteria apply to the judiciary testifies to the importance of courts. The fulfilment of the two requirements has proven to be a big challenge for national governments. This applies in particular to the first political requirement that entails stability of institutions guaranteeing democracy, rule of law, human rights and respect for minorities and the fourth criterion that requires the capacity of the state to implement EU legislation. Within the framework of this requirement, the emphasis has been placed on independence of judges and other judicial office holders, who represent an important element of the rule of law. The reform of Serbian judicial system started back in 2001, but it has been accompanied by constant modifications of the existing legal framework. In December 2008, a new set of judiciary laws was adopted, which is expected to facilitate fulfilment of the current requirements. The new legislation has introduced crucial changes. The High Court Council was given the power to select judges, with the exception of first election of judges and election of court presidents, whose appointment remains under competence of the National Parliament. Disciplinary liability of judges has been introduced, which will contribute significantly to enhanced effectiveness and responsibility of judicial office holders. A novelty in Serbian legal system is the complaint that may be filed against a decision of the High Court Council,

while the Judges Law sets forth that judges may file an appeal with the Constitutional Court against a decision not to elect a judge or to terminate judicial office. A system of advancement of judges has also been introduced, which is a major change relative to previous legislative solutions.

Nonetheless, some legislative solutions, including the election of judges and court presidents by the National Parliament, may compromise independence of judges. The criteria for selection of judges and court presidents also may jeopardise proper election, as the required criteria are unattainable for our judges, since they are too complicated to be applied in practice and encompass mostly quantitative indicators that may compromise the quality of the work of judges. Some criticism can be levied at the organisation of the High Court Council. Particularly striking is the fact that a special position in the Council is given to holders of political offices – the justice minister and the chair of the respective committee of the National Parliament – simply by virtue of their offices. Finally, the immunity of a judge is narrower than that of a member of the parliament. However, considerable progress has been made relative to the state of the judiciary in 2000.

ADMINISTRATIVE CAPACITY, EUROPEAN INTEGRATION PROCESS AND CHALLENGES OF THE CRISIS

Tanja Mišćević, Ph.D.¹

Discussions about the process of European integrations today, both within the European Union (EU) and in prospective member states (candidate countries and potential candidates), somewhat strangely fail to focus on the requirements that need to be met: the standards and European values. All of a sudden, the main topic has become the *Enlargement fatigue*. This term was coined four years ago, but its importance has grown with the crisis in the Union. Naturally, this has had an impact also on the EU candidate countries and potential candidates, themselves affected by the economic downturn.

At times, it appears as if the European political elite is trying to hide behind its public opinion, by introducing the concept of the fatigue into the context of a lack of support for discussion. Nonetheless, there seems to be no understanding that the emergence of the fatigue in the EU has engendered lethargy of public opinion in the EU aspirants – as the latest opinion polls indicated. In fact, we have arrived at a point where we need to inquire into the causes and the main reasons for this mutual weariness. This article will discuss some of the key issues.

Crisis in the EU and its impact on the enlargement policy

Actually, before the Treaty establishing a Constitution for the EU fared badly on referendums in France and Netherlands (May and June 2005), the European Union held a very positive view of further enlarge-

¹Faculty of Political Science, University of Belgrade

ment. After the “Big Bang”² in 2004, when the EU expanded to include eight countries from Central and Eastern Europe, together with Malta and Cyprus, the enlargement enthusiasm of the public and the politicians in Europe seemed unabated. This galvanised expectations of the Western Balkan states (Croatia, Bosnia and Herzegovina, Serbia, Montenegro, Macedonia and Albania), the only region in Europe remaining outside the EU, but on its way toward full membership. Their EU integration progresses finally were in full swing, especially after the Stabilisation and Association Process was promoted and the Thessaloniki Agenda adopted in 2003. In fact, the Thessaloniki Agenda for the Western Balkans³ has enhanced the process with features previously defined in the pre-accession strategies for countries of Central and Eastern Europe in the later stages of their association. Modelled on the pre-accession arrangements, a partnership for European integration, *European Partnership*, was introduced. The individual partnerships for each Western Balkan country formulated short-term (one or two years) and medium-term (three to five years) priorities that would dictate the tempo of political, institutional, legal, economic and other reforms. The Thessaloniki summit initiated a multilateral political forum between the European Union and the Western Balkans, as the focal point where a would-be candidate country can communicate information on progress and where the framework for dialogue on key issues of common interest is created. This political forum has advanced the process further through periodic meetings of the heads of states or governments and annual meetings of ministers of foreign affairs, interior, justice and others, if necessary. As of 2004, the Western Balkan states have also had access to Twinning programmes (institution building assistance for EU aspirants provided by experts seconded by the EU) and TAIEX (Technical Assistance Information Exchange Office) in order to ensure alignment of the countries’ legislation with the *acquis communautaire*. These countries have also benefited from community programmes that are otherwise accessible only to the EU member states (e.g. *Progress*, *CIP*, Framework Programmes, *Erasmus Mundus*, etc.).

In 2005, the Stabilisation and Association Process gathered momentum and opened up entirely after it was decided to start negotiations

²A colloquial term often used for the 2004 and 2007 enlargements, e.g. as in the report *Big Bang, Smaller Shocks, 2004 Enlargement Impact on EU Policies and Processes*, Burson-Marsteller, Brussels, 2006.

³*The Thessaloniki agenda for the Western Balkans: Moving towards European integration*, <http://www.eudelyug.org/en/documents/Agenda.doc>

on stabilisation and association agreements with all the remaining Western Balkan states. At the same time, membership talks were also opened with Croatia and Turkey, signifying a substantial progress in the EU enlargement policy. In December of the same year, the decision on autonomous trade measures applying for Western Balkans was renewed with the aim of being implemented until the association agreements come into effect. Simultaneously, the second half of the year was marked by the onset of the crisis in the EU after the Treaty on EU Constitution floundered and the blame game began.

Two states negotiated their Stabilisation and Association Agreements in 2006 (Serbia and Montenegro, Bosnia and Herzegovina), Albania signed its Agreement, while Croatia and Macedonia were granted the EU candidate status – the first country was also given a date for opening of the membership talks, while the latter was not. The Union itself has gained new impetus after the big enlargement: as a much larger market, it attained a high level of economic development, particularly in the new member states, and was preparing to admit two more countries, Bulgaria and Romania, at the beginning of 2007. Despite the apprehensions prior to the enlargement concerning the ability of the many new member states to integrate into the agenda and activities at the EU level, and about their individual reactions, it seems that the Union has only had considerable political and economic benefits from the expansion.

Contrary to the popular view and frequent pretext that enlargement cost is the main problem in the EU, the results clearly repudiate such arguments. To evaluate the enlargement success by relying on objective indicators, the European Commission prepared a report and presented its analysis of the economic effects of the enlargement.⁴ The Commission concluded this was not only the largest enlargement ever, but also a step forward toward unification of Europe that has made the EU stronger and culturally richer. The enlargement process has helped build and consolidate democracy, strengthen European security, but also prepared Europe to tackle the challenges of globalisation by making it far more competitive. The European economy today accounts for 30% of global GDP and for over 17% of global trade. Trade between the old and new member states only almost tripled in 10 years (from 175 billion in 1999 to 500 billion in 2007), while trade between new member states grew five times (from 15

⁴Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank, *Five years of an enlarged EU – Economic achievements and challenges*, Brussels, 20.2.2008, COM(2009) 79/3.

to 77 billion!).⁵ Before the economic crisis erupted in late 2008, employment grew at a stable one-percent rate. The pre-accession claims that jobs would be transferred to new member states proved wrong – this level of employment growth was the average for all the EU countries.

Another immense concern before the enlargement was related with potential hindrances that a large number of member states might create in the EU decision-making process. This also proved to be unfounded. On the contrary, instead of having serious disagreements between the increased number of member state representatives and their respective interests, there have not been any major instances of official or high-scale conflict in the decision-making process, primarily in the Council of the European Union. Some analysts find the official statements, which are included in minutes of the Ministerial Council meetings, to be the reason for the practically smooth legislative process despite the enormous variety of national interests involved.⁶ These official statements represent member states' reservations or strong opposition with regard to particular issues, even in cases when such views were not expressed during the vote. In this way, decisions can be reached, while the member states can maintain the right to highlight their idiosyncrasies, which are important to them. Another possible explanation for the phenomenon is the consensus, which is used frequently in the decision-making process – it takes more time to reach one, but it is also more efficient, as it represents a cross-section of all the interests involved.

Despite all the positive indicators and the (definitely not straightforward) progress the countries have made in European integration, things went awry somehow. The fiasco of the Constitutional Treaty, writing of the new reform treaty, which was dubbed the Lisbon Treaty in December 2007, and its failure to pass the 2008 referendum in Ireland, all brought the EU crisis to its culmination. The new Treaty, a result of the need to compromise after the EU Constitution was rejected, was meant to resolve the issues concerning enhanced efficiency, promotion of democratic legitimacy of the enlarged Union and the coherence of its foreign policy. The Treaty was signed in Lisbon, in December 2007,⁷ and con-

⁵*Five years of an enlarged EU – Economic achievements and challenges*, European Economy, No. 1/2009.

⁶For the impact of the enlargement on the EU decision-making process, see, for instance: Sara Hagemann and Julia De Clerck-Sachsse, *Old Rules, New Game – Decision-Making in the Council of Ministers after 2004 Enlargement*, Centre for European Policy Studies, March 2007, ISBN 978-92-9079-699-2.

⁷The English text of the Treaty is available at the following webpage <http://www.consilium.europa.eu/showPage.aspx?id=1296&lang=en>. The Serbian translation of changes introduced by the Lisbon Treaty can be found in: *Reformski ugovor EU iz Lisabona*, translated and edited by Milutin Janjević, Službeni glasnik, Beograd, 2008.

tained no emblems of constitutionalism, no EU symbols, no renaming of secondary legislation (decisions) into laws or framework laws. On the other hand, to improve the EU efficiency, it simplified the methods of work and voting procedures in order to streamline the functioning of the EU of 27. Qualified majority decision-making was extended to 50 new areas.⁸ The EU citizens were to be involved directly in the EU decision-making, as one million of them would be able to make an initiative calling on the EU Commission to make a proposal (in the area of justice, freedom, security, fight against terrorism, fight against racism, combating organised crime, energy policy, public health, humanitarian aid and sports). The EU would get a President of the European Council for the first time, who would only chair meetings of the member states' foreign ministers. The President would be elected by the European Council for a term of two and a half years, and be directly connected with the election of the European Commission President and results of the European Parliament elections. The six-months rotating presidency would still apply for other configurations of the Council. The role of the President of the European Council would be to provide continuity and efficiency of work of the European Union and its institutions. The Lisbon Treaty also envisaged that the composition of the European Commission would remain unchanged until 31 October 2014 and each member state would retain its own representative in the Commission. After that date, the Commission would operate on a system of rotation, established unanimously by the Council of Ministers.

In response to the problem of making the EU more democratic and more transparent, the Treaty offers to strengthen the role of the European Parliament and national parliaments, by providing more opportunities to hear the voice of the EU citizens and introducing a clear division of competences in a multi-level system of governance. The European Parliament would receive new powers concerning lawmaking, the EU budget and approval of international agreements. Special emphasis should be placed on the fact that the Lisbon Treaty envisages increased use of the co-decision procedure, which would become the prevailing decision-making method for a major part of legislation. National parliaments would have a greater chance to participate in the EU work, particularly due to a new mechanism

⁸Starting from 2014, the calculation of qualified majority voting will be based on the double majority (member states + people), which is achieved when a decision is taken by 55% (at least 15) of member states representing at least 65% of the EU population. The period between 2014 and 31 March 2017 will be a period of transition, during which member states can still demand that decisions be reached through the decision-making model established by the Nice Treaty.

for monitoring the EU activities, which guarantees that the Union would act only when action would be more effective at the EU level (subsidiarity principle). The Treaty also reinforces and details European values, stipulating that membership would be granted only to European countries that not merely observe, but also further these values. The Charter of Fundamental Rights would become a binding document, an integral part of the Treaty, thus gaining legal force in the process.

As regards strengthening the role of the EU in the international arena, the Treaty envisages promotion of this role by introducing the new position of a High Representative for Foreign Affairs, who would also be a Vice-President of the EC and be assisted in his or her work by the new External Action Service. This is expected to increase coherence and visibility of the EU's external action.

However, these solutions did not receive support in Ireland. To solve the problem of ratification of the Lisbon Treaty and mollify Ireland, member states had to make further concessions to the country in view of the new referendum it was to hold. These amendments were not to be quintessential or extensive modifications of the Treaty, as this would require a re-vote of the Treaty in all the states that had already ratified it. After several months of talks, at its summit held in December 2008, the European Council decided to make additional concessions to Ireland once the Lisbon Treaty comes into force. When that happens, the European Council will decide that the Commission should not change the number of its Commissioners – and each member state would continue to be represented by one Commissioner even after 2014. Furthermore, Ireland would get additional legal guarantees concerning three issues: the Treaty of Lisbon would not extend the EU competencies to fiscal matters, it would not influence the security and defence policies of the member states (particularly in view of the Ireland's policy of neutrality) and giving of legal status to the Charter of Fundamental Rights would not affect the provisions of the Ireland's Constitution concerning the right to life (no abortion ban).⁹ The legal basis for the exceptions would be probably a Protocol on Ireland that would accompany the Treaty of Lisbon and be signed by all the member states. The Protocol would be ratified together with the next (at this moment, probably Croatian) accession treaty.

⁹For more on this subject: Sebastian Kurpas, Piotr Msciej Kaczynski, *Inching towards a Second Irish Referendum*, CEPS Commentary, 15 December 2008, <http://www.ceps.eu>

The crisis in the EU, inaugurated by the failed attempts to adopt amendments to the founding treaties, has deepened with the growing economic and financial recession at the beginning of 2009. At the same time, 2009 is the election year for the European Parliament, which involves appointment of a new European Commission, not to mention national elections in some member states (Germany, in particular). The results of the European elections, which were held in June 2009, show that the composition of this body has shifted to the right of the political spectrum, with a hefty defeat of the socialist and entry of the extreme right.¹⁰ Though the results flabbergasted the public initially, this may not be a real problem, because every time the European Parliament comprised a large number of representatives of Christian democratic parties, it promoted deeper integration – as the moves toward completing the single market and creating the monetary union demonstrated.¹¹

Crisis in the EU – the effect on administrative capacities of the EU candidate countries and potential candidates

Naturally, the outlook is not very bright in countries aspiring to join the Union either, as they are definitely more affected by the global financial and economic crisis. The fact that they are outside the European Union is not insignificant, as they may profit only slightly from any EU response to the crisis. Furthermore, at this point they all face all sorts of more or less serious troubles, which pose various threats to their association and pre-accession efforts. One of the major problems confronted by the only would-be EU region remaining outside the European Union is the absence of a strong consensus on adopting the European values, on the one hand, while pursuing the membership, on the other hand. The refusal to realise the imperative of the consensus is typical for both the population and the political elites.

Nevertheless, the EU has also failed to foster the necessary attainment of European values – there has been no clear strategy or vision for the future of the Union or its enlargement. This state of affairs is particularly unsustainable in the time of the crisis and “enlargement fatigue”. The combination of the above has secured continuation of activities on

¹⁰Official results can be seen at <http://www.elections2009-results.eu>

¹¹Further information: Desmond Dinan, *Europe Recast – A History of European Union*, Lynne Rienner Publishers, London, 2004.

the EU enlargement, but without any substantial success, while the public in the Western Balkans has become only slightly familiar with the by no means simple obligations involved in the process. The obligations may be political, economic and legal, or specific, created individually for each group of the associated countries, depending on their overall position. It seems that the main culprit for the economic crisis and budget deficits in the Western Balkan countries has been found in the public governance or state administration. This may be perilous, of course, as appropriate administrative capacities are a precondition for a country's European integration. This criterion was introduced at the European Council meeting in Madrid in 1995.¹² At that point, a new requirement was added to the 1993 Copenhagen criteria: the necessity for an EU candidate country to have appropriate administrative capacities and be able to effectively meet the membership obligations. More precisely, the condition to have administrative structures fit to take on the obligations of membership was only reinforced on that occasion, as it had been already contained in the third Copenhagen criterion and the need to adopt the EU standards. The reason for placing special emphasis on this criterion was the fact that administrative institutions of a future EU member state would have to take charge of the transition and harmonisation on the road toward the EU. From this perspective, administrative capacities refer to a range of features of public administration setup with regard to public policy implementation and successfulness; it is the ability, preparedness and potential of the administration to accept and apply EU policies in an efficient and effective manner.¹³ Such strengthening of institutional and administrative capacities, also known as administrative modernisation, is particularly prominent where the political factor of EU approximation is involved – the topic of administrative modernisation is in the centre of the debates concerning the enlargement.¹⁴ Adjustment and modernisation of administrative capacities as a precondition for a country's approximation toward the EU membership is frequently referred to as Europeanisation of state administration – a result of the Union's influence on development of governance in the EU

¹²Madrid European Council, *Presidency Conclusions*, http://www.europarl.europa.eu/summits/mad1_en.htm

¹³See also: Toni Verhejen, *Upravljanje evropskim poslovima u zemljama kandidatima za članstvo: popis trenutnog stanja*, u SIGMA Radovi br. 23, Priprema državnih uprava za evropski administrativni prostor, Evropski pokret u Srbiji, Kancelarija za pridruživanje EU Vlade Srbije, 2006, p. 19.

¹⁴Frank Bollen, *Capacity Building for Integration – Managing EU Structural Funds: Effective Capacity for Implementation as Prerequisite*, EIPA, Maastricht, 2001

candidate countries.¹⁵ This is the outcome of the need for administrative structures of a candidate country or potential candidate to concentrate on developing strategies and competences so as to maximise their chances to efficiently align with the agenda. Typical aspects of administrative capacity include quality of civil servants, specific organisational characteristics, relationships between various organisational units within the structure and the style of interaction between administrative structures and their socio-economic environment. The European Union channels the capacity issue toward search for solutions that would help the candidate country or potential candidate develop its administration's ability to define and resolve the problems that are bound to emerge in the process of meeting the EU membership requirements. The work of such administration must be based on certain assumptions – and the basic principles include efficient and effective implementation of the *acquis*, openness, participation, accountability, effectiveness and coherence.

The administrative capacities required for the European integration process can be viewed from a horizontal or vertical perspective. Horizontal capacities refer to the need to create structures that will secure coherence, transparency and efficiency of the efforts – the institutions to coordinate the process of European integration. On the other hand, vertical capacities are related with sector capacities and adjustments in various sectors – for instance, agriculture, transport or environment. Actually, their main goal is harmonisation with the *acquis*: the passing of aligned legislation and its effective implementation.

Evidently, in the time of a serious economic crisis, public administration reform and capacity building come under great pressure. Candidate countries and potential candidates are wedged between their main objective, the EU approximation, and the overstrained government budgets that cannot sustain any increases, but require cuts instead. This is not an easy task, particularly in the light of the demands made by the European Commission with regard to public administration reform. These demands are made clear in annual Progress Reports for candidate countries and potential candidates. Through these Reports, the Commission gives an assessment not only of the number and structure of civil servants, but also of the procedures they apply in their work and their respective budget appropriations.

¹⁵On Europeanisation of governance in the pre-accession process see, for instance: Heather Grabbe, *How Does Europeanisation Affect CEE Governance? Conditionality, Diffusion and Diversity*, Journal on European Public Policy, Vol 8, Issue 4, December 2001, p. 1013-1031

The European Commission's assessment of a candidate country's or potential candidate's administrative capacities is presented in two parts of the report: in the one directly related with the capacity issues and in the section concerning political conditions (democracy and rule of law).¹⁶ In one of its segments, the report reviews the five main areas that affect administrative capacities: elections, the legislative, executive and judicial sectors and anti-corruption policy. It provides evaluations regarding functioning of the institutions of the executive, judiciary, local authorities and state administration, as well as those related with financial matters and financial control mechanisms. The central part of the evaluation concerning this criterion, which is included in the report after the political and economic criteria and European standards, is a special chapter dedicated to administrative capacities for implementation of the *acquis*.

The most interesting, but also the most difficult task placed before candidate countries and potential candidates is the need to create appropriate regulatory bodies and facilitate their work. These new bodies are established in line with relevant legislation by the parliament, instead of by a government agency, and are guaranteed complete (even financial) independence in their work in order to be able to regulate their respective areas without any interference. These bodies are set up to regulate the rights concerning competition, telecommunications, environmental protection, public financial control or fight against corruption. This serves actually to diminish the government's involvement in these areas, by creating room for competition, while reducing the opportunities for corruption. Nonetheless, it is the main cause of the problems they face— even if the relevant legal provisions exist, the functioning of these regulatory bodies is fraught with conflicts arising from the fact that the state agencies fail to reconcile with curtailment of their powers in areas in which they used to be the absolute authority. The significance of a positive evaluation concerning functioning of these bodies grows as the country's membership in the European Union approaches.¹⁷

Another hindrance in the time of the crisis is the fact that the Commission has become much more rigorous in its evaluations of the Western

¹⁶European Commission reports are available at the EC website: http://europa.eu/pol/enlarg/index_en.htm

¹⁷Serbia is an epitome of this: While the 2006 Progress Report for Serbia focused on adoption of relevant legislation regulating protection of competition in line with the *acquis*, the 2007 Report cited that the Competition Commission and Committee had been established and presented a new demand for Serbia to fulfil: securing smooth operation of these bodies. The reports may be viewed and compared at the website: www.seio.gov.rs

Balkan countries in all areas, including the existence of the appropriate administrative capacity for implementing membership obligations.¹⁸ Furthermore, a problem specific to the region is seen as the need for the European Commission to "...continue to further improve the quality of the enlargement process. Enlargement policy will put more emphasis on the fundamental issues of state-building, good governance, administrative and judicial reform, rule of law..." because institution building and good governance, in particular, in Western Balkans remain a matter of great concern for the European Union.¹⁹ Budget constraints brought on by the crisis have limited the possibility of fulfilling the requirements concerning a country's appropriate administrative capacities in charge of the EU integration and eventual EU membership. It seems even more difficult if the process is perceived as it really is, as Europeanisation, or an "...impact of the EU accession process on the national modes of governance..."²⁰ or "a sort of a virtual policy in which the political agents, particularly those on the national level, strive to fulfil the EU demands".²¹ The danger lies in the fact that modernisation or Europeanisation requires the administrative structures to redefine their position within society in order to recreate their relationships with political parties, business community and the civil society. The ideal opportunity to establish a new and independent position for public administration is the time of the country's biggest transformation, when it is preparing for EU membership and applying the EU models. With the crisis present both at the national and the EU level, this concept will be seriously tested.

This brings us to the state of affairs in Serbia – in the midst of the process of European integration, administrative capacity building and attempts to respond to the crisis. Needless to say, in eight years of its Stabili-

¹⁸See also: Dimitry Kochenov, *Behind the Copenhagen facade: The meaning and structure of the Copenhagen political criterion of democracy and the rule of law*, European Integration online Papers, Vol. 8 (2004), No. 10, <http://eiop.or.at/eiop/texte/2004-010a.htm>, p.13.

¹⁹Communication From the Commission to the Council and the European Parliament – *Enlargement Strategy and Main Challenges 2007-2008*, Brussels, 6.11.2007, COM (2007) 663 final, http://ec.europa.eu/enlargement/pdf/key_documents/2007/nov/strategy_paper_en.pdf

²⁰Heather Grabbe, *How Does Europeanisation Affect CEE Governance*, p. 1013-1031.

²¹Jurgen Dieringer, Nicole Lindstrom, *The Europeanisation of Regions in EU Applicant Countries*, Paper for the 7th EACES Conference, Forli, June 2002.

sation and Association Process, Serbia has constantly tackled major internal political problems, which have hampered its progress toward EU membership, despite its good administrative capacities. A great disadvantage to Serbia throughout these years has also been the status issues (formation of the state Union, non-functionality of the relations within the Union, the question of the future status of Kosovo, cooperation with the International Criminal Tribunal for Former Yugoslavia), which have consumed a lot of time and turned political capacities away from the EU integration. In these circumstances, there was no elbow room for a real political consensus on the EU to be reached between major political figures in Serbia.

A serious problem Serbia is facing is the fact that the Stabilisation and Association Agreement (SAA) still has no legal effect, because the implementation of the Interim Agreement was recalled and has been awaiting the Council of Ministers' decision that Serbia is fully cooperating with the ICTY ever since the SAA was signed in April 2008. This has created a twofold problem: a serious precedent has been established in which the weaker party (Serbia) reduced its customs tariffs and has been applying the Agreement unilaterally as of 1 February 2009, while it was unable to move on to the next formal step and file the application for EU membership. Still, the EU integration process is far from interrupted – on the contrary, though overshadowed by the big political criteria, it continues with adoption of numerous regulations in the area of agriculture, environment etc. This momentum has been supported by the new Rules of Procedure of the Parliament, which have cut the time available for discussions and decision-making. The proof of progress is the alignment with the roadmap for visa liberalisation, while the news that the European Commission may decide to alter the list of countries whose nationals need a visa is a signal that the situation is improving.

As regards administrative capacity, the performance of the Serbian European Integrations Office continues to receive good evaluations, but the opinion that Serbia has not been successful enough in implementation of sectoral policies and building of regulatory bodies, which are highly important for harmonisation with EU rules, has also persisted. In fact, a large number of new and harmonised laws are not a sufficient argument for advancement, because the legislation needs to be implemented effectively as well. The issue of the capacity of local authorities has not been delved into properly, which is a major error, as implementation of European rules and standards applies not only to Belgrade, but also to the local levels. The question of regionalisation is seen through the prism of political connotations only, without taking into account its most important element, de-

mocratisation, or the economic and developmental potential it may create for a region. There are frequent criticisms as to the size of our administration, while there is no knowing how many people we really need.

Following the lead of many states, the Serbian Government responded to the global financial crisis with expenditure cuts, which have affected mostly the public administration and local authorities. These measures may have a side effect – dissatisfied with their wage and facing further salary cuts, the most qualified individuals may leave the public administration. To avoid that, it would be necessary to create various incentives, including further training (which is yet another thing they are denied currently), faster advancement, higher salary grades etc. Also, the saving measures must be accompanied by a systemic analysis of the required employee profiles, which is something that has been announced by the Regulatory Reform Council.

The necessary rationalisation must recognise the fact that administrative capacity is not all about a specific number of persons aligning and coordinating the EU integration efforts, or meeting the obligations emanating from the process. This kind of thinking would increase the numbers of civil servants and weigh down on public coffers even more. The number of persons forming a country's administrative capacities must be sufficient to cover the needs of all sectoral policies on the central, local and regional level, and to maintain coordination of the process from the centre, but it is much more important that civil servants possess specific qualities. The entire administrative system must be open and accountable in order to enable communication with citizens and any stakeholders in the society. The capacities that have received good evaluations must be preserved, as the country hopes to face the moment when the process will be accelerated any time soon. This moment will be the start of membership negotiations – the structures (both administrative and political) in Serbia are already readying themselves for the next step, though opening of the accession talks is at least two years away, even in the best case scenario. Administrative structures must be prepared to take charge of the negotiations, which require a particular setup, know-how and skills.²² Furthermore, the political elites must back fully the arrangements with

²²For these reasons, 35 working groups have been formed, corresponding with relevant negotiation chapters of the *acquis*. Also, the National Program for Integration of Serbia into the EU was formulated in November 2008 as an agenda of all the activities Serbia needs to undertake until its entry into the EU, i.e. until the moment when Serbia will be ready to assume all the obligations of the EU membership. The National Program for Integration of Serbia into the EU is available at the website: <http://www.seio.gov.rs/code/navigate.asp?Id=2>

the European Union, which entails specific knowledge and skills, but also the existence of political will.

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SERBIA'S EU ACCESSION SEEN THROUGH THE PRISM OF COMPETITIVENESS OF SMALL AND MEDIUM-SIZED ENTERPRISES

Ana S. Trbovich, Ph.D.¹

Business-enabling environment

Economic development by means of reforms, foreign direct investment and promotion of entrepreneurship were among Serbia's logical priorities when the country reopened to the world and was attempting to rebuild the broken economic ties, including those of European integration, after the political watershed in 2000. Serbia has taken large strides in improving the investment climate and the overall business environment. The success has drawn on the Law on Foreign Direct Investment as one of the first laws adopted by the first Serbian democratic government of the 21st century, but also on other laws, such as the Law on Business Registration.² Associations representing foreign investors, such as the Foreign Investors Council (FIC), American Chamber of Commerce and other foreign business associations and economic diplomatic representatives, have actively contributed to advancement of the business climate in Serbia. The FIC White Book has played an important role in this process, as a document that

¹Faculty of Economics, Finance and Administration – FEFA, Belgrade. The author wishes to express her thanks to Jovanka Jovanović (Serbian Ministry of Economy and Regional Development), Dejan Trifunović (Serbian Chamber of Commerce) and Natalija Sandić (FEFA student) for their contribution to this study. The study relies partly on CEVES report *International Competitiveness and Economic Growth of Serbia*, November 2008. In terms of methodology, the present analysis follows the guidelines of the European Charter for Small Enterprises.

²The number of days needed to start a business was reduced from 51 to 5 days and to 1-3 days for sole-traders, while the minimum required capital was decreased almost ten times (from \$5 000 to €500 in 2004).

identifies the weaknesses and proposes measures to improve the conditions for foreign investment and generally doing business in Serbia. On the other hand, the managers of small and medium-sized enterprises have not had a legitimate representative, except within the Serbian Chamber of Commerce or the Union of Employers, where large enterprises have often been dominant. The voice of the small and medium-sized enterprises was directly heard for the first time in the 2008 Out of the Maze campaign of the National Alliance for Local Economic Development (NALED), when they were given an opportunity to suggest changes to the Serbian business regulations.³

Systematic efforts to improve Serbia's investment climate were launched in June 2004, when the government adopted the Action Plan for Removing Obstacles to FDI and established the inter-ministerial Commission for Economic Development to monitor the implementation of the strategic document. Two years later, in March 2006, the Serbian Foreign Direct Investment Strategy was also adopted. Although the Strategy has set out solid guidelines, the defined deadlines have not been observed from the very beginning, which has undermined the significance of this document as the cornerstone of an enabling business environment in Serbia.

Yet, one must not neglect the fact that investment climate is not identical to a country's business environment. To advance the business environment, conditions conducive to all business – foreign and domestic, large and small – should be created. In the first years of reforms, after the political watershed in 2000, the SME sector received less attention from the Serbian executive and legislative authorities than the large foreign investors, partly due to a lack of a legitimate representative of the SME sector in Serbia. To create the best business environment, Serbia should work on creating favourable conditions for small and medium-sized enterprises, regardless of their country of origin, while still giving special attention to foreign investors, which bring into Serbia the much needed capital, new technologies, access to foreign markets, modern business methods and higher business and export potential. Notably the small and medium-sized enterprises account for almost 99.8% of all companies in Serbia, and they are heavily concentrated in Belgrade and South Bačka District, where 40 percent of the total number of registered small and me-

³More on this subject in the text below and on <http://www.naled-serbia.org> website. An exception to the rule is the less-known poll conducted by the Union of Employers in 2006: Union of Employers, Development Problems of Small Entrepreneurs in Serbia and Proposed Solutions, Belgrade, 2006.

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

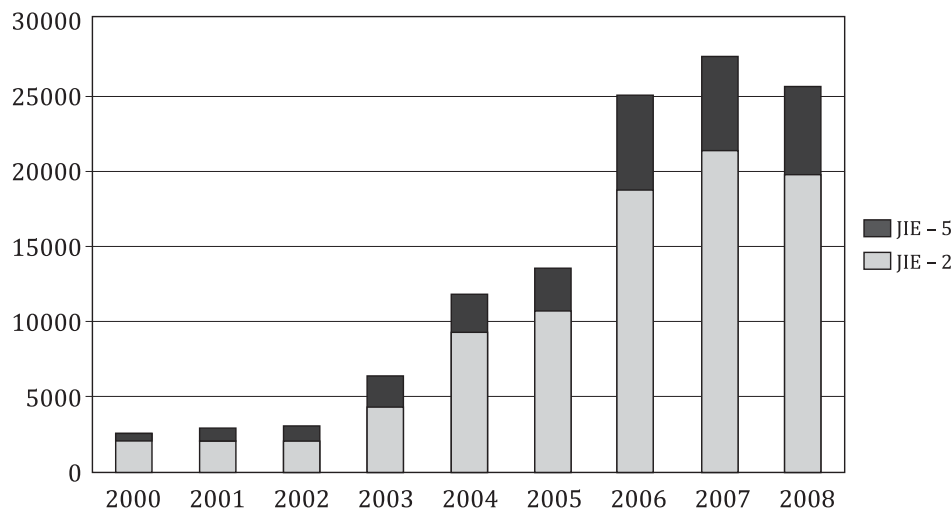


Figure 1: Foreign direct investment in South East Europe 2008 (net, USD million; SEE-2: Bulgaria, Romania; SEE-5: Albania, BIH, Macedonia, Serbia, Montenegro; source: European Bank for Reconstruction and Development, 2008)

dium-sized enterprises operate. Future focus should be on strengthening the less developed regions⁴, because the SME sector in Serbia currently creates 67% of employment, 55% of GDP and almost 50% of exports.

Between 2001 and 2006, Serbia recorded foreign direct investment growth, on average, which peaked in 2006 (USD 4.3 billion). However, after 2006, the foreign direct investment inflow into Serbia has nearly halved (USD 2 billion in 2007, USD 2.36 billion in 2008).

Of 181 countries ranked by the World Bank's Doing Business Report, Serbia was 94th in 2008, falling by 26 notches compared to 2006. Among the former Yugoslav republics, Montenegro fared better and took 90th place, Macedonia was 71st, while Slovenia, the only FRY country that performed better than Serbia in 2006, moved even higher into 54th place. Hence, beside the statistical overview and country rankings for a specific year, the analysis can be viewed from a dynamic perspective, as a measure of a country's advancement on the World Bank's *Doing Business* list. A dynamic comparison measures the efforts made by the public ad-

⁴See <http://www.merr.gov.rs/>, "Sektor MSP jedan od ključnih stubova ekonomskog razvoja", Belgrade, 19 May 2009.

SERBIA'S EU ACCESSION SEEN THROUGH THE PRISM OF COMPETITIVENES

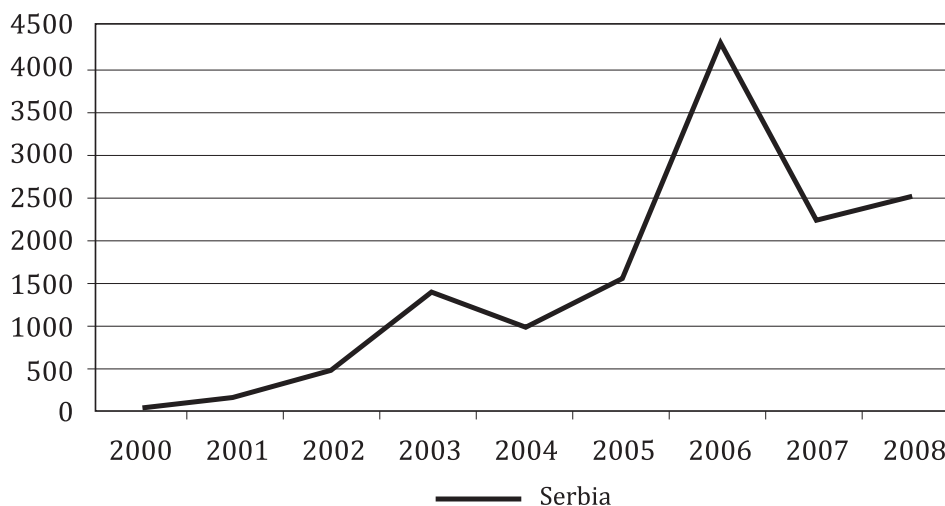


Figure 2: Foreign direct investment into Serbia, 2000-2008
(net, USD million; source: EBRD, 2008)

ministration to reduce the administrative burden for business, simplify procedures and accelerate the processes etc. In other words, it evaluates the steps taken to develop the private sector as the undisputed engine of future economic growth. Serbia was declared the champion of reform by the World Bank in 2006. In 2007, though it was not among the top ten reformers, the customs reform implemented in Serbia stood out as one of the three boldest and the most effective reforms in the world.⁵ However, the efforts to ameliorate the business environment in Serbia in the last year observed (2007-2008) were modest. The transfer tax rate was slashed from 5% to 2.5%, and the total costs of title registration declined in turn from 5.35% of the property value to 2.85%⁶. Apart from the tax rate cut, Serbia has not conducted any major reforms that would enhance the business environment, given that its rating has deteriorated. Although Serbia was commended for the progress it made, it also joined the list of countries whose policy measures have in fact worsened the business environment. The time required to issue a licence in the Belgrade Sec-

⁵The International Bank for Reconstruction and Development/ The World Bank, *Doing Business 2007: How to reform; comparing regulation in 175 economies*, 2006, 3.

⁶Belgrade Centre for Advanced Economic Studies (CEVES)/USAID Serbia Competitiveness Project, *International Competitiveness and Economic Growth of Serbia*, November 2008.

retariat for Urbanism soared to as much as 75 days, and Serbia ranked only 171st out of 181 countries in terms of granting of building permits, a service that is one of the key preconditions for promotion of entrepreneurship and a factor in foreign investors' choice of investment destination. Furthermore, relative to other countries in Europe and the region, Serbia is a foot-dragger in creating environment conducive to small and medium-sized enterprises, despite the certain progress it made last year.⁷ After it changed its Rules of Procedure in 2009, the National Parliament of the Republic of Serbia adopted a set of reform laws within a short time period. Now efforts should be directed at implementation of the laws in order to improve the business environment and, by the same token, Serbia's rankings in international reports.

Serbia's current ranking in these surveys is not favourable, because it is only at the level of the Western Balkan average⁸, while it lags considerably behind the countries of Central and Eastern Europe⁹ that already joined the EU. According to the World Economic Forum rankings, Serbia took 85th position out of 134 countries. Notwithstanding a small progress year on year (when it was ranked 91st), Serbia was still merely at the level of Western Balkan average (average ranking of these countries was 86), while the gap relative to the countries of Central and Eastern Europe (whose average position was 56) was immense.¹⁰

Figures 3 and 4 show the factors named by the companies as the biggest hindrances to business in the 2008 and 2007 polls. The biggest obstacle from the viewpoint of companies was political instability. Corruption was second, followed by the red tape. Two years in a row, these three factors were cited as the most problematic, which highlights the lack of any major progress in enhancing the business climate with regard to the services the state provides to companies. The order has changed, however. While the red tape was seen as the prime problem in 2007, it was pushed back by political instability in 2008, in the aftermath of several extraordinary elections held in Serbia over the last two years. This suggests

⁷See *SME Policy Index 2009*, <http://www.investmentcompact.org/dataoecd/7/25/43084042.pdf>.

⁸This group of countries includes: Albania, Bosnia and Herzegovina, Macedonia, Croatia and Montenegro.

⁹In this text, this group of country encompasses: Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia.

¹⁰Belgrade Centre for Advanced Economic Studies (CEVES)/USAID Serbia Competitiveness Project, *International Competitiveness and Economic Growth of Serbia*, November 2008.

SERBIA'S EU ACCESSION SEEN THROUGH THE PRISM OF COMPETITIVENES

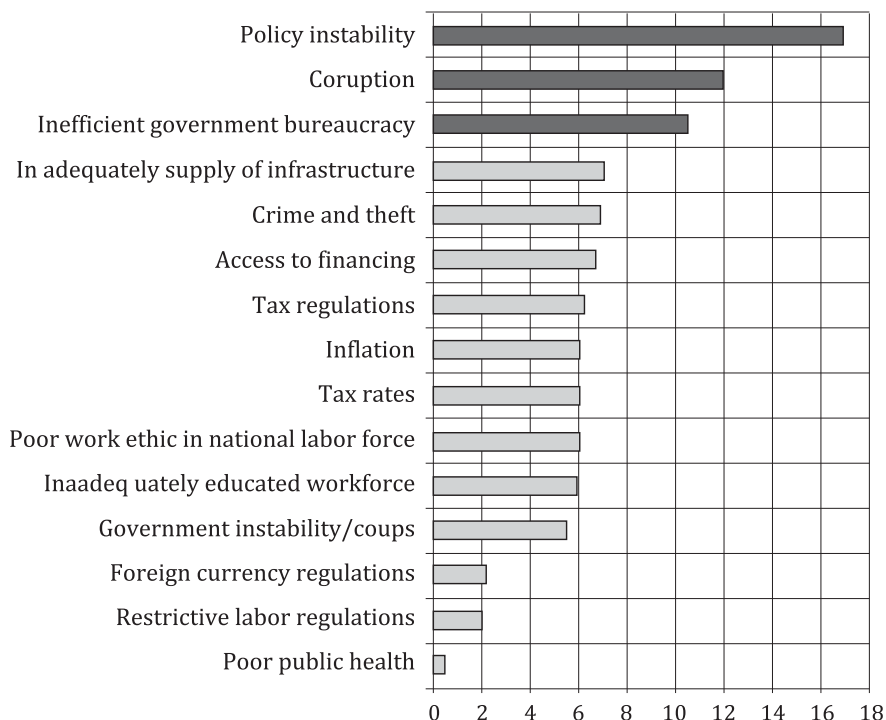


Figure 3: The most problematic factors for doing business 2008-2009, (source: Global Competitiveness Report);

that, despite certain advancements, the public administration will have to do much more to create a favourable business environment.¹¹

According to the European Bank for Reconstruction and Development (EBRD), Serbia is only halfway through its transition, in the middle of the process of switching to an effective market economy. The growing unemployment underpins this statement, while the key assumption for a successful completion of transition is job creation. According to EBRD indicators, this goal is much more distant for Serbia than it is for the majority of the neighbouring countries, and particularly for those that already joined the EU.¹²

Though Serbia is the leader in the region in terms of growth, EBRD has pointed out that one of the reasons for this is the low base, while Ser-

¹¹European Bank for Reconstruction and Development, *Transition Report 2008*.

¹²Ibid.

IMPACT ASSESSMENT OF SERBIA'S EU ACCESSION

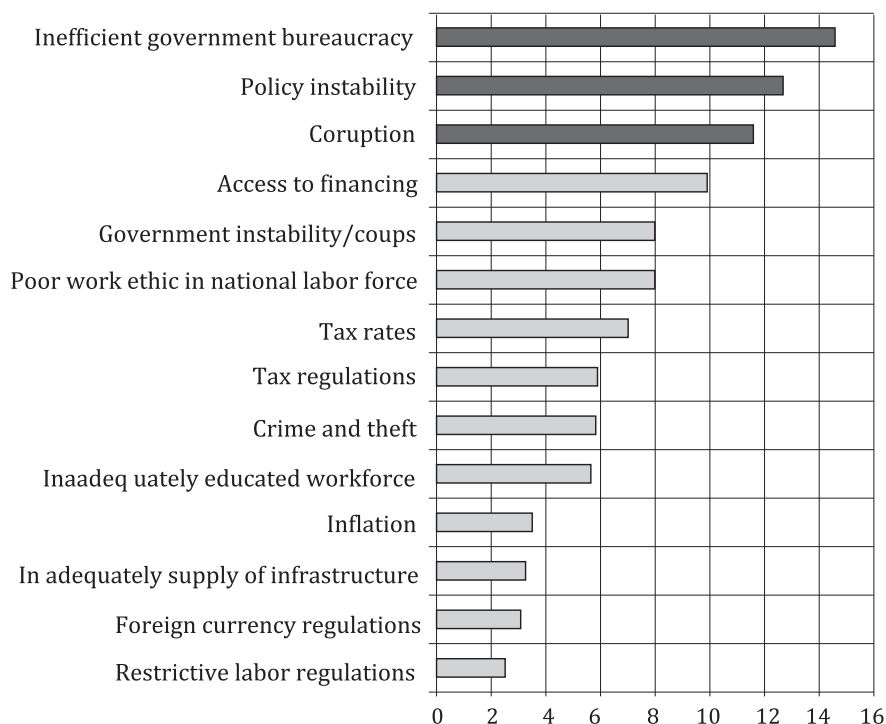


Figure 4: GCR 2007-2008

bia is still struggling with macroeconomic and structural problems. EBRD has emphasized that Serbia's first priority should be the restructuring of public enterprises.¹³ It is disconcerting that, on top of this problem, Serbia has seen a relatively low level of transition in terms of infrastructure overhaul or stronger competition. As regards competition, slight progress has been made over the past two years, but the situation is still below the EU standards. Infrastructure reforms have shown some progress last year, but there is still long road ahead.¹⁴

Over the past nine years, Serbia has failed to eliminate the lingering problems, such as relative political instability, deficient implementation of laws (rule of law not fully established), the general land issues (property rights and construction permits), the country's tainted image, bureaucracy and perceived corruption. Serbia's competitiveness is still held back by

¹³Ibid.

¹⁴Ibid.

lack of understanding or application of technical standards, quality control, rules of origin, consumer protection and accreditation process.

Entrepreneurship in Serbia – Strategic and institutional framework

In 2003, Serbia joined the European Charter for Small Enterprises, which provides guidelines for entrepreneurship development.¹⁵ The Government of the Republic of Serbia has adopted not one, but several strategic documents concerning development of small and medium-sized enterprises (SME). The quality of the latest document, the Strategy for Development of Competitive and Innovative Small and Medium-Sized Enterprises 2008-2013, is that it links for the first time specific objectives with budget appropriations through an annual action plan. However, annual budget planning in practice has still failed to fully observe the strategic guidelines of this or any other Serbian strategy.¹⁶ The Strategy aims at “developing an enterprising, knowledge- and innovation-based economy, which will foster a strong, competitive and export-oriented SME sector, and also contribute significantly to an increase in the standard of living in Serbia”. Implementation of the Strategy in the near future should ensure creation of a more efficient regulatory environment for the small and medium-sized enterprises, a balanced regional distribution of SMEs and faster development of the sector. The Strategy has been aligned with the *Small Business Act*, a document adopted by the European Commission in June 2008.

In August 2006, the Council on Small and Medium-Sized Enterprise was established. Its objective is to coordinate the Serbian SME policy. The composition of the Council was changed in November 2007 and now five out of the 12 Council members are SME owners, while other members come from the public sector. Business representatives take part in a different, wider advisory body, the Forum for Small and Medium-Sized Enterprises,¹⁷ which was set up in February 2008. There is still no consensus as to which entrepreneurs should take part in the work of this body, as

¹⁵*SME Policy Index 2009*, <http://www.investmentcompact.org/dataoecd/7/25/43084042.pdf>.

¹⁶Other, related strategies have been adopted, such as the Economic Development Strategy, Strategy for Foreign Investment Promotion and Development, EU Association Strategy and Strategy for Increasing Serbian Exports 2008-2011.

¹⁷See <http://www.pks.rs/forum>.

there are no recognized SME business associations yet.¹⁸ A fledgling SME body is the Committee for Small and Medium-Sized Enterprises of the Serbian Chamber of Commerce, which counts 26 members.

For a long time, it was unclear who in the Serbian government was responsible for promoting competitiveness and entrepreneurship. The Ministry of Economy and the Ministry of Science and Environmental Protection shared the competence in practice from 2001 through 2008. As of July 2008, the jurisdiction was granted to the Ministry of Economy and Regional Development, i.e. to its Sector for Small and Medium-Sized Enterprises. Another entrepreneurship fostering institution, which is particularly important for the SME sector, is the Serbian National Competitiveness Council (SNCC). First established in 2003 and then re-launched in 2008, the SNCC deals with the issues that affect SME business. It is symbolic and appropriate that the vice-chair of the SNCC is Serbia's coordinator for the European Charter for Small Enterprises and the Assistant Minister of Economy in charge of the SME sector.

Entrepreneurship in Serbia – Access to finance

The main obstacle to development of small businesses in Serbia is the scarcity of finance options to start or grow one's business. The commercial banks have become more efficient, but high interest rates and rigid lending conditions became even tighter at the beginning of 2009 due to the global financial crisis. Access to finance is still the key problem for small and medium-sized enterprises, and resolving this issue should become the priority for SME development in Serbia. Serbian government did intervene in an attempt to provide more favourable loans, with support of the European Investment Bank, Italian government's credit line worth around EUR 30 million and budgetary appropriation of EUR 200 million. There are also plans to increase the number and size of financial instruments available.¹⁹ Progress has been made in providing subsidies (mostly implemented by the Agency for Small and Medium-Sized Enterprises) and guarantees, but financing of micro-loans is still limited, while venture capital is still undeveloped.

¹⁸There are trade/related/sectoral associations, but not a single body that would represent the entire SME sector.

¹⁹See <http://www.merr.gov.rs>, Srbija ima trend rasta i razvoja malih i srednjih preduzeća, 7 May 2009.

Credit guarantees are extended by the Guarantee Fund of the Republic of Serbia, Vojvodina Guarantee Fund and by some smaller, mostly donor-based funds. Unfortunately, the successfulness of these funds cannot be evaluated, because they do not trace the number of loans issued to small businesses and treat farmers as entrepreneurs, which is inconsistent with the usual practice worldwide. Export Credit and Insurance Agency (AOFI) also disburses loans to small businesses and the relevant data are available. To facilitate access to finance for small business, AOFI has reduced the requirement concerning the minimum value of exports of firms applying for loans from EUR 1 million to EUR 300 000²⁰. Serbian Development Fund provides financing and micro loans for new companies. Foreign donors also engage in micro financing. The National Investment Plan has also envisaged subsidies for young firms. Since 2006, Serbian government has replaced foreign donors in financing export promotion through trainings or support for attending trade fairs or product marketing (EUR 1.2 million was disbursed in 2006 to small and medium-sized enterprises exclusively).²¹

In 2002, the regional centre for development of small and medium-sized enterprises was established as part of the programme of non-financial assistance to the SME sector in Serbia. The programme was funded by the European Union and implemented by the European Agency for Reconstruction. The centre is currently implementing the project Young Entrepreneur Belgrade 2009, whose objective is to provide incentives for SME and entrepreneurship development in Belgrade. Within the project of Institutionalisation of Mentoring as a Service in the SME and Entrepreneurship Support System, the Agency for SME Development and the Japanese International Cooperation Agency have organised training of prospective mentors, while the implementation of the project has also gathered five partner agencies, including the Regional SME and Entrepreneurship Development Centre Belgrade²².

The operation of venture capital funds and equity funds in Serbia is contingent on the Law on Investment Funds, adopted in the spring of 2006. However, the implementation of the Law had to wait for the by-laws – the rulebooks that were adopted in December 2006 and provided for this type of SME financing. This has also opened the possibility for establishing public-private partnership between the state and the funds

²⁰See <http://www.aofi.rs>.

²¹See <http://www.aofi.rs>, <http://www.siepa.gov.rs>.

²²*Budemu* <http://www.mspbg.rss/>.

in order to support innovation, but its potential has been unused and the government should undertake measures to promote it.

The investment funds, just like other institutional investors, may foster SME development by becoming long-term sources of enterprise financing as majority or minority owners, for limited or unlimited terms. This would boost enterprise efficiency, stabilise their current market position and expansion into new market segments, improve the quality of products and services and secure financing for new development endeavours. The funds may decide whether to acquire a share in SME capital on the basis of financial reports, plans and projections, while businesses should strive to attract investment funds, as quality and long-term sources of financing, through transparent operation and continuous improvement of their business results. Small Enterprise Assistance Fund (SEAF) for instance, provides funding and operational support to enterprises that do not have access to traditional sources of capital and operate in developing markets²³. SEAF also helps the chosen enterprise connect on the global level and strengthens its credibility, which accelerates the expansion and profitability of the business. Although SEAF becomes a shareholder by investing into an enterprise, the company involved does not have high lending costs (as is the case with traditional bank loans) and does not run the risk of low liquidity. After a few years, SEAF sells its share and withdraws from the ownership structure, reaping higher yield in proportion with the assumed risk. The emergence of more funds like this one (there are only few investment funds in Serbia) may be very useful to many small businesses that have a solid development potential, but lack capital, managerial expertise and contacts for easier access to foreign markets.

Entrepreneurship in Serbia – tax policy, inspection, business councils and training

Although the tax policy in Serbia has considerably improved, while fiscal decentralization and payroll tax cuts in particular have provided incentives for small and medium-sized enterprises and facilitated their business, there is still room for reforms. The tax system currently does not allow for a simplified filing of tax returns for small businesses, while their tax burden is still relatively high. Moreover, business owners are ignorant about computing their tax liabilities. The tax system should definitely ad-

²³*Budemu* <http://www.seaf.com>.

just further to the SME constraints by establishing a simpler procedure for small businesses and providing tax-related advice to SMEs. A breakthrough has been made in the form of taxpayers' trainings, which the Tax Administration initiated in 2009.

Inspection service reform is one of the priorities for improving the general business environment in Serbia. The cost of inspection imposes a heavy burden on small and medium-sized enterprises, as it consumes the time they would otherwise be dedicating to daily business. Furthermore, SMEs are inadequately acquainted with competences of the inspections and their own obligations, which may become a source of corruption or bribe solicitation.

A small but important progress regarding customs has been achieved with amendments to the Decision on Criteria Defining Customs Quotas for Import of Particular Commodities in 2008. The amendments have ensured duty-free import of new equipment (except for passenger motor vehicles) that is not produced in Serbia, but is used in the industry, mining, agriculture and fisheries, forestry, water management and construction. The value of the imported equipment must not exceed EUR 200,000 in dinar equivalent and must be used for the business activity of the user of the equipment. The former EUR 500 000 threshold affected directly small and medium-sized enterprises and individual agricultural producers.

There is a large variety of trainings available to SMEs in Serbia, but of inconsistent quality. The existing SME training centres need to be evaluated and a system of quality control established, which could be additionally promoted by means of a system of vouchers that would allow the users to choose between different trainings offered by the state. Additional efforts are required in terms of adequate business counselling of SMEs. Euro Info Centre, whose objective was to provide advice to SMEs doing business with the European Union, closed in 2004, after only three years of operation in Serbia,²⁴ and was finally reopened as the Enterprise Europe Network (EEN) within the Serbian Agency for Small and Medium-Sized Enterprises.²⁵ SME business centres should be developed at the municipal level also (many municipalities did open their Offices for Local Economic Development), while the SME Agency should continuously

²⁴Serbian Chamber of Commerce has set up a new portal on doing business with the EU, which now includes a special section for small and medium-sized enterprises (see <http://pks.komora.net/>). The Ministry of Economy and Regional Development and some government agencies, Business Registration Agency, for instance, have special SME portals.

²⁵See <http://www.een-srbija.rs>.

evolve the quality of the services it offers to firms. This area has attracted attention of donors and several foreign projects, including an EU project implemented by the European Bank for Reconstruction and Development that subsidizes small and medium-sized enterprises using professional consulting services (*BAS/Business Advisory Services*).

Entrepreneurship in Serbia – education, business incubators and industrial parks

Serbia has not made sufficient progress in use of technology in business, especially with regard to small and medium-sized enterprises. To overcome this issue, in addition to changes of the legal framework, obstacles such as the lack of know-how and financial constraints of small businesses need to be removed. The additional problem is that the brain drain, triggered by the wars and economic hardships of the nineties, has persisted. Many highly educated people still leave Serbia in search of employment abroad, which underpins the importance of programmes like the Young Talents Fund. The current capacities for applied, commercial research of Serbian universities and research institutes are unknown and their results and potentials would need to be assessed. Commercial research should be supported, inter alia, through development of adequate infrastructure, particularly for telecommunications. Technology parks are one of the ways to promote commercial research. The technology park in Novi Sad is closest to implementation of this concept in Serbia at this moment, because firms that use advanced technologies (telecommunications, computer programmes, biotechnology) are established within the university centre there. The new Law on Innovation Activity has changed the way financial aid is awarded to researchers in order to foster commercial research. However, research centres and professors at public universities still receive funding and wages indiscriminately, without differentiating between those that conduct research and those that do not, and the latter are, unfortunately, prevalent. Furthermore, researchers do not have the possibility to earn additional money through commercial research, while the legal loophole in this area continues to serve as a hindrance to such endeavours. The announced implementation of scientific development strategy will start in autumn 2009, with the aim of changing this situation. The strategy envisages that within the next five to ten years at least half of the knowledge workers will be employed in private firms. The

programme priority will be to invest into biomedicine, new materials, environmental protection, IT development and energy efficiency.²⁶

Due to the strong expert and financial support from the European Union and other international partners, Serbia has made pivotal advancements in the development of vocational secondary education and promotion of entrepreneurship through vocational education. Beside the strategic framework²⁷, many novelties have already been applied through pilot programmes implemented in a third of Serbian secondary schools. However, not enough consideration has been given to entrepreneurship promotion through other forms of learning, where higher education can play an important role.

The connection between business and education is exceptionally weak with regard to higher education in Serbia, though economists agree it is of decisive importance for development of the Serbian economy. The attitude toward higher education will determine Serbia's competitiveness on the global level. A serious reform of research work is urgently needed. The reform should rely on some of the steps that have already been taken, such as the programme that promotes innovation through financial prizes awarded to scientific teams and small businesses in a public competition.²⁸

Staff training or continuous professional development is crucial for raising competitiveness and attracting new investments. Indjija municipality was among the first ones to have acknowledged this fact and opened a Training Centre in two remodelled classrooms of a local school. This is an exception, however, and according to the World Economic Forum's rating Serbia was only 121st out of 131 countries ranked in terms of staff training.

Business incubators, as programmes for development of start-up companies, particularly of those relying on high technologies, have started springing up in Serbia. The Norwegian government's programme *Entrance* has helped design of the Business Incubators and Clusters Programme in Serbia 2007-2010, which was adopted by the SME Council. The

²⁶See the draft Serbian Science and Technological Development Strategy 2009-2014, <http://www.nauka.gov.rs>. For more information, see the chapter on science and research of the FEFA study *Impact of Serbia's EU Accession* (the executive summary presented in this book of the same name).

²⁷Further details are available in the chapter on education in the FEFA study *Impact of Serbia's EU Accession* (the executive summary presented in this book of the same name).

²⁸See <http://www.inovacija.org>, and USAID Competitiveness Project, *Skills Gap Analysis in Four Sectors of Serbian Economy*, 2008, <http://www.compete.rs>.

National Investment Plan has earmarked funding for support to business incubators and industrial parks, but without any specific strategy. Financing for infrastructure for business incubators in 15 Serbian municipalities has been provided.

It is excellent that a growing number of municipalities in Serbia have become aware of the advantages of an industrial park, at least in its most simple form of an industrial zone containing the necessary infrastructure. These municipalities have attracted investment by curtailing the time required to launch production and the cost of building. Industrial parks in Serbia have the added value as they serve to circumvent the many difficult land issues (property rights and granting of permits), which are still the greatest obstacle to foreign direct investment.

Entrepreneurship in Serbia – simplify legislation

Some local administrative procedures have already been simplified in a few towns, while other municipalities that wish to provide incentives for investment and entrepreneurship strive to follow their lead by streamlining the procedures for granting of construction and other permits. Additional impetus will come from the possibility of e-business in line with the Law on Electronic Signature. Although the Law was adopted in 2004, it became applicable only at the end of 2008, due to the delays in adoption of bylaws and appointment of a certification authority. Still, further regulatory amendments are needed (e.g. the Law on Electronic Document was passed only on 8 July 2009) and computer usage in Serbia is relatively low. Small businesses can overcome this through work of municipal business centres that would have computers and Internet access and that would provide computer training. Public-private partnership can be established in this area as well. For instance, Microsoft has held a series of free trainings for small and medium-sized enterprises all over Serbia, expanding their computer literacy. The advantages of e-business have been partly exploited by the customs service, Public Procurement Administration and many municipalities in Serbia. More than half of municipalities use the *Hermes* computer programme that was developed in Serbia on the basis of British and US models. The programme has accelerated substantially the granting of construction permits, though the actual forms need to be submitted as hard copies.

In an attempt to streamline and decrease the volume of legislation, Serbia has also embarked upon a Regulatory Impact Analysis, but this intervention has not been very effective due to the lack of expertise within the public administration to assess the economic impact of regulations. Serbian Government adopted the Regulatory Reform Strategy 2009-2011²⁹, which envisages a Comprehensive Regulatory Reform (CRR) aimed at cutting administrative burden for businesses by at least 25% by 2011. Nonetheless, the first stage of the reform necessitates compiling all the regulations, which will take about a year, while the businesspeople have already identified legislation that impose the chief obstacles to their business through a campaign of a non-governmental organisation, the National Alliance for Local Economic Development (NALED). It would be advisable, for the sake of advancement of the business environment, to couple the CRR campaign with implementation of the reforms suggested in NALED's *Grey Book*,³⁰ which takes on a special importance in the light of the Global financial crisis.

Conclusion – reform priorities from the perspective of small and medium-sized enterprises

Association of European chambers of commerce – *Eurochambres*, in agreement with the Serbian Chamber of Commerce, has laid out a plan for putting into action the Eurochambres' proposal for follow-up of the Law on Small Enterprises by the end of 2009. There are three priorities. The top one is to improve access to finance for SMEs. To attain that goal, the measures to promote delayed repayment, encourage banks not to restrict access to finance for SMEs and improve investment programmes have been proposed. The next priority is to have regulations that respond to SME needs. To develop and advance the SME sector in that regard, the regulators will need to apply the Think Small First principle³¹, step up the efforts to cut 25% of administrative costs for firms by 2012, reduce start-up time to 3 days and promote the idea of a "second chance" for entrepreneurs. Strengthening SME access to market is the third priority, which involves timely implementation of the EU Services Directive, designing

²⁹See <http://www.srp.gov.rs>.

³⁰For more information, see <http://www.naled-serbia.org>.

³¹*Think Small First* is the programme that was introduced in the United Kingdom in 2000 as a framework for support to small and medium-sized enterprises.

solutions to provide SME access to e-services of other EU member states and application of the European Code of Best Practices, which facilitates SME access to public procurement contracts. In a nutshell, European integration is a synonym for better business for small and medium-sized enterprises. Any alternative would retard development of the business environment and international competitiveness of small and medium-sized enterprises in Serbia.

The World Bank has recommended that countries should cut unnecessary administrative procedures and simplify regulations, publish as much regulatory information as possible, introduce standard forms, and use the internet as a tool that alleviates frustrations stemming from regulations, without changing their spirit or purpose.³² WB has sent four key and complementary messages regarding business environment: embark bravely into reforms at the beginning of a mandate, publish regulations, reduce and streamline administration and establish e-government. Special attention should be paid to small and medium-sized enterprises, particularly with regard to financing in Serbia. If entrepreneurship is to be promoted and the country's competitiveness is to be enhanced, the emphasis in the medium term must be placed on strengthening the links between education and the business sector.

³² The International Bank for Reconstruction and Development/ The World Bank, *Doing Business 2007: How to reform; comparing regulation in 175 economies*, 2006, 5.

EFFECTS OF ACCESSION ON THE NEW MEMBER COUNTRIES: THE ECONOMIC DIMENSION

András Inotai, Ph.D.³³

After four-and-a-half-years of membership of ten new member states (NMS) and with a nearly two-year experience of another two acceding countries to the European Union (EU), a first effort can and should be taken to evaluate the short-term balance of the historic enlargement of the European integration. Obviously, for several reasons this survey remains partial and half-hearted. First, it is one-sided, for the impact of the NMS on the EU-15 in general, and on key EU policies in particular, falls beyond the scope of this article. Second, NMS did not only experience the impact of membership but that of global challenges and of domestic economic policies. These three levels (global, EU, national) can hardly be separated, so that the membership record includes several overlappings and interdependences. Third, benefits and costs, advantages and disadvantages, “pluses” and “minuses” in different policy areas reveal different time horizons. While the impact of accession became manifest almost immediately (or in the first few years) of membership, the evaluation of the adjustment process in some other policy areas requires more time. Fourth, accession and post-accession adjustment have an interdisciplinary character. Thus, in many cases, economic impacts can hardly be strictly decoupled from political, social, psychological or even historical components. Still, some general assessment can be made, with relevant (although not definite) results in general, and for cross-country comparison, in particular.

³³Institute for World Economics of the Hungarian Academy of Sciences, Budapest. Paper presented at the FEFA conference organized on May 9, 2009 on “Effects of Serbia’s EU Integration,” and at a conference „Effects of EU Enlargement, organised by TEPSA in cooperation with the Institute for World Economics, Budapest, on October 22-23, 2008.

1. NMS became full-fledged members in May 2004 and in January 2007, respectively. However, in several areas, they had to accept a several year embracing phasing-in process before enjoying full-fledged status. The phasing-in process has a double character.

On the one hand, several chapters had been negotiated (and closed) with transitional measures – on both sides. The NMS had to accept three important restrictions with vital impact on the speed and quality of the adjustment process. Direct payments for farmers started at a fraction of the amount provided to EU-15 farmers and started to close the gap in an annual process lasting until 2013. Full-fledged participation in the EU budget became a reality as of January 2007, when the new seven-year financial framework of the European integration entered into force. During the first 32 months of membership all NMS had access to the pre-accession fund, a fraction of the money they became entitled to as of 2007. Last but not least, free circulation of labour, one of the four key freedoms of the EU, has only been granted by some countries at the moment of accession and by some others during the first years of membership, without having created a free labour market up to the current moment.

On the other hand, the development of the integration process (deepening) has prescribed some rules of the game that have to be fulfilled by new entrants, even if they are already “full-fledged” members of the EU. First, the Schengen requirements had to be fulfilled (it was achieved in a three-and-a-half-year process of adjustment). Second, membership in the European Monetary Union and the introduction of the common currency formulate serious conditions to be observed.

2. High growth continued after the accession, although not as a direct impact of membership. Economic actors had anticipated membership well before the political decision had been taken. Also, free trade between the EU-15 and the would-be new members contributed to higher growth well before 2004. In addition, foreign direct investments, a basic factor of the high growth pattern, fostered sustainable and high growth rates. It is another question to what extent the pattern of growth was based on investments and exports or was mainly supported by (artificially created) domestic demand. The answer lies in developments during the next few months, and is not a topic of the current analysis. However, it must be noted that accession seems to have dampened the speed of structural change and the political willingness to undertake fundamental reforms practically in all NMS. The knowledge, and maybe, even more, the feeling that a safe harbour has been reached, does not maintain the quality and

speed of adjustment that characterised the pre-accession period. (Some experts try to identify a certain “accession fatigue” in several NMS.)

More importantly, the first years of membership made clear that although the EU is rightly considered as the basic economic anchor of all NMS, it is not an automatic growth-driver. Even less, it serves as an actor compensating for or remedying serious policy failures committed by national decision-makers.

3. Trade developments became the most relevant and unprecendented success story of the enlargement. At the moment of accession, all NMS had to take on the EU’s external economic policy, including the immediate elimination of intra-EU trade barriers and the introduction of the common EU external tariff. The first led to huge trade growth among the NMS, mainly to the “detriment” of the EU-15. The EU’s share in total exports and imports did not change significantly, since trade creation impacts with the EU-15 could largely be exploited in the preceding years of tariff reduction and free trade by 2002 (excepting some agricultural commodities). However, intra-EU trade orientation reveals a rapidly growing importance of intra-NMS trade. In addition, some traditional bilateral trade balances reveal dramatic changes (from deficit to surplus and vice versa). Interestingly, some member countries used their membership position to increase their extra-EU trade above average. Some efforts are closely linked to the geographic neighbourhood (Russia, Ukraine, Western Balkans), while others started to focus on rapidly growing global markets, with EU membership in the background. In most countries, transnational companies (and their subcontracting networks) can be identified as the main winners of accession, while small- and medium-sized domestic firms could only partially exploit the opening up of a huge market (mainly remaining concentrated on cross-border trade with clear geographic, financial and logistic constraints).

4. Similar to growth rates, the inflow of foreign direct investment (FDI) cannot be directly linked to the moment of accession. Some spectacular (annual) increases of inflow of foreign capital were more connected with a new (or delayed) stage of privatisation, the “discovery” of new industrial locations and better legal and institutional background – a result of domestic development rather than of adjustment to EU rules. However, the growing confidence in the region composed of NMS has certainly had a positive impact on the decision-making process of large international firms. At the same time, the basic market-orientation of FDI did not change (either it developed an export-oriented structure before accession or remained largely domestic market-oriented). Neither the decision on

reinvestment or repatriation of profits was substantially influenced by accession. Finally, only modest shifts can be observed in the geographic location of international production and service centres (or subsidiaries), mostly due to the “maturing” of the host country and not as an immediate result of membership. Such fears and expectations did not become reality after 2004/2007. Western European companies did not massively close their locations in order to move them to the NMS. Similarly, FDI in the NMS of 2004 indicated strong insistence on already established and profitable locations despite the accession of two new member countries with clear comparative wage advantages in January 2007.

5. Fears of rising inflation were among the outstanding concerns of the NMS before accession. However, they did not materialise, at least not as a direct outcome of membership. Most price (and tax) adjustments had to be introduced by the new members before their accession. In fact, accession had two price-reducing effects, even if they were not (fully) transferred by importers, wholesale or retail traders to the consumers. First, the introduction of the common external tariff of the EU reduced the price of imported goods, since, excepting a very narrow range of commodities, national external tariffs were higher (sometimes substantially higher) than the EU common tariff. Second, competition on the “full-fledged” markets became stronger and led to lower consumer prices (provided that retail trade became fully or largely liberalised, without keeping a quasi-monopolistic or oligopolistic structure).

To some extent, appreciating national currencies have also contained imported inflation (and, at least statistically, supported the catching-up process of the NMS).

If some countries still had to face growing inflationary pressure, they can be identified either in global developments (higher energy and food prices) and/or in erroneous domestic economic policies (starting from huge budget deficits to unfulfilled structural changes and “bubble” phenomena).

6. Another positive development in most NMS was the declining unemployment rate. This was partly due to high growth and the job creating effects of sustainable modernisation. However, it should not be ignored that the sometimes surprisingly positive trends in some NMS have to be attributed to massive migration immediately upon accession. Although the dimension of migration did not reach the levels predicted before 2004, it was substantial in some countries, particularly if the rate is measured as a share of young, skilled, mobile population. At the same

time, some other new members reported very low figures of migration, either as a result of relatively high activity rates in the domestic economy or other forms of “job finding” in the grey economic zone (unregistered employment). In fact, very different migration patterns started to develop in the first years following accession. Some new members turned to be substantial sources of emigration, while others were increasingly considered as potential new host countries. In countries characterised by low levels of emigration, migration balance was kept in equilibrium or even indicated a small surplus (as in most EU-15 countries).

What is, however, striking is the fact that in the period preceding May 2004, Western European public opinion considered the “Polish plumber” as the most relevant factor threatening jobs. Instead, the really massive migration happened several years before accession and originated in the two Southeast Europe countries that joined the EU in 2007 only.

While the opening of some of the EU-15 markets after 2004 moderated labour market pressures in several NMS, it led in some areas to serious labour shortages, rapidly increasing real wages and, consequently, eroding wage-related competitiveness. It has to be noted that there is an abundant (although not always convincing) literature on the impact of migration on the host countries. In turn, very little attention has been devoted to the impact of emigration on countries. Here, one positive, although not necessarily sustainable trend has to be underlined. Countries with massive emigration started to register yearly increasing amount of remittances that became not only an important source of additional income and domestic demand-creating factor (although mainly for imported commodities), but also the main driver of the construction industry. Not less importantly, remittances became more and more important as a factor of covering huge and ever wider trade deficits (together with the inflow of FDI).

7. In terms of GDP per capita, all NMS could continue the pre-accession process of narrowing the development gap between the EU-15 and the NMS. Looking, however, at reviving inflation, erosion of competitiveness and growing pressure on the national currencies (even if pegged or fixed to the euro), the sustainability of this process may be questioned at least for some countries (mostly those with the highest catching up speed in the last years). Similar to the experience of some EU-15 countries over decades, catching up on national economic level was not always accompanied by narrowing the gap among different regions of the same country. In fact, such a process requires more time and definitely turns attention to the best possible use of EU transfers. A more balanced assessment will

only be possible after more time, probably by the end of the current financial framework period.

8. From the very beginning of membership, all NMS considered the access to EU funds as a historical and unprecedented chance of socio-economic modernisation. Expectations were particularly high from 2007 on, when the NMS became full-fledged members also from the point of view of EU transfers. Institutional, legal and financial preparation for successful application started everywhere, although at different speeds (and quality). Due to the shortness of time, it would be premature to draw any longer-term conclusion concerning the efficiency of using such resources. However, some observations can be made. First, several countries (both politicians and societies), particularly in pre-election periods, seemed to mix up goals and instruments. Obviously, EU transfers represent (one of) the most important elements of catching up, but should never be considered as the most important goal of accession. Successful membership in the EU depends on a number of other factors as well, even if the efficient use of EU resources can evidently enhance the degree of success (in more ways than one). Second, more analysis is needed in order to correctly measure the absorption capacity of a country (or region). It is a two-way street, in which not only the beneficiary has to be assessed but also the conditions of acceding and using such resources. Third, one of the fundamental dilemmas of the national development plans consists in identifying the priority areas of investing EU (and national co-financing) funds. There is no common rule and experience, whether less developed regions should be supported more than the developed ones, or the latter should get priority with the expectation of creating spillover effects for less developed areas in a relatively short time. Fourth, the deficiency of a regional envelope for all NMS is already felt, since much more coordinated developments in cross-country physical infrastructure and environmental protection could have been launched in the first years of membership. Such an approach would not have needed any additional money, just the restructuring of the "national envelopes" towards a "regional envelope". Geographic unity, the level of development and the underdevelopment of physical infrastructure, a main problem of national integration and regional cooperation, including higher level of global and European competitiveness could have been powerful arguments, in contrast to the "geographically scattered" previous enlargements by less developed countries. Fifth, countries with substantial amounts of remittances from migrant workers face the challenge of channelling at least part of this money into national development plans (instead of generating additional private consump-

tion with growing trade imbalances). Finally, despite the limited experience available at the moment, it has to be clear to each NMS that they do not have 15 years to start the catching up process based (partially) on EU funds, as happened with some less developed old members. Neither the politicians, nor the public opinion in the net contributing countries as well as in the net beneficiary ones are ready to guarantee such a long period of adjustment.

9. Although starting at a low level (25 per cent of the EU-15), the application of the direct payment system to the NMS has generated quick and fairly dramatic changes. However, the efficiency of the support very much depended on the quality of preparation of the respective national authorities, the mentality of the farmers and, not least, the legal environment of land ownership. Few or no ownership restrictions (just for farmers of the given NMS) stimulated the agricultural land market, increased concentration and productivity and let land prices grow (although still far behind those in the EU-15). On the other hand, fragmentation of ownership, the predominance of very small, therefore uncompetitive farms (and farmers) did not lead to substantial improvements. In some cases, the annual direct support has not been used for agricultural modernisation but for financing private consumption, mostly without any linkage to agriculture. Some countries have already liberalised their agricultural land market for EU citizens, some others are facing the deadline of 2011. Any argument about prolonging this date (until 2014) would be extremely counterproductive, without any meaningful support to the necessary modernisation (breaking up) of the outdated ownership structure.

10. With regard to the Lisbon Strategy, in the pre-accession years, the NMS performance was corresponding to or even exceeding their relative level of economic development. Except in few cases, unfortunately, this process did not continue in the first years of membership. It can be added that the EU-15 did not devote adequate attention to this vital strategic objective of the European integration.

11. In the first years of membership, energy became a major factor in EU-level policy making. Beyond developments on the global energy market, stubbornly high prices, the increasingly important question of long-term and "guaranteed" availability of oil and gas, the EU's environmental agenda also emphasized the energy issue. In addition, the NMS increased the EU's dependence on imported energy in three different forms. First, the share of imports in total energy consumption grew. Second, the structure of energy consumption and imports shifted towards oil and natural gas (the latter also predicted in the long-term EU energy strategy

until 2020). Third, and maybe most importantly, the unilateral character of dependence on Russian sources has to be highlighted. The combination of the above makes NMS closely interested in shaping a common European energy policy. This is expected to provide not only a higher level of supply security but is likely to generate additional revenue for some NMS affected by the geographic layout of the pipeline(s). There is, however less consensus on which (planned) pipeline should be given priority (or whether both would be needed). At present, neither Nabucco nor Blue Stream is likely to start operation before 2015. While there is widespread agreement on lessening unilateral dependence on Russia, it is by far not guaranteed that any pipeline crossing non-Russian territory only would not be under the control of Russian oil and gas monopolies. Moreover, diversification of supply channels is most welcome but it must not jeopardize supply security. High level of supply security, even if combined with substantial unilateral dependence, should be given priority against risky and nebulous "adventures". Finally, wide consensus on a common energy policy has certainly not been supported by long-term bilateral agreements between some EU-15 countries and Russia. Just the opposite, it may have generated mistrust and lack of confidence, particularly on the side of the small(er) NMS.

12. Membership of the NMS in the economic and monetary union and the introduction of the common currency proved to be a real watershed in the last years. It has to be added that the individual NMS represented very different starting positions concerning the volume of external debt, accumulated budget deficit or exchange rate policies. Newly independent states did not carry with them the "financial burden of the past" or the burden was shared between new nation-states. In turn, old nation-states had been rolling domestic and external debt from the very beginning of transformation, well into the first years of full membership. It is not accidental that the larger NMS economies are years away from adopting the euro, and they are, at the same time, those that sometimes hesitate concerning the best strategy of adjustment to the Maastricht requirements. No doubt, mistaken economic policies of some NMS in the last decade have exacerbated the problems and shifted potential EMU membership into the next decade. There has been a professional debate about the extent to which the Maastricht criteria, elaborated for highly developed market economies, can be applied to the NMS (particularly inflation rate, but also government deficit if it finances future-oriented investments and not social and state-level subsidies).

13. The two-stage historic enlargement of the EU towards the Eastern (North-East and South-East) part of Europe broke with one golden rule of previous enlargements. From the very beginning (1973, 1981, 1986, 1995), the widening process was always accompanied, and in most cases, preceded by ongoing deepening. Such was the common trade policy in the first half of the seventies, the Delors plan of creating the internal market during the mid 1980s and the acceptance of the EMU project years before the 1995 enlargement. The by far largest enlargement of the EU was, unfortunately, not accompanied or preceded by a process of deeper integration. Although several promises were made in the late nineties on reforming the common agricultural policy, restructuring the budget and remodelling the institutional and decision-making structure of the integration, efforts remained either fragmented or failed. The enlargement of 2004 and 2007 badly missed the deepening of integration. Some NMS are in favour of deepening but without giving up any part of their “national sovereignty”. Others prefer “shared sovereignty”, for they consider their interest better protected and implementable in a supranational rather than in an inter-governmental pattern of decision-making.

Geographic neighbourhoods can be identified as the most important motive of the further widening of the EU. In this context, interests differ, as neighbours do differ as well (Eastern neighbourhood vs. Western Balkans, let alone Turkey). In the last years, the NMS did not develop a clear strategy on future enlargement, although, based on their own experience, they would hardly raise any insurmountable barrier to such a move any time in the (not very near) future.

14. In truth, the arguments of “enlargement fatigue” do not possess a strong basis. Following their accession in 2004 and 2007, no NMS has behaved in a way that would block or break down the integration process or weaken the Union. In fact, it was three “old” members, two of them founding countries of the European integration that seriously jeopardised the European project and caused substantial delays or even near derailment of the process. More arguments seem to be justified in supporting the phenomenon of “accession fatigue” in various NMS.

Nevertheless, the real exam of the accession but also that of the half-a-century long integration project will come in the next months and years. The macroeconomic slowdown following the global financial crisis and accompanied by huge potential for conflict in different policy areas (from the labour market through the budget to the monetary union) will be the evident test of the current state of affairs of the EU. Several EU policies require relevant reforms, while outdated structures in the national

(domestic) economic field will also be relentlessly defied. In addition, global challenges are expected to exert huge pressure on shaping community-level policies (from the internal market over migration, energy to common foreign and security policy). Finally, some NMS have reached a turning point in their two-decades of transformation process, "enriched" with almost five years of EU experience. Therefore, a more balanced (but certainly not final) evaluation of the enlargement from the point of view of the NMS can be carried out in the next months (or one year). This evaluation should not forget the presence or absence of longer-term EU strategies of the individual countries that should (have already) outline(d) the criteria of successful membership. The lack of this effort cannot be explained just by "accession fatigue". The more the crisis widens, the more urgent and imperative such a strategy will be – not only on the level of the NMS (and the EU-15), but, not less importantly, also on the level of the European integration. Here the success or failure of all member countries will be enshrined for the next decade(s).

THE CZECH REPUBLIC IN THE EU

Experience of a young member state from the view of state administration

Tomáš Výprachtický¹

1989 – 2004: Return to Freedom, Return to Europe

Historical tradition

The idea of a 'Return to Europe' lay deeply in the roots of the movement that overthrew the communist regime in Czechoslovakia in 1989. The sense of belonging to Europe and to European civilization and culture was very strong and could not be wiped out by forty years of communist dictatorship.

This is not very difficult to explain – European tradition in Bohemia, Moravia and Silesia, once referred to as "Lands of the Czech Crown", is very long; these lands formed part of the Holy Roman Empire as early as the 10th century. In the 16th century, the lands of the Czech Crown were incorporated into the Habsburg Central European monarchy, which they remained a part of until after the end of World War I in 1918. This is to say that, throughout this period of centuries, the Czech lands belonged to some sort of integrated entity closely connected to the key values and historical moments that have created what we now call 'Occident' or 'European Civilization'. In 1989, the Czechs knew that the motto 'Return to Europe' did not mean setting out on a mystery tour. They were only determined to come back to the place from which they had been previously removed.

Velvet Divorce – Dissolution of Czechoslovakia

Increasing tension between the two parts of the Czechoslovak federation plagued the first years of freedom and regained sovereignty after

¹Department for European integration, Czech Government.

1989. In Slovakia, particularly, the return to freedom also meant a very strong impulse toward national self-determination. Therefore, over the first four years following the 'Velvet Revolution' in 1989, the Czech-Slovak dispute about the common future of the two nations partly overshadowed the idea of the 'Return to Europe.' This controversy also caused a certain delay in the process of accession to the EU, since the EU-Czechoslovakia Association Agreement, signed in 1991, could never come into force, which was the implication of the splitting of the federal state in 1993. On the other hand, this delay also carried a positive message. By getting a chance to cope with the challenge of dissolution of the common state, the two nations were granted an opportunity to show that they were able to bring about a peaceful and effective solution to a serious problem – the problem of their mutual coexistence. The 'Velvet Divorce' was vital evidence that the Czech and Slovaks were mature enough to do it.

EU accession process – basic data

After the successful resolution of the Czechoslovak question, all the country's political and administrative capacities could fully concentrate on the process of accession to the EU, which was, besides the seeking of NATO membership, the main goal personifying the leading motto 'Return to Europe'. The EU-Czech Republic Association Agreement went into effect in 1995 and in January 1996, the Czech Prime Minister Václav Klaus submitted the application of the Czech Republic for EU membership. The actual negotiations, however, started almost three years later, in November 1998, and took four years of hard work. The European Council endorsed the 'Eastern Enlargement,' the accession of 10 new countries including the Czech Republic, in December 2002. In April 2003, the Treaty of Accession was signed in Athens. In June 2003, almost 80% of voting Czech citizens said YES to the EU membership in the national referendum, which fulfilled the last condition for EU entry. In May 2004, the motto 'Return to Europe' became reality.

Political Background in the Czech Republic

Parallel transformation

When approaching the EU, the Czech Republic and its society had to go through a triple parallel transformation. This included transition from the totalitarian system of one ruling political party towards parlia-

mentarian democracy, transformation of a central-planned economy to a free market model, and, eventually, adopting the huge number of European law regulations – *acquis communautaire*. It was first such a process in modern history without any experience of a similar kind at hand.

Political transformation and the democratic heritage

The transition towards parliamentary democracy was a great challenge. After forty years of communism, the society and its political structures were seriously misshaped and distorted. The Czech Republic, however, enjoyed the advantage of a long-standing democratic heritage since the second half of the 19th century, which proved to be very beneficial for the restoration of the democratic multi-party system. This democratic tradition in Bohemia, Moravia and Silesia reaches as far back as to the constitutional changes in the Austro-Hungarian Empire in the 1860's, establishing principles of parliamentary constitutional monarchy. Contrary to other central European countries, in Czechoslovakia the democratic system was preserved even after the break-up of the Habsburg Empire in 1918 and sustained until World War II. In this respect, it should also be mentioned that Czechoslovakia was the last remaining democracy in central Europe before World War II, offering shelter to refugees from the Nazi persecution.

The democratic heritage, unfortunately, was broken up by the Nazi and subsequent Communist dictatorship. Soon after the restitution of democracy in 1989, however, it became evident that core elements of the long democratic and parliamentary tradition had remained intact – forty years of totalitarian rule was not long enough a period to uproot the original tradition. There are several reasons for this, but the most significant one is rather obvious: in 1989, many members of the generation who remembered the democratic regime before 1939 were still alive. Grandparents could hand over personal experiences to their own grandchildren, who were therefore not dependent on written documents alone. The effect of this was that the political party scheme has stayed similar to the one before World War II. The advantage was that the Czech Republic did not have any serious problems in meeting one of the Copenhagen Criteria which is achieving stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities.

Economic transformation

Meeting the second of the Copenhagen Criteria, which is the existence of a functioning market economy as well as the capacity to cope with

competitive pressure and market forces within the Union, was the second essential goal to fulfil on the way to the EU. In this regard, there were two major moments. The first one was the transition from the ineffective central planned economy to the market-oriented economy in the first half of the 1990's, when both people and companies had to change or adjust their economic habits almost overnight. The second moment was the period of economic downturn in 1997-1998, showing the weak elements of the Czech already-transformed economy as to its competitiveness in the context of the interconnected and interdependent European markets. The overall situation, however, began improving in 1999, partly thanks to the implementation of the pre-accession partnership with the EU, which gradually enabled the Czech economy to exploit the opportunity of easier access to the world's largest single market.

Legislative and administrative transformation

The last great task of the state's political representatives (as well as the bureaucratic machine) was of legislative and administrative character. Within the scope of four years (from 1998 to 2002), it was necessary to achieve harmonisation of the already valid domestic legislation with the EU secondary law – *acquis communautaire* –, as well as to secure the same harmonisation of the new domestic rules being run through the legislative process at that time. This gigantic project became known as the 'legislative storm' or sometimes even 'legislative whirlwind'. It was the final battle to be fought before the successful completion of the accession process to the EU started in 1996.

Specifics of the Czech EU Membership

Strong Eurosceptic voice

As was already mentioned several times above, in the Czech Republic, the idea of the return to Europe was one of the cornerstones of political orientation and activity after 1989. There was a broad consensus among all relevant political parties, as regards to the Czech EU membership. There are, however, certain specifics typical for the Czech Republic, distinguishing this country from the majority of the new EU members joining the Community in 2004 and 2007. The most significant one has

been a strong Eurosceptic voice, present even in the highest spheres of the Czech politics.

From the very beginning, there has been a strong phenomenon present in Czech politics: two major political parties, each of them with a different programme as far as the EU project and the Czech EU membership are concerned. Civic Democrats, the right-wing dominant political party founded by the first Czech Prime Minister Václav Klaus, were for a long time characterised by very strong Eurosceptic positions, comparable only to these of the British Conservative Party, although it was the Prime Minister Václav Klaus who officially submitted the application of the Czech Republic for the EU membership, and the Czech EU membership has never been put into question by this political party. 'Euroscepticism' of Civic Democrats, in this case, does not mean questioning the EU project as such. It means questioning some current concepts of the European integration, in particular the idea of 'ever closer Union', meaning gradually strengthened cooperation, i.e. transferring more and more powers and competences of member states to the Brussels centre. The Civic Democrats plead for the concept of 'two-way flexibility' allowing not only for handing over national powers to the common centre, but also for taking back of some Brussels competences if they prove to be ineffective (which is, in fact, a very interesting and inspirational idea with little chance of being brought into effect in the framework of the contemporary European Union – there are too many relevant players with different interests, both in member states and EU institutions, to reach consensus on such an issue).

Political parties – programme and electorate

The left-wing major political party, the Social Democrats, on the other hand, have always based their foreign policy programme on very pro-European positions. The paradox is that the above-mentioned positions of both political parties contradict the attitudes of their constituencies. The voters of Civic Democrats are recruited mainly among the more educated and high skilled (as to their profession) urban population with generally pro-European views, while the electorate of Social Democrats comes for the most part from the less educated blue-collar workers or rural dwellers (who are, in general, either not interested in politics at all or rather concerned only about local issues and indifferent, or even resentful, when it comes to any external dimension of domestic politics).

The above-mentioned paradox, actually, is not very surprising in light of the Social Democrats and their electorate. It is relatively typical throughout all European political systems that left-wing voters are generally more domestically-oriented and rather suspicious towards any 'outlandish' or 'alien' topics beyond their own horizons (while the parties of the Socialist International, at the same time, are mutually very cooperative, being one of the two main political streams in the EU, together with the European People's Party).

The actual Czech specificity for a long time was the strong Euro-sceptic position of the Civic Democrats whose voters are, at the same time, one of the most pro-European thinking groups of the Czech society. The answer to this riddle would need a thorough sociological analysis, which we do not have space for in this paper. With use of a little simplification, it is possible to say that the right-wing voters used to give their support to the Civic Democrats 'in spite of' the Eurosceptic leanings of this party. The party, on the other hand, paid little attention to any opinion polls showing the mood of its supporters. The main reason for it was the personal attitude of the founding father of the party, Mr Václav Klaus. This politician, over the course of years, has become one of the loudest critics of the contemporary model of European integration. In his point of view, the European Union of these days is an over-regulated bureaucratic structure subjected to the unlimited and uncontrolled will of non-elected European officials, who are actually the only players in the game gaining power and benefit from the ever-closer cooperation and integration of the EU member states. The EU, according to Mr Klaus, should give up any attempts at closer political cooperation beyond the scope of customs union and the common market. Therefore, Mr Klaus is one of the most expressive critics both of the original project of the European Constitution and of the current project of the Lisbon Treaty.

The above-mentioned attitude was enhanced by the fact that Václav Klaus and his Civic Democrats lost two parliamentary elections in a row (in 1998 and 2002) and ended up in opposition for the period 1998 – 2006. As the major opposition party in the Parliament without any governmental responsibility, the Civic Democrats could afford strong Euro-sceptic rhetoric that in fact served as one of the main tools of criticising the socialist government over the course of pre-accession negotiations and the first years of EU membership. However, after the second lost parliamentary elections in 2002, Václav Klaus stepped down from his position as party leader and handed it over to his successor, Mirek Topolánek.

Later on, this turned out to be the breaking point of the Civic Democrats' 'Euro-orientation'.

Civic Democrats – victory of pragmatism

The parliamentary elections in 2006 and subsequent formation of a coalition government led by the Civic Democrats only confirmed the common saying that 'no one is ever Eurosceptic once in power', or, more accurately, 'no governing party is ever Eurosceptic'. Soon after taking over the government responsibilities, the Civic Democrats came to realise the inevitable fact that a loud Euroscepticism of any member state's government – and particularly of a small or middle-sized member state's government – is of no utility at all and actually counter-productive as to the real chance to promote any issue of national concern. To put it bluntly: it is much easier to be Eurosceptic while being a leader of an opposition party than while being a leader of a major party of a government coalition who is at the same time Prime Minister of his (or her) country. This was something that Mirek Topolánek has quickly learned.

The government's experience was the decisive factor for transforming the orientation of Civic Democrats towards the EU politics. Particularly for the party ministers (and the Prime Minister in the first place), travelling to Brussels and other European capitals to meet their counterparts proved to be very effective for blunting the edge of their Euroscepticism. It is partly a question of simple human vanity (politicians just find themselves more important if they meet their colleagues from abroad very often). For the most part, however, it is essential that politicians get the chance to discuss the actual European problems and issues, matter-of-factly, so that they realise that the only way to bring off any project of national interest within the EU leads through building alliances and maintaining contacts with representatives of other member states. In the case of the Czech Republic and its politicians, this process was accelerated by the fact that the country had been scheduled to exercise the office of the EU Council presidency in the first half of 2009. Therefore, soon after entering the EU, a thorough process of preparations for the presidency was launched; it emphasized the need for a deeper engagement both of state administration and of political spheres in the overall EU agenda. This was a very useful catalyser for the country's bureaucratic and political capacities to acquire the knowledge of the EU real politics.

President – the European anomaly

Therefore, nowadays, the only remaining exception of the Czech Republic among the other EU members is its President. Václav Klaus, who won the presidential election in 2003 after resigning from the position of the Civic Democratic Party leader, is a person distinct from any other head of state of government throughout the whole EU. The nature of his criticism towards the EU was already described above. What should be mentioned further is that the intensity of this criticism has a rising trend; from the beginning of his second presidential term of office (started in 2008), Václav Klaus has gradually become one of the most important informal leaders of the Eurosceptic movement, at this time fighting, in particular, against the adoption of the Lisbon Treaty. Such a contradiction between the President of the country (who is formally the head of state) and the government (that is responsible for creating and executing of the state's foreign policy), in any case, does not contribute to the comprehensibility of the Czech Republic's position and attitudes within the European Union.

Coordination of EU Affairs

The following paragraphs perhaps will not be very entertaining; or, maybe, interesting only for readers with some experience of working in state administration. However, despite dryness of this topic, the following lines will deal with certain issues that are essential in the matter of effective and successful functioning of an individual member state within the structures of the contemporary European Union.

Need for a strong national coordinator

Once a country becomes a member state of the European Union, it must establish an operational mechanism of inter-ministerial coordination of the EU affairs, in its own system of public administration. Such a step is a 'conditio sine qua non' for effective promoting of any issues of national interest. For a member state, in any case, it is necessary to speak with one voice in all branches and at all levels of the European Union's decision-making process. However obvious and evident such a condition may seem to be, it is often not so evident when it comes to the day-to-day practice in many areas of the realpolitik in the EU institutions. This is to say, in general, that in almost any state administration the individual min-

istries and departments aspire for as much autonomy and competence as possible; some of those ministries, at the same time, represent different views and interests. Typically, for example, there is always a certain antagonism between the ministries of industry and transport on one side and the ministry of environment on the other one. If the activities of such ministries are not adequately supervised and conducted from some upper level, they very often (if not always) tend to present their own views and opinions, even in the Council of the European Union, as the official country's position, despite the different views of some other relevant bodies of the state administration. This is why there is always need for a strong and competent coordinator of the country's EU policies, for observing and enforcing of integral and coordinated action of all state's representatives on the outside, i.e. in the Council of the European Union, in the first place. The national coordinator must be granted both essential competences and personal and expert capacities to be able to perform its function.

Two political models and their strengths and weaknesses

In the Czech Republic, two basic models of coordination of the EU policies have been experienced so far.

In the period 1998 – 2007, the main body of state administration responsible for inter-ministerial coordination of EU affairs was the Ministry of Foreign Affairs. This ministry conducted all the processes of the accession negotiations from 1998 to 2002. Subsequently, the Minister of Foreign Affairs, who at the same time was the Deputy Prime Minister, was charged with responsibility for coordination of all pre-accession activities until May 2004, when the Czech Republic entered the European Union. Following the 1st May 2004, the Minister for Foreign Affairs started to exercise the function of the national coordinator of the country's positions in the main platform of EU member states, the Council of the European Union.

In consequence of the results of the parliamentary elections in summer 2006, a new coalition government was appointed on a different party platform. For the state administration of the Czech Republic, one of the most remarkable implications of this political alternation was the change in the national coordination of EU affairs. In January 2007, a new Deputy Prime Minister for EU affairs was appointed. This Deputy Prime Minister took over all the responsibilities and competences of the Minister of Foreign Affairs as regards to the coordination of EU affairs within the Czech state administration.

Both the above-mentioned models of coordination have their pros and cons. The first one, based on the Minister of Foreign Affairs as the responsible person, is more flexible with reference to the external dimension of a member state's activities. From an outsiders' viewpoint, the member state is more 'readable' for its partners if it has only one 'Mr or Ms Europe' who is accountable for presenting the national positions at a ministerial level; if there is any question that his or her counterpart abroad needs to discuss immediately, there is always only one telephone number to be dialled. Furthermore, the management of the Permanent Representation in Brussels (which is the main spokesperson of a member state for all the EU institutions) also works more smoothly if it is directed from one headquarters only.

The second model, constituting the office of a specialised minister responsible only for EU affairs, on the other hand, enables the person in charge to concentrate fully on the questions of the country's EU policies. This distinction is very important and it gives the 'EU Minister' a significant advantage, in comparison with a typical Minister of Foreign Affairs. The Foreign Minister simply cannot pay so much attention to the whole EU agenda, since his overall portfolio is much more extensive and the EU topics are only a part of it, although a very important one. Another privilege of the autonomous EU Minister is his position in the government that is slightly different from that of the Foreign Minister. The EU Minister, contrary to his other colleagues in the government, does not have any 'core agenda' of his own, he only coordinates the activities of his colleagues when they are representing the country towards the EU; therefore, there is not so much competition and tensions between him and the other members of the government. Such discrepancies are usually inevitable when the national EU coordinator is the Foreign Minister. That is to say, the Foreign Minister, besides being the EU coordinator, is also responsible for the forming of national positions in the field of the Union's Common Foreign and Security Policy, which makes his stance of the coordinator less neutral.

The Committee on the European Union

Apart from the model of division of competences between the members of the government, the responsible coordinator must establish a functioning coordination mechanism, both for the political and working level of the state administration. In the Czech Republic, for this purpose a specialised inter-ministerial body has been established – The Committee on the European Union.

The Committee on the European Union is a working body of the Government of the Czech Republic set up to determine and coordinate national positions in the European Union. Its Chair at the government level is the Prime Minister, at the working level it is chaired by the Minister for European Affairs. It is composed of the members of the Government or of their deputies at the working level. Sessions of the Committee are held regularly once a week or when necessary.

At the government level, the Committee on the European Union participates in formulating strategic interests of the Czech Republic related to its membership in the European Union, in defining the Czech position towards crucial issues under discussion in the EU bodies and in dealing with other issues that are related to the Czech Republic's membership in the EU. Its most important political task is approving of the mandate for the Czech delegation at the European Council.

The Committee on the European Union at the working level deals with and approves the instructions for the Czech Permanent Representative at the meeting of the Permanent Representative Committee (COREPER), mandates for Czech ministers at the Council of the EU and other materials related to the current EU agenda.

The Committee on the European Union turned out to be a very effective stabilising factor over the course of political and government changes, during the first five years of the EU membership. It has confirmed the fact that a well established and functioning state administration and bureaucratic mechanisms are at least as important as good political echelon.

Czech EU Membership – Costs and Benefits

The process of accession of any country to the EU is connected with many challenges, efforts, and necessary investments, but at the same time with remarkable opportunities, benefits and acquisitions. The final score of each country depends on the level of its own determination and the will to pursue the goal of making its EU membership a success.

Open economy, new challenges and opportunities for citizens

The main platform of European integration remains in the field of economy and trade, despite the dynamic strengthening of political cooperation in other areas (especially in the last twenty years), such as the

justice and home affairs. The opportunity of accession to the Union's Single Market, generally, is the decisive reason for the efforts of all countries aspiring for the EU membership.

This was the case of the Czech Republic as well. As an open economy, the perspective of which is fully dependent on its exports, it was approaching the EU with a view toward boosting its growth and making up for lost time caused by forty years of an ineffective central-planned communist economy. This target has been carried out abundantly; immediately after entering the EU in 2004 and the subsequent removal of all remaining administrative barriers to entry to the single market by Czech exporters, the rate of growth of the Czech economy soared to a level of 4%. In the following years, the rate of the Czech GDP growth kept a steady momentum from 4% to 6% until the outbreak of the economic crisis in the last quarter of 2008.

The great success of Czech exporters, however, was dearly purchased by the necessary restructuring of the Czech economy. At the beginning of 1990's, this economy was burdened by the communist legacy of dependence on the energy-demanding heavy industry. After the breakup of the Council for Mutual Economic Assistance (also referred to as Comecon) and disintegration of its markets, the Czech economy had to adapt to the demands of Western European markets, which brought serious problems to some regions originally dependent on the heavy industry sector. These regions were quickly inflicted by high unemployment rates and in spite of gradual improvement caused by the overall economic recovery, the situation there remains far from being satisfactory. More plainly: for dismissed low-qualified metallurgic workers with only a small chance of finding another job, it is difficult to find some other benefits of the Czech EU membership and economic growth beyond the fact that the state collects enough taxes to pay them their dole money.

On the other hand, there are many groups in society for which EU membership means unconditional benefits without any side effects. Those are, in the first place, language-skilled students, qualified workers or travellers. For all these people, in particular, the lifting of barriers between the member states of the European Union means freedom of movement and exploiting of the EU's potential to the full. For such people, the EU is not a threat – it is an opportunity.

State Administration

As was already mentioned earlier, EU membership, and the long and winding road to it, has meant an enormous challenge and workload

for the state administration. The increased demands on the state's bureaucratic machine, connected particularly with the accession process and the subsequent thorough preparations for the Council Presidency in 2009, has caused a significant expansion of the number of staff working in the state administration (with all the consequences for the national budget). On the other hand, there is usually a wide difference between these new civil servants and their elder colleagues. Working for the government in connection with the country's EU membership has attracted many young, motivated people with great expert knowledge and language skills, which has given the public administration of the Czech Republic new, more dynamic and flexible face. Such a phenomenon is rather typical for all the post-communist countries entering the EU in 2004 and 2007.

Transitional Periods

History teaches us the following: all the EU enlargement waves, when countries with a significantly lower life standard were entering the EU (1981, 1986, 2004, 2007), were marked by outbreaks of certain political moods and general apprehensions, both on the sides of the 'old' and the 'new' member states' broad public. Not surprisingly, there are many politicians in such cases, ready to lend their protective hand to their potential voters; it is obvious that for some kind of politicians it is the easiest way of gaining popularity and political capital. The 2004 enlargement wave was no exception to this rule: many people in Western Europe (and especially in Germany and Austria) were afraid of an invasion of cheap labour from the East, while many inhabitants of the new member states (particularly those from border regions in the Czech Republic, Poland and Hungary) were anxious about the purchase of real estate and farmlands in their neighbourhood by the rich Western Europeans. These apprehensions led to the introduction of transitional periods for the application of some EU fundamental freedoms (such as free movement of labour force or capital), in spite of many serious analyses (the findings of which proved to be correct, later on) showing that such anxieties were unfounded. In this case, the political demand outweighed the reality – even the serious political leaders on both sides of the border simply could not afford to leave the space open for populists, and by doing so, jeopardise the process of EU enlargement itself. Even in 2004, the adoption of transitional periods was a necessary toll to be paid in order to obtain general political consent on a further step in the project of reunification of the once divided continent.

Shared Sovereignty

For a small or middle-sized country (on a European scale), the EU membership brings cost and benefits even in the dimension of power and influence in the international affairs. This is also the case for the Czech Republic. After joining the EU, Czech politicians have realised quickly that a surprising number of state competences are subject to the common decision-making process in Brussels. In such a situation, the state and its political and administrative representatives must necessarily establish effective mechanisms for pushing ahead as much of the country's influence and positions as possible, within this decision-making process. Some of these mechanisms have little in common with transparency and official methods and rules of functioning of the EU institutions. However, these informal procedures are prerequisites for promoting any issues of national interest.

The shared sovereignty of the EU member states, on the other hand, means also greater opportunities for smaller countries to push forward their particular visions and views in the global competition. For doing so, however, it is necessary for these countries to be able to build up effective alliances with other like-minded countries within the Union. Such a building of alliances is only possible if it is based on concrete and tangible projects with high added value for all the parties involved (such as energy security projects, for example). Thus, it is the best way of contributing to the common benefit of all EU members, as well as to international and global stability and prosperity.

FIVE YEARS OF SLOVENIAN EU MEMBERSHIP: IMPLICATIONS AND LESSONS LEARNED

Anže Burger, Ph.D. and Marjan Svetličič, Ph.D.¹

1. Introduction

On May 1, 2009, Slovenia celebrated five years of EU membership. The road to membership was historically short but bumpy. Its experiences are highly relevant for other potential members from the region on their road to the EU membership due to similarities in its historical background.

The objective of this article is first to present basic turning points in the road to membership and secondly highlight what were the initial dilemmas. The fourth section is devoted to the dilemma regarding the timing of the membership, while section 5 examines transition or EU-specific implications of membership. They are going to be compared with the actual implications and performance of Slovenia as the new member state in section 6. Future challenges will be presented in section 7.

2. Brief history

Slovenia's road to membership was not so short. However, it progressed even faster than some other new transition member states that became associated members earlier than Slovenia. One of the reasons for the delay was the dispute with Italy regarding the Article 68 of the Slovenian constitution, preventing foreigners to buy property in Slovenia. At

¹Faculty of Social Sciences, University of Ljubljana.

the end of 1995 the so called Spanish compromise resolved the issue and Slovenia was able to sign the Association agreement and apply for membership on June 10, 1996.

Table 1: *Turning points of the Slovenia road to EU membership*

Dates	Events
December 1995	Spanish compromise regarding real estate ²
June 1996	Signing of the European agreement (implemented on Jan. 1999) and application for membership
March 31, 1998	Membership negotiations started
January 1998	Accession strategy adopted by the Government
May 1, 2004	Slovenia became EU Member
January 1, 2007	Slovenia became a member of the Eurozone
December 12, 2007	Slovenia became a part of Schengen area
January 1– June 30 2008	EU Council Presidency

In order to achieve all this, preparations started rather early on the political as well as on the expert level. The first comprehensive strategy for international economic relations and increasing competitiveness was already adopted in 1996/97, following some three years of work. At that time, EU membership was not at the centre of the strategy although it was implicitly included in the deliberations. In May 1997, formal elements of the strategy for EU membership were adopted at the political level and the special membership strategy had been initiated and formally adopted in September 1998.

There are two key lessons relating to the European integration process: i) it takes a lot of time and political and expert effort to become a member and ii) compromises are needed.

3. Initial dilemmas and alternatives

At the beginning of the process, Euro enthusiasts tended to say that there is no alternative for Slovenia but to become an EU member.

²More in Marjan Svetličič, "Slovenian state strategy in the new Europe," (TKI working papers on European integration and regime formation 1998, 34, footnote 29. Esbjerg (Denmark): Sydjysk Universitetsforlag: South Jutland University Press, 1998.

Experts disagreed³, saying that there were alternatives and costs and benefits of integrating and non-integrating. "But even if the costs of joining were high, the higher costs of non-joining could still support the decision to join, provided that the benefits of joining were higher than (or equal) to the benefits of not joining. The costs of non-integrating are basically the costs of fragmented small markets operating below minimum efficiency."⁴ . It was claimed that it is politically unwise to say to the public that there is no alternative. One should recognise the costs of non-integration, what is the Best Alternative to a Negotiated Agreement (BATNA), that is, according to the negotiations theory the real basis to assess the negotiations outcome or counterfactual in more economic terms. The study indicated several alternatives: 1) complete liberalisation of trade (Singapore model), 2) EFTA or some other regional bloc, 3) reintegration in new Yugoslavia, which was the option initially advocated by some Western democracies, and finally 4) stand alone inward looking strategy.

In-depth evaluation of the costs and benefits of each of these alternatives showed that in view of the very intensive real integration of the Slovene economy into the EU market,⁵ and as Slovenia therefore had to follow the rules on such markets irrespective of membership, EU membership was the best among possible alternatives. Switzerland and Norway can illustrate that adopting *acquis communautaire* is a must for a small country like Slovenia, irrespective of EU membership.

4. Accelerated or delayed membership?

The major dilemma was whether to speed up the process of membership or, alternatively, to take more time in order to be better prepared for membership. There were advantages and disadvantages of both alternatives. A study undertaken to resolve the issue showed that the trade-off pointed clearly in favor of rapid integration until 2004⁶. Major arguments

³Marjan Svetličič, "Svetovno podjetje: izzivi mednarodne proizvodnje," (Zbirka Alfa 1996, 1), p. Ljubljana: Znanstveno in publicistično središče, 1996. 321; Marjan Svetličič, Slovenija in Evropska unija, V: Strategija ekonomskih odnosov s tujino, Slovenija in Evropska unija. Ljubljana (Slovenia): Ministrarstvo za ekonomske odnose in razvoj, 1996.

⁴Marjan Svetličič, "A small country going into Europe: economic pragmatism and nationhood": Danica Fink-Hafner and Terry Cox, eds. Into Europe?: Perspectives from Britain and Slovenia, p. 218. Ljubljana (Slovenia): Scientific library, 18: Faculty of Social Sciences, 1996.

⁵EU accounted for 67% of total Slovene exports already in 2002.

⁶Marjan Svetličič, *Zunanje determinante razvoja Slovenije in implikacije hitre oziroma odložene vključitve v Evropsko unijo*. Teorija in praksa, 2000.

for the chosen strategy were that slower integration would postpone the much needed transition-related reforms, that the door to EU may not be open permanently so wide, and that the slower path may postpone the membership for too long in waiting for the other potential members to become part of the accession process. It was a historic moment, the momentum of which one must take advantage of. Present enlargement fatigue and economic crisis have proven that the right decision was made.

In the case of rapid accession, there is a danger of weakening one's bargaining position under time pressure and lack of accession knowledge that accumulates in longer accession process. Costs of accession would also be concentrated in a rather short period and firms would have little time to adjust, which could bring about unemployment and social problems. Irrespective of the disadvantages of a rapid accession process, it is still better not to postpone transformation by postponing EU membership. It became quite clear that the costs of accession are much more transition-specific than EU-related, although the latter has been strongly emphasized during the debates in the press and in the public in general. Postponed integration would also imply less inward FDI and hence less potential for beneficial dynamic integration effects. Last but not least, fewer funds from the EU for structural reforms and regional development were to be expected. It was estimated that a member can get five times more funds from the EU than an associated member.

5. Expected implications

Trade integration theory identifies two types of static trade effects (trade creation and trade diversion) and several dynamic effects of integration. In view of the specific history of Slovenia, static trade effects were assessed to be less important than dynamic effects. Namely, the largest part of static trade creation effects have been absorbed already in the special status and association membership stage. In that period, Slovenia had the benefit of using the Yugoslav quotas. A large part of Slovene exports therefore enjoyed duty free access to EU markets already before the membership. In view of rather modest trade relations with non-EU members, trade diversion effects were also assumed to be insignificant. Nevertheless, due to tectonic changes in the world we are facing today, such effects are to be taken more seriously since emerging or developing countries will become the most important markets in the world in the decades to

come. Arora and Vamvakides⁷ established that even controlling for other growth determinants, a 1% point increase in growth in a country's trading partner is correlated with 0.8% point rise in domestic growth. The long-term dynamic effects of integration for which the theory predicts to be five to six times more important than static effects⁸ appeared in the case of Slovenia the most important ones.

6. Impact of EU membership

Five years is too short a period to be able to make a robust assessment of EU membership. The time for doing it is also making it more complicated since it is almost impossible to demarcate the impact of EU membership effects from the boom of China and other BRIC countries⁹ expansion before the crisis, the substantial increase of commodity prices during this period, or with the implications of transition. Effects are strongly intertwined. It is also very difficult to separate direct from indirect effects of membership¹⁰. General assessment is that the transition effects have been stronger than the effects of EU membership per se. Therefore, we will elaborate more on the implications of membership and not really try to calculate EU membership effects robustly per se. We will evaluate major trends and try to indicate to what extent they can be attributed to EU membership or some other factors.

As expected, dynamic integration effects (enhanced competition leading to increased productivity/innovativeness, access to technology, better allocation of resources, economies of scale) have been qualitatively much more important than static trade creation and trade diversion effects. To illustrate; the competition on the Slovene market has, as perceived by the Eurobarometer survey, increased 69% in the last two years, much the same as in other new member states (NMSs)¹¹.

What should not be forgotten are also general security, political, psychological, and cultural effects of membership. These include more

⁷Vivek Arora and Athanasios Vamvakidis, *Economic Spillovers*, 2005.

⁸More in Salvatore D, *International Economics*, seventh edition, John Wiley & Sons Inc.

⁹Brazil, Russia, India and China

¹⁰See UMAR. *Pomladansko poročilo*. Ljubljana, 2005.101.

¹¹“European Economy, *Five years of an Enlarged EU; Economic Achievements and Challenges*, 2009, Graph III.2.6.

stability and security, which is extremely important for countries living in the unstable Balkans. Psychologically, the advantage of freely travelling within the EU and all other liberties is what the general public at large observes and appreciates in the everyday life. One therefore also has to assess such soft effects and not only hard economic data.

General growth performance of Slovenia as an EU member has been until the present crises very good. GDP as well as GDP per capita increased substantially and Slovenia was the fastest in catching up to the EU15 among NMSs.

Table 2: General Slovenia growth indicators 2004-2007^{12, 13}

	2004	2007	2008
GDP (mil. EUR, current prices, fixed exchange rate)	27,073	34,471	37.126
GDP growth rates, constant prices	4.3%	6.8%	3.5%
GDP per capita, current exch. rate	13,599	17,076	18,219*
GDP p.c. relative to EU27 average	83% (2003)		90%
Export to EU25 (% of total exports)	66.1 %		70.6%
Import from EU25 (% of total imports)	82.2 %		78.9%
Current account (% of GDP)	-2.7		-5.5

The growth rates were substantially higher than the World or EU15 averages, but are expected to be negative in 2009 (4 % according to UMAR).

The main channel through which Slovenia was affected by the global crisis is trade, as foreign demand (especially from Germany, Austria and Italy) has fallen sharply. The contribution of net exports to aggregate growth already became negative in 2007¹⁴. Tight integration with the EU common market and economic openness make Slovenia highly responsive to EU fluctuations of output. As much as 74% of Slovenian growth rate

¹²UMAR, *Socialni razgledi*, ur. Matjaž Hanžek, Tanja Čelebič, Valerija Korošec, Vanja Pečar. Ljubljana, 2009, 15,17, 159. Bank of Slovenia, Price Stability Report, Ljubljana March 2009.

¹³Authors' calculation.

¹⁴See Bank of Slovenia, *Price Stability Report*, Ljubljana, March 2009,13.

can be explained by the EU growth rates fluctuations (see EU explained growth). One percentage point change in EU growth rate has resulted in 1.4% change of growth in Slovenia¹⁵.

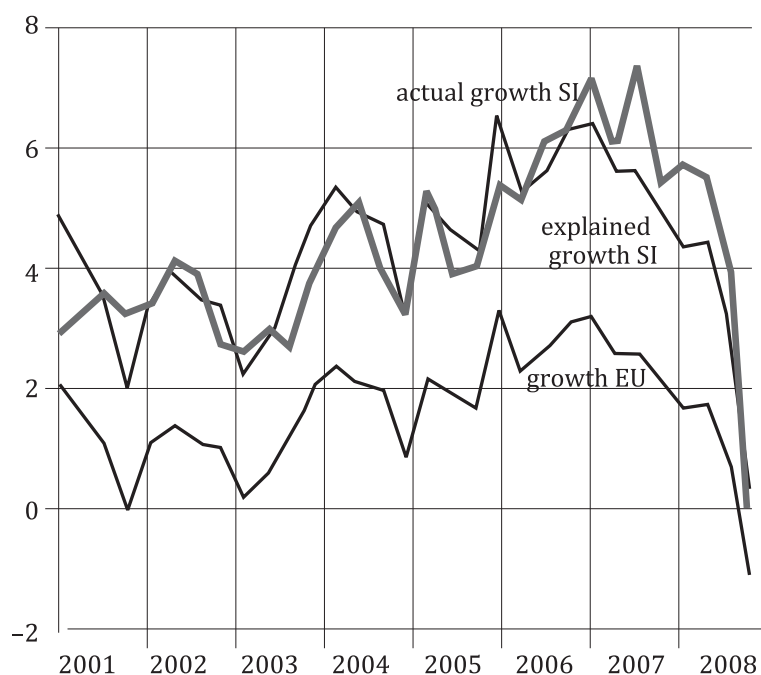


Figure 1: Slovenian growth compared to EU 2001-2008¹⁶

The unemployment rate decreased substantially before the outburst of the crisis in 2008, but started to increase afterwards. In the first half of 2009 the ratio of working population to total population dropped from 49% back to 1993 level of 42%.

As part of the preparation for the adoption of Euro the inflation rate was lowered by the social agreement of 2002 to keep wage growth below that of productivity, as well as by subsequent entry in ERMII mechanism, but picked up soon after its adoption. Partly as “cost inflation as a consequence of artificially keeping inflation down in the Euro preparation period”¹⁷. Some signs of overheating emerged after Euro area entry

¹⁵Jože Mencinger, *Kako smo prišli, kjer smo? Gospodarska gibanja*. Ljubljana, March 2009, 30.

¹⁶Ibid, 30.

¹⁷Ibid, 33.

in 2007, which coincided with strong commodity price shocks, with inflation peaking mid-2008 at the highest level within the euro area and unemployment falling significantly below its estimated natural rate¹⁸. After euro area entry, fiscal policy was not sufficiently restrictive to provide an appropriate policy mix vis-à-vis the euro area monetary stance, which was relatively loose for a booming catching-up economy.

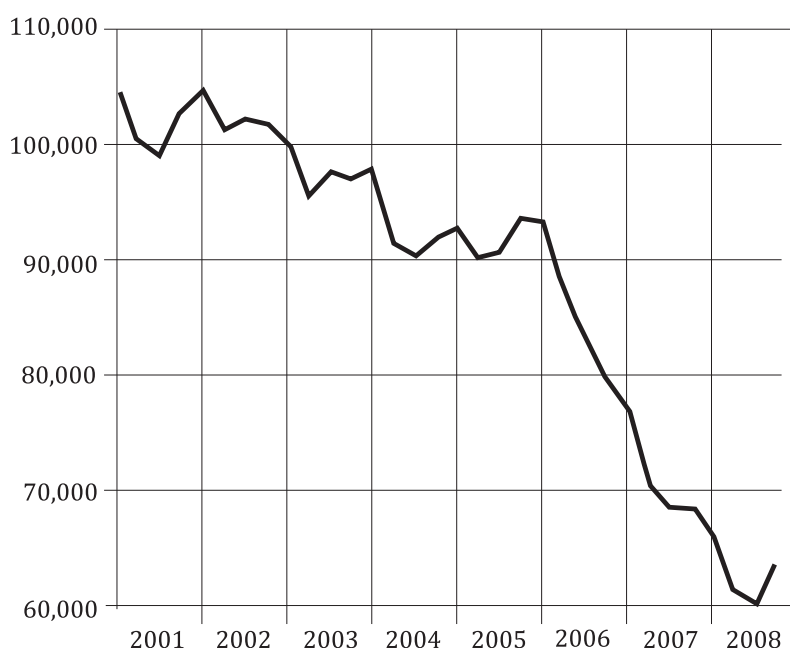


Figure 2: Registered job seekers in Slovenia 2001-2008¹⁹

Despite all negative shocks, the competitiveness of the Slovene economy has modestly improved after EU entry, but is still lagging much behind old member states. Competitiveness ranks are oscillating between 35th and 42nd place (WEF) and 22nd and 32nd (IMD) in the period 2002-2008.²⁰ Its global export market share as an indicator of global competitiveness has increased from 0.15 in 1999 to 0.21 in 2007, mostly thanks to substantial increase of export to NMSs (share increased from 0.43 to

¹⁸OECD Economy Surveys: Slovenia. Organisation for Economic Cooperation and Development. Paris 2009, 11.

¹⁹Ibid. 3.

²⁰See UMAR. *Poročilo o razvoju*. Ljubljana, May 2009.

0.76) but also to old member states (from 0.27 to 0.35%)²¹. In the World Bank's ranking of Ease of Doing Business, Slovenia occupies only the 54th place (up from 64th place in 2008). Among the EU members, only a few countries report stronger obstacles to entrepreneurial activity.

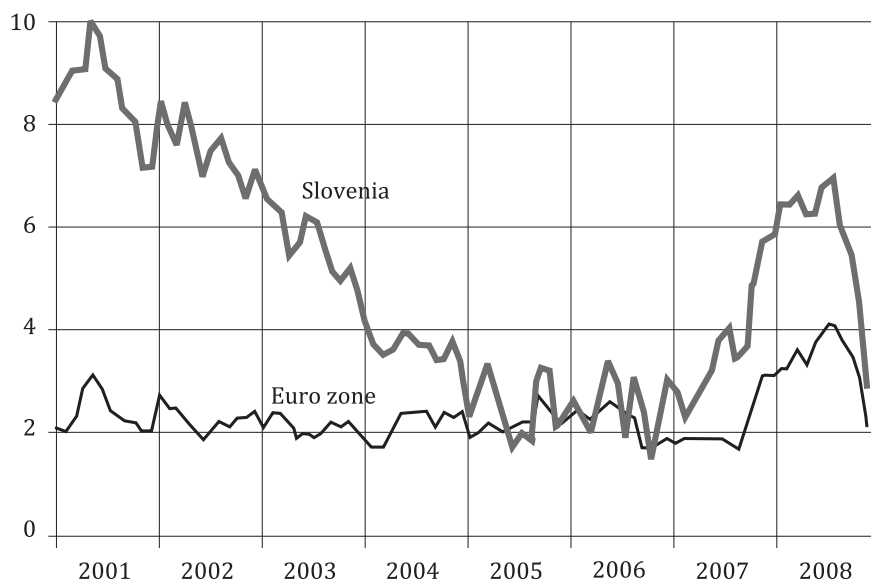


Figure 3: Rate of inflation in Slovenia 2001-2008²²

As a new EU member, the Slovene economy became even more open to trade. The share of exports of goods and services in GDP increased from 59.5 % in 2004 to 72.3 % in 2007. Export of goods alone increased from 46.2 % to 61.4 % in the same period. Consequently, Slovenia is much more open than EU27 (39.9 % for goods and services in 2007;²³). Substantial increase of trade flows in both directions demonstrates strong trade creation effects.

The highest growth rates have been achieved with new members but also with some old members like Greece and Finland. Trade conditions

²¹European Economy, *Five years of an Enlarged EU; Economic Achievements and Challenges*, 2009, 63.

²²Jože Mencinger, *Kako smo prišli, kjer smo? Gospodarska gibanja*, Ljubljana, March 2009, 33.

²³IMAD, *Development report*, Ljubljana, 2008, 93.

deteriorated meanwhile for trade with Croatia, Bosnia and Herzegovina and Macedonia due to the re-introduction of tariffs for export in these countries. The situation gradually improved after the signing of stabilisation-association agreements, foreseeing gradual tariff reduction. Import growth outperformed export, contributing to the deteriorating current account that was in balance until 2003. Traditional trade surplus in services was unable to finance increasing import bill and recent outflow of FDI profits. Terms of trade for goods and services also deteriorated (2007 being a short exception) due to faster import to export prices in the entire post-accession period²⁴.

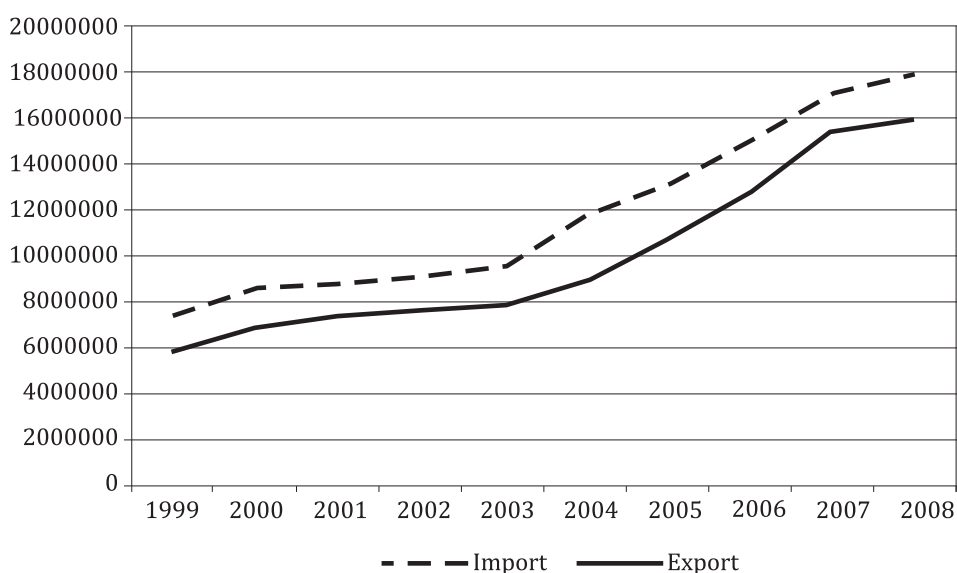


Figure 4: Slovene Import and export from/in EU27 1999–2008; in 1000 EUR²⁵

Structural changes have been positive, but too slow. The share of labour intensive goods in exports have been significantly reduced, yet the increase in more technology intensive sectors was much more modest, particularly in difficult to imitate R&D intensive goods.

²⁴Bank of Slovenia, *Price Stability Report*, Ljubljana, March 2009, 45 and 47.

²⁵Eurostat

FIVE YEARS OF SLOVENIAN EU MEMBERSHIP

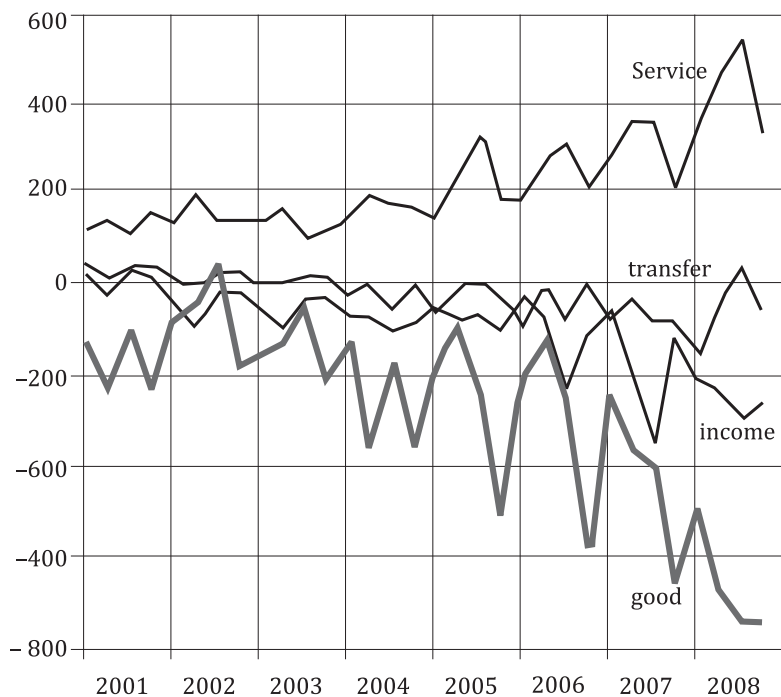


Figure 5: Current account of Slovenia 2001-2008 and its structure ²⁶

Table 3: Changes of shares of types of goods in Slovene export in terms of factor intensity in total export 2004-2008^{27, 28}

	Raw material int. goods		Labour-intensive goods		Capital int. goods		R&D int. goods; easy to imitate		R&D int. goods; difficult to imitate	
	2004	2006	2004	2006	2004	2006	2004	2006	2004	2006
Slovenia	4	6	27	22	29	32	11	11	29	28
NMSs	14	14	23	20	23	25	14	15	26	26
OMSs*	12	15	17	15	23	23	28	27	28	27

²⁶Jože Mencinger, *Kako smo prišli, kjer smo? Gospodarska gibanja*. Ljubljana, March 2009, 36.

²⁷European Economy, *Five years of an Enlarged EU; Economic Achievements and Challenges*, 2009. 67.

²⁸OMS: Old member states.

The strongest change in manufacturing export has only been in the medium and low technology intensive sectors while no changes have occurred in the share of high technology and Information Communication Technology (ICT) goods.

Table 4: *Changes of shares of types of goods in manufacturing exports of Slovenia by technology intensity 2004-2008²⁹*

Country	Low-tech industries		Medium-tech industries		Medium-high-tech industries		High-tech industries		ICT industries (part of high technology)	
	2004	2006	2004	2006	2004	2006	2004	2006	2004	2006
Slovenia	26	19	20	25	48	51	6	5	4	3
NMSs	28	21	20	22	38	42	13	14	13	14
OMSs	21	18	16	19	46	46	18	16	12	12

Traditional export structure still prevails. Restructuring process has been taking place but modestly. Partly it can be explained by more modest inflow of FDI in modern sectors which could have stimulated higher value added export. Slovene manufacturing firms are still exporters of medium technology intensive goods with even increasing shares. The gap behind NMSs in high technology exports is the widest and even widening. Nevertheless, employment in high-tech manufacturing and knowledge intensive high technology services increased in 2004-06³⁰. In the service sector, tourism experienced the largest gains from EU membership: 26% more tourists came to Ljubljana the first year after the accession and the flow is still increasing.

Modest improvements in the structure of Slovene exports stem from the unfavourable production structure. Combined share of agriculture, extractive industries and manufacturing in Slovene GDP stagnated at 30% since 1997. Manufacturing share even gained 1.9 percentage points since 1997 and in 2007 comprised 27.4% of GDP, compared to 20% in EU15. There is a huge heterogeneity in relative expansion and contraction across sub sectors of manufacturing: Manufacture of coke, refined petro-

²⁹European Economy, *Five years of an Enlarged EU; Economic Achievements and Challenges*, 2009, 68.

³⁰Ibid, 72.

leum products and nuclear fuel (DF), Manufacture of leather and leather products (DC), and Manufacture of textiles and textile products (DB) experienced the largest relative decrease in output³¹, whereas Manufacture of food products, beverages and tobacco (DA) and Manufacture of textiles and textile products (DB) contracted the most in absolute terms (-1.0% and -1.1% points, respectively). On the other hand, Transport equipment (DM), Basic metals and fabricated metal products (DJ), and Electrical and optical equipment (DL) experienced the largest relative and absolute increase in activity within manufacturing since 1997.

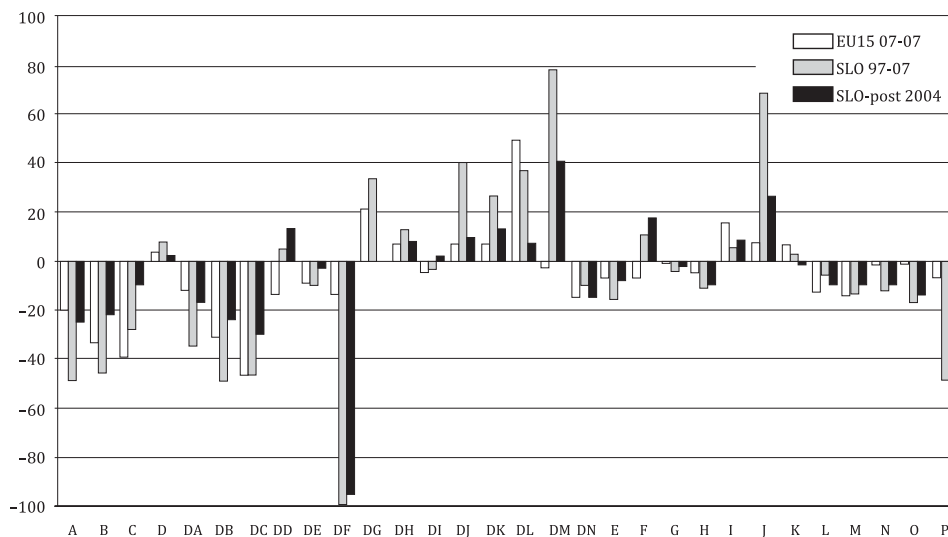


Figure 6: Growth of value added share in Slovenian GDP by sector, 1997-2007 (in %)³²

In line with capital deepening during the catching-up process, Slovenian construction sector makes up a larger share of GDP (7.4% in 2007) than in EU15 (5.5%) and, contrary to EU15, experienced positive growth of its share in GDP, especially after the EU accession. Despite an increase in employment share and productivity/performance of service industries (G-P)³³, value added share in GDP declined in all the service sectors but

³¹See Figure 6

³²Source: own calculations using Eurostat data.

³³See Anže Burger and Metka Stare, "Public and Private Services Transformation in the CEECs," *Service Industries Journal*. Routledge, 2010

Transport, storage and communication (I), Financial intermediation (J), and Real estate, renting and business activities (K). Their combined output remained unchanged since 1997 at 60% of GDP. In terms of private-public dichotomy, private services (G-K) gained the value added share in GDP but the convergence to EU15 employment shares was absent. On the other hand, public services' (L-O) share in GDP declined yet at the same time, considerable convergence in employment share towards EU15 average was achieved in the 1997-2007 period.

Joining the EMU was obligatory for Slovenia and the rest of NMSs. After fulfilling all the Maastricht criteria, Slovenia became member of the Euro zone on January 1st 2007 as the first NMS. Micro economic advantages of introducing Euro (elimination of exchange rate fluctuations and risks and related costs, more transparency and comparability of prices and currency conversion elimination) have materialised and international transactions became cheaper. Among macro economic advantages the most important ones are macroeconomic stability, lower inflation and interest rates. All these facilitated integration in the EU and consequently economic growth, particularly in 2007³⁴.

Accepting the Euro meant losing instruments of monetary and exchange rate policy which had de facto happened already. Secondly, the soaring inflation after Euro introduction in 2007 and 2008 was only modestly a result of Euro introduction (assessed officially only at the 0.3% level;³⁵).

Furthermore, the present global financial crisis illustrates all the benefits of being part of Eurozone. Now Euro area membership is more attractive, both for its actual members and for its potential members. The euro cannot protect countries from all the effects of the crisis, but can prevent additional difficulties which result from the existence of weak national currencies. Many NMSs are now seeking accelerated ways to become members of Eurozone since members have certain protection against fluctuations of national currencies in the era of great monetary instability³⁶.

Foreign direct investments³⁷ are agents of dynamic integration effects. Inward and outward FDI increased significantly after the acces-

³⁴See Vlado Lavrač, *Evro po dveh letih v Sloveniji*, *Bančni vestnik*, No. 3. Ljubljana, 2009, 9-11.; Vlado Lavrač, *Bančni vestnik*, No. 1-2, Ljubljana, 2009, 9-11.

³⁵See: UMAR, *Spring Forecasts of Economic Trends*, Ljubljana, 2008, 11.

³⁶Vlado Lavrač, *Ekonomska in monetarna unija*, V Sabina Kajnič in Damjan Lajlh, *Evropska unija od A do Ž. Uradni list*, Ljubljana, 2009, 52.

³⁷More in UMAR, *Poročilo o razvoju 2009*. Ljubljana, May 2009. 109-112.

sion (in 2007 mostly as a result of methodological changes in monitoring FDI³⁸) but also as the result of a sharp increase in net liabilities due to increased borrowing of subsidiaries from foreign owners mainly in the financial sector (banks, leasing companies, insurance companies) in 2007 and 2008 Slovenia has obviously become more attractive location for FDI but due to small market can not attract much of market oriented FDI. EU accession notwithstanding, flows of inward FDI have remained subdued in terms of GDP, particularly in comparison to other transition economies. In some key service sectors, high market concentration and dominant state involvement have deterred inward flows of FDI. Slovenia is among the EU Member States with the lowest inward FDI stock to GDP ratios. Among old Member States, only large countries like Germany, Italy and Greece have lower ratios of inward FDI stock to GDP, while Slovenia has the lowest ratio among NMSs. It has been expected that membership will imply substantial increase of FDI flows. However the experiences of other countries have also demonstrated that much of this membership enhanced effects have been realised before the membership.³⁹

Table 5: Flows and stocks of inward and outward FDI in Slovenia in 2000–2008⁴⁰

	2000	2005	2006	2007	2008
Inward FDI stock, end year	3,109.8	6,133.6	6,822.3	9,542.9	n.a. ⁴¹
Annual inflow	149.1	472.5	513.3	1,050.3	1,234.7
Inward FDI stock, % GDP	14.8	21.7	22.0	27.7	n.a.
Stock of outward FDI, end year	825.3	2,788.7	3,452.2	4,888.8	n.a.
Annual outflow of FDI ⁴²	-71.7	-515.6	-687.0	-1,319.0	-977.6
Stock of outward FDI, % GDP	3.9	9.9	11.1	14.2	n.a.

³⁸Since 2007, the Bank of Slovenia has namely been covering claims and liabilities between the parent company and its affiliates more widely. A more reliable estimate is that increase was only 4.5 %.

³⁹Marjan Svetličič and Matija Rojec: *The Global Economy, Security, and Small States in the Post Cold War World*, ed. Zlatko Šabič and Charles Bukovski, Preager, Westpoint, Connecticut, London, 129-144.

⁴⁰Source: <http://www.bsi.si> – Bank of Slovenia website; SI-STAT data portal – National accounts, 2009, 2008

⁴¹Remark: n./a.- no data

⁴²A minus sign denotes an outflow.

In terms of outward FDI, Slovenia is performing much better. The share of outward FDI stock to GDP of 14.2% was in 2007 only surpassed by Cyprus (31.3%), Estonia (27.6%) and Malta (15.7%). In line with its development level, Slovenia was far behind the old EU Member States (except Greece) as regards outward FDI stock to GDP ratio. Slovenian firms are among the leading ones in the dynamics of outward internationalisation among transition NMSs. This is important in view of the research findings, which argue that it is multinationality that matters the most for competitiveness and not the ownership. Firms started investing abroad already during the socialist era and very strongly after 2000. Major destinations were the former constituent republics of Yugoslavia, exploiting first-comer advantages and expected high rates of return on capital, as well as just transforming their previous internal links to international ones after the republics became independent states. Following several years of increase, FDI outflows from Slovenia also recorded a decline in 2008 so that after three years Slovenia again became a net importer of foreign direct investment.

Due to the openness of Slovenia and relatively strong orientation towards the EU market even before the membership, accession did not cause major disturbances. Some protected industries (tobacco and food processing, textile, leather and shoes⁴³) failed to restructure on time and are now facing serious problems due to the enhanced competition, rising labour costs and decreasing demand.

Slovenia is still the second least indebted Euro member state: it held 105.3% of gross external debt to GDP in 2008 which is almost a half of the average of the Euro area in 2007 (Euro area 192 %;⁴⁴) However, the debt increased from 41% of GDP in 2000.

Taking into account only budget-related flows, Slovenia was net contributor to the EU budget in 2007. All transfers between Slovenia and EU included, however, Slovenia is still receiving more from EU than paying to it. The absorption of EU funds has been frequently indicated as one of the major problems. Absorption rate defined as the ratio of ex-post

⁴³In food industry production was reduced by 6.8% in 2004. Agro and food exports plummeted, whereas imports increased by 12% in 2004. The decline of textile industry has been more the result of global changes in the industry, while EU membership had minor effects. Forwarding industry also faced major challenges due to the elimination of tariffs. (More in Marjan Svetličič: *Zunanje determinante razvoja Slovenije in implikacije hitre oziroma odložene vključitve v Evropsko unijo. Teorija in praksa, Vol.37, No1, 129-144*)

⁴⁴See: UMAR, *Poročilo o razvoju 2009*. Ljubljana, May 2009,97

amount of funds that have been spent to the ex-ante spending targets is in the case of structural funds however not much different than that of NMSs: 94% for Slovenia vs. 91% in NMSs. In the case of the Cohesion Fund and ISPA it is as low as 64%, yet still higher than in other NMSs⁴⁵.

The fears of membership having substantial negative effects on trade with Western Balkans have not materialised so much despite the abolition of bilateral free trade agreements. Initially, exports to Bosnia and Macedonia were reduced, but later picked up. Income inequality increased immediately after independence until 1993 (transition effect). After 2004 inequalities slightly reduced and after 2006 slightly increased, both mainly as a result of a new personal income tax introduced in 2004 and 2006⁴⁶. Despite the slight increase in the transition period, income inequality in Slovenia is the lowest in the EU as a result of generous welfare state and progressive taxation.

Among the greatest fears in old member states was an increase of immigration flows from NMSs. Despite the miniscule threat due to its smallness, restrictions to free flow of labour from Slovenia were nevertheless implemented. The experience confirmed that not much outflow of labour can be expected from Slovenia due to cultural, linguistic and other reasons. Emigration from Slovenia was very modest although increasing but still representing less than 50% of inflow of labour. Former Yugoslavia was the major source region.

Table 6: *International migration in and out of Slovenia 2004-2007*⁴⁷

	2004		2007	
	Number	From/in former Yugoslavia as % of total 2006	Number	From/In former Yugoslavia as % of total 2006
Immigrants from abroad	10,171	85	29,193	87
Emigration	8,269	64	14,943	73

⁴⁵European Economy, *Five years of an Enlarged EU; Economic Achievements and Challenges, 2009, 207.*

⁴⁶Tine Stanovnik, *Kaj se dogaja z dohodkovno nenenakostjo v Sloveniji*, Delo, Ljubljana, March 2, 2009.

⁴⁷UMAR, *Socialni razgledi*, ur. Matjaž Hanžek, Tanja Čelebič, Valerija Korošec, Vanja Pečar, Ljubljana, February 2009, 167-168.

7. Conclusions and challenges

Although it is impossible to determine to what extent the accession itself contributed to the performance of the Slovenian economy in the last five years, Slovene membership in the EU can be overall assessed as a success story. Accepting the Euro has also proven to be a success, particularly now in times of the crisis since it insulated the country from exchange rates fluctuations.

The membership effects are also to a large extent preparation specific and depend on sound reforms and ex ante adjustments at all levels of the economy and society. The Slovene economy has to adjust to new specialisation and allocation of resources as the EU becomes a large new "domestic" market for Slovene firms. It implies a general change of mentality not only of business practices and policies. It is also necessary to realise that there is a new policy arena and that competitiveness starts to depend not only on the material factors but also on the ability to influence decisions in Brussels. Some *Balkan* practices are not working in Brussels. Local decisions have wider EU context including those of local courts. Therefore, some "old boy's networks" practices may later strike as a boomerang⁴⁸.

Most of the adjustment costs, including initial high unemployment rates and inflation have been transition- rather than membership-specific phenomenon. Although most important effects appear to have been trade creation, trade diversion effects should, in view of tectonic changes in the world and rising importance of emerging economies, be taken very seriously in the future. Therefore, gaining market shares in emerging markets is one of the major challenges, since keeping market shares in the EU will be increasingly tough thanks to tougher competition from non-members.

Furthermore, negotiating a membership is not, what is sometimes wrongly assumed, negotiation with Brussels, but with other member states and even more importantly, negotiations with own domestic public. All decisions have to be orchestrated and synchronised at home in order to have a strong bargaining position externally. Active role of economic sphere is highly needed already in negotiation phase so that the proposals and decisions are aligned with the interest of real players that can get better and on time prepared to new challenges. In such a way disappointments with results usually following the first year of membership are ex

⁴⁸See Peter Ješovnik, Marjan Svetličič, *Kako z ekonomsko-poslovno diplomacijo okrepiti zmožnosti slovenskih subjektov v Evropski uniji*. V: Miro Hacek (ur.), Drago Zajec (ur.). *Slovenij v EU : zmožnosti in priložnosti*. Ljubljana: Fakultet za družbene vede, 2005.

ante reduced since expectations are kept realistic throughout the negotiating process.

Negotiations also demand new kind of skills that are more soft than hard. New competencies like foreign languages, communication, and negotiation skills need to be developed, so that negotiators improve their ability to articulate their hard knowledge more efficiently⁴⁹.

Finally, potential new members should also not forget that the “normal” aspiration of younger generations in potential member countries is to become an EU member. For them it is something that belongs to them as Europeans and the task of the present generation is to make this aspiration of the young happen.

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⁴⁹Marjan Svetličič and Sabina Kajnič, *Small States Presidency Competences; the case of Slovenian EU Council 'Presidency' in 2008, Forthcoming in Halduskultuur – Administrative Culture*. Tallin (Estonia): Tallina Tehnikaülikool/Tallinn University of Technology, 2009, <http://www.ttu.ee/hum>

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