

**USAID/Serbia**

**Annual Report**

**FY 2004**

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## Serbia

### Performance:

Background: The program managed by the United States Agency for International Development in Serbia and Montenegro in FY 2003 pursued three Strategic Objectives in the Republic of Serbia. These Objectives advanced ten U.S. International Affairs Strategic Goals: regional stability; democracy and human rights; economic development; global growth and stability; counter terrorism; humanitarian assistance; open markets; U.S. exports; reduction of illegal drugs; and environmental improvement. Although heavily focused on strengthening democracy and governance goals of the Agency's Democracy, Conflict and Humanitarian Assistance Pillar, the program also supported the Agency's Economic Growth, Agriculture and Trade Pillar through significant support for encouraging broad-based economic growth and contributions to human capacity building and environmental protection.

The past year has been one of severe challenges both politically and economically. The Republic ends the year having witnessed the assassination of its Prime Minister, three failed presidential elections and the dissolution of Parliament, leaving it without a president and parliament. The success of the Serbian Radical Party, whose candidate took the most votes in the failed presidential election, signals the level of citizens' base fears concerning their position within Serbia's changing economy and of disgust with the Serbian leadership's infighting, corruption and perceived preference for bowing to international pressures. Over 80 pieces of legislation necessary to institute the regulatory and legal framework to drive the democratic and economic reforms forward remained unaddressed as the government was paralyzed for 10 months. Accusations of corruption at the highest level led to high profile dismissals and resignations. Progress on other aspects of political development was slowed, stalled, or even reversed.

Media reform has been disappointing. The trends show a return to media restraints and control that were hallmarks of past eras. The public information law passed by Parliament during the State of Emergency instituted after the Prime Minister's assassination and amid restrictions on civil society and media activity fell far short of the bill that most media reformers wanted to see. The Broadcast Council charged with allocating republic-wide frequencies was inaugurated in April of 2003. Appointments were made in what many believe was an extralegal fashion skewed so as to ensure that media, granted privileged access to the airwaves during the Milosevic period, would continue to enjoy that status. If the council goes forward as presently composed, equal access to the airwaves for independent media outlets will be questionable. Civil society fared scarcely better during this period, as long-awaited legislation that could ensure a more regular, supportive legal climate for its work remains stalled.

The Government of Serbia's (GOS) record on rule of law during this period was decidedly mixed. Positive developments included the passage of organized crime and domestic war crimes statutes that grant prosecutors additional tools in trying these special cases, as well as provisions for witness protection. The GOS also allocated space for a Special Court to try these cases, which USAID and other parts of the U.S. Government are helping to establish.

Serbia continued to make progress on an ambitious economic reform program in 2003, but the economy remains weak and vulnerable to reform delays and external shocks. The macroeconomic indicators remained relatively stable. However, the fragile economic gains are heavily dependent on continued donor support, uncertain privatization revenues, a political and social environment supportive of continued fiscal discipline and significant recovery of productive and export capacity. High public expectations for a quick economic turnaround following the ouster of Milosevic and removal of international sanctions have not yet been met, and increasing demands for wage increases and more attention to the social costs of transition are putting heavy pressure on already overextended budgets.

The EU-brokered 2002 Belgrade Agreement which provided the framework for the Union of Serbia and Montenegro dominated the executive and legislative agenda displacing reforms legislation. At year-end the legislative agenda was choked with unpassed bills; there is a backlog of 80 economic related laws alone. Stalled are laws such as the Bankruptcy Law and the Business Service Law that will significantly improve the business climate, and the Value-Added-Tax (VAT) Law that is a predicate for tax and fiscal reform, as well as municipal finance. The Government of Serbia did pass some important commercial laws in 2003, including the Concessions Law, the Law on Leasing and the Secured Transaction Law.

The key economic structural success of 2003 was registered in the first quarter. The government abolished the communist-era Central Payments Bureau (ZOP) which was a shackle on business and commerce. In ZOP's place, the National Bank constructed a Real-Time Gross Settlement System (RTGS) which clears virtually all electronic payments in the Serbian economy efficiently and inexpensively. Continued tight fiscal and monetary policy succeeded in further reducing inflation in Serbia from 38 percent in 2001 to an expected 8 percent for 2003. The budget deficit was held in check at approximately 4 percent of GDP. The percent of state-owned assets fell from 95 percent in 2001 to less than 42 percent in 2003. Serbia's currency (the dinar) remained stable due to continuation of the central bank's policy of virtually pegging the dinar to the euro. However, in line with IMF and OECD recommendations, the central bank increased flexibility in its exchange rate policy to counter a trend of real appreciation, resulting in a gentle nominal depreciation of 8.6 percent. The success in reducing inflation and maintaining currency stability are still the most visible benefits of reform for Serbs. Despite strict IMF controls on public wages, real wages rose by nearly 15 percent in FY 2003. While Serbs are generally dissatisfied with the pace of improvement in their economic conditions, the reform program has shown results. Per capita GDP has increased from less than \$1,000 in 2000 to about \$1,940 in FY 2003, but remains half of the level in 1989. Macro-economic stabilization has arrested a dramatic rise in poverty during the 1990s under the Milosevic regime, but 10 percent of Serbs live below the poverty line with another 10 percent just above it.

The banking system as a whole has undergone significant structural reform. The percent of state-owned assets has plummeted from 95 percent in 2001 to less than 42 percent in 2003, and it is expected to continue to decrease. The government took bold steps in early 2002 when it placed the four largest banks, representing 75 percent of banking sector assets, into bankruptcy. Subsequently, 19 additional banks were placed under the aegis of the Bank Rehabilitation Agency (BRA), including 8 minority state-owned banks for which BRA serves as trustee of the state shares. These actions signal a commitment towards increased safety and soundness in the banking system; however, the BRA has been wracked by mismanagement and shaken by the political fallout which saw its governor removed. Consequently, few steps have been taken to sell, resolve or liquidate these distressed banks. Currently, there are 48 licensed Universal Banks in the system, of which 10 are foreign-owned, and 23 private domestic institutions. When minimum capital increases to €10 million at year-end 2003, a handful of these private banks will fall short of this threshold, and will necessarily close, or be forced to consolidate. Despite a relatively large number of banks, given Serbia's population and economy, total assets barely exceeded €5 billion, with loans to the private sector representing less than 15 percent, and compares with rates in neighboring countries of between 25-50 percent. Foreign banks accounted for more than two-thirds of the new loans in the first nine months of 2003, according to National Bank statistics.

**U.S. Interests and Goals:** U.S. assistance to Serbia and Montenegro is based on fundamental U.S. national interests in Europe. The union of Serbia and Montenegro is crucial to the economic development of Southeast and Central Europe and to the political stability of Europe as a whole. As a social, political and geographic crossroad amid Western and Eastern Europe, Turkey, and Greece, the Union occupies a key geographic juncture in the Balkans.

The U.S. Departments of State, Treasury, Agriculture, and Commerce are all presently working together in delivery of assistance for the achievement of U.S. objectives.

**Donor Relations:** USAID is the largest of the bilateral donors active in Serbia, and has cooperated actively with multilateral and bilateral donors. Among the most significant of the donors that USAID works with are the World Bank, the IMF, the European Union, European Bank for Reconstruction and

Development (EBRD), and the European Investment Bank (EIB). USAID also collaborates with a large number of bilateral donors, notably the United Kingdom (UK), Germany and Switzerland. USAID's collaboration has centered macroeconomic stabilization and restructuring, which includes building an economic policy and legal environment that is conducive to business development and job creation, and which is oriented towards reintegration with regional and world institutions, such as the World Trade Organization and the European Union. Among the principal donors, the World Bank allocated approximately €359 million between 2001 and 2003, of which €170 came in the last year; the majority of the Bank's resources are invested in power and education sector reform. In the economic sector, however, USAID has worked actively with the World Bank teams on numerous laws, including the Bankruptcy Law, the Company Law and others under its the €78 million Private and Financial Sector Structural Adjustment Credit (PFSAC). Once these laws are ratified, USAID and the World Bank will jointly implement them by creating and strengthening the relevant institutions. The Bank's PFSAC conditions are often developed with USAID input, and support reforms that are of mutual interest. In 2002, Serbia and Montenegro successfully completed a one-year IMF Stand-by arrangement and secured the approval of the IMF Board for a three-year \$829 million Extended Fund Facility (EFF). The EFF sets important budget and monetary targets, and had disbursed two tranches through 2003. USAID advisors to the National Bank of Serbia and to the Ministry of Finance and Economy coordinate, to the greatest extent possible, with the IMF Resident Representative. The European Union committed €223 million in the past year with major investments focused on energy, agriculture, border crossings and public administration. Lesser sums support commercial law reform and private sector development, and USAID works closely with EU implementers in each of these areas. The EBRD and EIB pledged approximately €143 million and €124 million respectively in 2003. These sums are part of the total €586 and €528 million, respectively, pledged between 2001 and 2003. The lion's share of both the EBRD and EIB programs target municipal infrastructure development and energy sector rehabilitation. All USAID programs are carefully coordinated with other donor efforts and orient Serbia for ultimate accession to the European Union.

**Challenges:** The key challenges facing the new government in 2004 include economic growth; job creation; decentralization and devolving of power to municipalities; judicial reform and, finally; addressing and reinvigorating democratic reform efforts. Among the principal obstacles to business development and job creation are: shallow finance and banking systems, and generally poor legal and regulatory, judicial and fiscal regimes in Serbia. The micro-economy and development of small and medium-sized businesses remains a principal policy concern of donors and most government officials. The business sector is in crisis as evidenced by the protracted decline in industrial output throughout 2003, export stagnation and increasing unemployment, which touched off a series of union actions in the fall. It is not at all clear that the reforms that had been implemented are rooted enough to be sustainable given the upheavals that the republic has experienced this year. Given the four principal obstacles to growth, jobs, and prosperity, the U.S. Government and USAID are investing in efforts that will reduce or remove them.

**Key Achievements:** Despite the political shocks and stalled economic reform efforts that paralyzed Serbia for more than half a year, there are significant successes to be noted. The program witnessed significant results in its projects that address key elements of the economy dealing with economic reform and focusing on strengthening those institutions that will promote and sustain economic reform and the transition from a socialist to a market economy. The challenge in the coming years will be to sustain the resource levels for civil society, the rule of law, and macro policy reform activities.

The Community Revitalization through Democratic Action (CRDA) Program, which was initiated in the latter half of FY 2001, is the U.S. Government's most visible and popular program in Serbia. CRDA has engaged the citizens of over 350 communities representing 4 million people throughout Serbia in a new development and decision-making process. CRDA is changing the dynamic of municipalities in Serbia. The citizens who are engaged in the community councils, the focal point of all CRDA activity, consistently report that the most important aspect of the program is that they are being heard. CRDA delivers tangible results as well, such as water supply, electricity, roads, schools, clinics and income-generating activities to improve quality of life. By the end of FY 2003, the five American NGOs had initiated 2,200 community projects and completed over 1,300 with a thousand new projects planned for the third year. The scale and rapidity of the implementation of CRDA exceeds that of any other program of this type and is

reflected in the fact that over 90 percent of the funding was expended within a year of obligation. The response of the communities has been extraordinary. They have contributed over 45 percent of the project costs from non-USAID resources. In the health sector, the CRDA Program expended over \$4 million in FY 2003 to equip and rehabilitate health facilities and to initiate community-based programs focused on such topics as reproductive health and breast cancer prevention in 83 communities around Serbia. The reproductive health activities included education and information projects on STDs, including HIV/AIDS. As a result of our activities, over 230,000 persons have increased access to modern reproductive health diagnostic tests and treatment. CRDA projects are bridging traditional ethnic divisions as community councils realize that citizens' priorities are often the same. By getting people to work together towards a common goal, the program is helping to build a sense of trust and cooperation between different ethnic and religious groups, particularly in Southern Serbia. A survey conducted in August 2003 in selected CRDA communities found that the program had improved attitudes toward democracy, community involvement and the United States.

The Serbian Local Government Reform Program (SLGRP), which was launched to bolster the management capacity of local governments and to increase transparency and citizen involvement in local decision-making, is presently working in 40 municipalities and will expand its operations to another 47, including those in the metropolitan Belgrade area. The 87 participating municipalities will cover over 70 percent of the population of Serbia. During the first two years of operations, 1,022 training sessions, attended by 26,363 participants, were held to improve the management capacities of local government staff. More than half (58 percent) of these participants were women, reflecting the important role that they play in local government. The training includes financial management; public services management; information technology applications; and citizen participation. As a result of these efforts, transparent and accountable budgeting and financing systems have been established in 38 municipalities, and all 40 participating municipalities have held public budget hearings for the first time. In addition, public-private partnerships to create business improvement districts have been established in four municipalities. Municipal information centers and/or one-stop permitting centers are being set up in five municipalities with more to be established in additional municipalities during the second year. The Association of Municipalities and Towns will be an effective representative of local governments as well as a provider of services and information to its membership. At the national level, the SLGRP has been providing the Ministries of Finance and Local Government assistance on decentralization policy reforms, identifying appropriate approaches to decentralization and drafting of legislation to transfer responsibilities, resources and authority to local governments.

USAID's rule of law achievements include the delivery currently in process of \$800,000 worth of courtroom and office equipment to support the operations of Serbia's newly-established Special Court for Organized Crime and War Crimes, and training activities conducted for trial participants and court staff on all aspects of handling complex, high-profile, high-security cases. ABA/CEELI support to the Judge's Association of Serbia resulted in the association adopting a progressive code of ethics. Support for legal aid in the conflict-prone Presevo Valley resulted in two successfully resolved human rights-related court cases, including a decision against the (then) Yugoslav Army. USAID has recently initiated a donor working group to coordinate rule of law assistance more effectively. Its rule of law activities are also coordinated with an Embassy working group on organized crime/war crimes assistance chaired by Post's Regional Legal Advisor.

The banking system as a whole has undergone significant structural reform. USAID has invested in two credit facilities: Opportunity International (OI) and ProCredit (previously MicroFinance Bank). Both are important facilitators of small and medium enterprise (SME) development, targeting mainly micro-entrepreneurs in agriculture, production, services and trade. At fiscal year-end 2003, OI's savings and loan, known as Opportunity International Stedionica (OIS), had disbursed nearly 2,000 loans valued at €3.3 million creating 945 jobs. The performance of OI's portfolio is sound, with only 0.63 percent of outstanding loans past due more than 30 days, and with no write-offs. Together, OI and ProCredit have worked actively with other USAID projects, including the Community Revitalization through Democratic Action Project (CRDA), to multiply their impact. In northern Serbia, for instance, OI and ProCredit originated more than \$1 million in agriculture-related loans to CRDA beneficiaries.

Gender implications: In USAID's Interim Strategic Plan for Serbia and Montenegro gender is a key cross-cutting issue. The gender issue is integrated and institutionalized at all stages of Mission's work, e.g. policy or activity planning, implementation, and monitoring and evaluation.

**Country Close and Graduation:**

Not applicable.

## Results Framework

### **169-0130 Accelerated Development and Growth of Private Enterprise**

#### **SO Level Indicator(s):**

Serbia Ranking on WEF Growth Competitiveness Index

**IR 169-0131** Financial and Banking Systems Stabilized and Restructured

**IR 169-0132** State and Socially-Owned Enterprises Privatized

**IR 169-0133** Commercial and Related Laws Enhanced and Strengthened

**IR 169-0134** Serbia and Montenegro/Serbian Economy Reconnected to International and Regional Market Networks

### **169-0200 More Effective, Responsive, and Accountable Democratic Institutions**

#### **SO Level Indicator(s):**

Public Opinion Polls (% of Citizens Satisfied with Pace of Government Action on Reform)

**IR 169-0201** Capacity and Competitiveness of Independent Media Enhanced

**IR 169-0202** Civil Society, Political Party, and Trade Union Capacity to Serve and Represent Citizen Interests

**IR 169-0203** Rule of Law Increased

### **169-0210 Increased, Better Informed Citizens' Participation in Political and Economic Decision Making**

#### **SO Level Indicator(s):**

% of SLGRP Municipalities in Which There is Citizen Input to Key Decisions (n=50)

CRDA Communities Mobilize at Least 25% of Project Costs

**IR 169-0211** Citizens Improve their Living Conditions through Participation in Community Development Committees

**IR 169-0212** Improved Interactions Between Citizens and Local Governments

**IR 169-0213** Transparent Financial Management and Improved Service Delivery by Local Governments

**IR 169-0214** Broadened Minority Participation in the Political Process and Decision-Making

### **169-0230 More Effective, Responsive and Accountable Local Government**

### **169-0310 Humanitarian Community Services and Facilities**

### **169-0410 Special Initiatives**

### **169-0420 Cross-Cutting Programs**