



**Project no.**  
513705

**Project Acronym**  
CEEC AGRI POLICY

**Project title**  
**Agro economic policy analysis of the new member states,  
the candidate states and the countries of the western Balkans**

**Instrument**                      Specific Support Action

**Thematic Priority**              Scientific Support to Policies

**D12-1 First 6-monthly report**  
**MONITORING OF AGRICULTURAL POLICY,**  
**MARKET AND TRADE DEVELOPMENTS IN SERBIA AND**  
**MONTENEGRO**

**Due date of deliverable:** December 2005

**Actual submission date:** December 2005

**Start date of project:** 01.05.2005

**Duration:** 24 Months

**Organisation name of lead contractor for this deliverable :**  
FACULTY OF AGRICULTURE, UNIVERSITY OF BELGRADE

**Revision**      Final

<b>Project co-funded by the European Commission within the Sixth Framework Programme (2002-2006)</b>		
<b>Dissemination Level</b>		
<b>PU</b>	Public	X
<b>PP</b>	Restricted to other programme participants (including the Commission	
<b>RE</b>	Restricted to a group specified by the consortium (including the Commission	
<b>CO</b>	Confidential, only for members of the consortium (including the Commission Services)	

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## DOCUMENT HISTORY

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01.09.2005.	Dr Vlade Zanic	1. General review 2. Assessment and Outlook on sugar sector
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	Dr Natalija Bogdanov	1. General review
08-11-2005	John Malcolm	Revisions
22.11.2005		Revisions
	Dr Vlade Zanic	1. General review 2. Assessment and Outlook on sugar sector
	Dr Petar Muncan	2.Assessment and Outlook on sugar sector
	Dr Zorica Vasiljevic	3.Assessment and Outlook on wine sector
	Dr Miladin Sevarlic	3.Assessment and Outlook on wine sector
	Dr Natalija Bogdanov	1. General review
2-12-2005	John Malcolm	Final version

## **1 General review**

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### **1.1 General overview of agricultural and national economy developments**

The macroeconomic situation in 2004 in the Republic of Serbia improved compared to 2003. Namely, overall economic activity had a rising tendency in 2004 which was reflected in around 7,5% of GDP growth, a 7,1% increase in industrial production and a 19,8% rise in agricultural production, as well as favourable trends in the services sector. Retail prices growth was 13,7% December to December.

In 2004, employment rise was minimal, amounted 0,3%. In 2004 the registered goods export amounted USD 3.701 million and import 11.139 million USD. Foreign trade balance, as well as the balance on goods and services and current account recorded a substantial year on year deficit growth.

Agriculture's importance to the economy is both deep and diverse. Primary production from agriculture, hunting and forestry accounted for 21 percent of GDP in 2000-2004. If the food and beverage processing activities associated with agriculture are added to primary production, agriculture is the largest sector in the economy with 25 percent of GDP. Exports of primary agricultural products, processed food, beverages and tobacco products accounted for some 26 percent of total exports in the period 2000-2004, second only to the exports of other manufactured goods.

Approximately about one fourth of labour force is employed in primary agriculture and food processing industry. Figure on employment includes the estimated number of family members working on the private farms.

The total agricultural production volume in 2004 increased by 19,8 % in comparison to the previous year. Gross agricultural output of crop production increased by 44,0%, mainly as a result favourable weather condition, while livestock output declined by 0,2%.

### **1.2 Overview of agricultural and rural sector development**

#### **1.2.1 Production**

Cereals dominate crop production, accounting for 40% of agricultural land, or 62% of a cultivable land. The most important cereals are wheat and maize. Rye, barley and oats make up only 10% of the cereals area. The most important industrial crop is sunflowers following by soybean and sugar beet. Vegetable and forage crops are the next most important component of land use. The main vegetable crop is potatoes. Lucerne and clover are the main fodder crops and plums the main fruit crop.

In wheat and maize production Serbia is self-sufficient, including a small surplus for export. However, the yields are low in comparison to the Western European standards. Before 1990 there was significant investment in plant breeding, but since 1990 yields have fallen.

Official data shows that the numbers of all livestock except pigs fell during the last fifteen years. Despite the fact that socially owned enterprises owned less than 10 % of all livestock,

they are responsible for sharp fall in livestock numbers. In most cases, production has fallen even more than livestock numbers, due to the additional difficulty of providing adequate feed and veterinary care. Even before 1990, productivity has always been low by western standards.

The decline in livestock numbers is a consequence of the fall in demand for livestock products, as disposable incomes have fallen, particularly for more expensive beef and lamb. Producers of livestock reduce the number of breeding stock because of expensive inputs and lack of cash.

### 1.2.2 Prices

The markets for cereals, meat and dairy products, fruit and vegetable processing, oilseeds and sugar are dominated by socially owned agro-kombinats and food-processors. The private sector is active in bakeries, flourmills, feed mills, slaughterhouses, the marketing of fresh fruit and vegetables, and input supply. Private enterprises as a rule operate in the local markets.

The marketing structures influence the overall price level. The price of non-agricultural products increased during the 2004 and in the first eight months of 2005, while prices of crop agricultural product have seasonal variations. However, prices of selected crop and livestock products on the representative markets in Serbia in foreign currency terms, the most used Euro, are almost unchanged.

### 1.2.3 Agricultural Trade

In the period 2000 to 2004 a foreign agricultural trade deficit was recorded, but decreasing. In 2004 it was only 40 millions US \$, and a total agricultural export volume amounted approximately 822 million US \$. In 2004, the main trading partners were the EU-15 accounting for some 45% of Serbian food exports and around 34% of Serbian food imports, Western Balkan Countries (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Moldavia, Macedonia and Romania) members of the free trade agreement, took 41% of Serbian food exports and supplied some 14% of Serbian food imports. Other countries buy some 6% of Serbian food exports; supply some 41% of Serbian food imports. The main trading partners in the EU-15 are Italy and Germany. Serbia exports mainly cereals, fruit and vegetables. Sugar is an important export product, but not because of the competitiveness, but because of the special agreement with the EU and the Western Balkan countries about duty-free sugar export to the EU.

## **1.3 Agricultural and rural policy developments**

In the 2004 the Ministry of Agriculture drafted the Agricultural strategy for Serbia, which after public discussion was adopted by the Government in August 2005. The Ministry's plan is ambitious: most of the policy options should be implemented in 2005 and 2006, all of them at the latest by 2010 or on possible EU accession. Basic current activities are the formulation and entering into force of a new Law on Agriculture and yearly updates of the National Programme for Agriculture, the establishment of a monitoring system and, in a broader sense, the strengthening of personnel capacities and adequate working conditions.

The strategy is clearly focused on further moves towards EU and WTO membership. Therefore all agricultural policy measures foreseen are in line with the general approach of the EU CAP. The government is looking for the “optimal” level of protection. Within the Agricultural Strategy, increased competitiveness plays a major role. The emphasis is put on structural policy and rural development instead of market and price policy interventions. In addition to actions in the two above policy areas, the focus is on the rebuilding/developing of institutions as a key factor for agricultural development. The Ministry and other institutions will be further developed, such as a farm register, a market information system and other policy information systems, a paying agency, organisations dealing with training, knowledge transfer, agricultural education, and advisory services.

Immediate priority should be given to measures that strengthen the ability of private sector agents to respond to market challenges. The emphasis should be on developing appropriate incentive structures, strengthening marketing institutions and marketing chains, and providing producers and processors with the operating and investment capital they need to increase productivity and output. The priority in the process of preparing for WTO negotiations should be focus on the real issues: reductions in both import protection and the Aggregate Measure of Support (AMS). Alignment with EU policy should focus initially on issues such as phytosanitary standards and product quality, as required by the *acquis communautaire*. Full alignment with EU trade policy and the CAP should be viewed as a medium- to long-term goal, to be pursued once EU accession is a more imminent prospect.

#### **1.4 Issues related to the enlargement**

The Republic Serbia is in the process of negotiations with the EU regarding the association agreement. A precondition for EU integration is membership in the WTO. Formally Serbia had applied for the WTO membership and is in the process of negotiations. A basic issue is the treatment of the sensitive sectors, like agriculture. Integration means a reduction of import tariffs. In the 2004 the average tariff equivalent for Serbian agriculture amounted to some 22%. Integration into WTO and EU opens new markets with powerful buyers. Market liberalisation is seen as the main initiator of innovation and competitiveness.

At the same time competition will increase so Serbian producers have to compete with the advanced farmers of Western Europe and the USA. Integration will be a big challenge for the small private farmers in Serbia having on average less than 3 hectares of arable land. The second groups, which will need to make changes, are small private food processors, which at the moment do not achieve EU food standards. Finally, the third group is state owned companies which should be privatised, but their have difficulties to find a buyer.

Probably the biggest challenges in Serbia are the institutional changes and capacity building for creating a system comparable with other EU countries. Serbia has to adjust border control, create a system of laboratories and clarify the role of the institutions avoiding overlapping in responsibilities.

## 2 Assessment and Outlook

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### 2.1 Wine sector

Note: Due to so-called "two tracks" for Serbia and Montenegro's negotiations with the EU, the tables show data only for Serbia (1999 to 2004), without data for the Autonomous Province of Kosovo & Metohija that is under UN jurisdiction.

Although Serbia is one of the most important regional producers and consumers of grapes and wine, viticulture's share of the total value of Serbian agricultural production is rather small, ranging between 2.9% and 5.5% in recent years. Excluding 1999 when Serbia had a modest surplus in foreign trade in wine, there has been a permanent deficit in foreign trade in wine which has varied between 24 and 157 thousand HL. Deficit is result of permanent increasing trend of wine consumption in Serbia on one side and insufficient wine production (particularly the red wine and high-quality ones) on the other side.

#### 2.1.1 Wine consumption

The "Survey on the Households' Consumption in Serbia" (Republic Bureau of Statistics – Belgrade), estimates annual wine consumption at between 3.1 and 3.3 lit/per capita which gives an unrealistic low annual consumption. The Survey has been done on sample of 4,328 households (0.16% of total household number in Serbia without Autonomous Province of Kosovo & Metohija – 2,614,847). A study by FAO puts it at 8.8 to 10.9 litres per head. Hence in the absence of an official wine balance sheet, the accompanying table has been estimated by the authors.

There is absence of appropriate statistical data on wine consumption in Serbia. Republic Bureau of Statistics – Belgrade has finally started to harmonize local statistics on wine consumption with international statistical methodology not earlier than 2003. In addition, there was recently present a lack of legislative concerning records on wine sales. In order to avoid tax obligation, many producers and enterprises dealing with wine sales did not want to make records on the wine sales.

#### 2.1.2 Wine imports

The volume and value of wine imports has varied significantly from year to year between a low of 8 million litres and a high of 21 million litres since the war year (1999), with nearly 80% coming from Macedonia (FYROM) and being mostly table wines. The next largest suppliers are Italy (4.4%), and France (3.9%), which supply high-quality wines

#### 2.1.3 Vine production

The most common varieties of grapes used for wine production are as follows:

- High-quality red wines: Kaberne sovignon, Burgundac black, Merlow, Vranac (indigenous variety), Jagodinka varieties
- Quality red wines: Game black, Prokupac (indigenous variety), Frankofka, Black portugizac, Skadarka black, Srpski rubin varieties
- High-quality white wines: Sovignon, Shardone, Semijon, White burgundac, Yellow muskat, Muskat otonel, Rajnski rizling, Italijanski rizlinga, Green silvanac, Bagrina, Tamjanika varieties

- Quality white wines: Smederevka, Rkaciteli, Buvije, Neoplanta, Sirmijum
- Table wines: Zupljanka, Slankamenka, Bela sasla, Crvena sasla, Kreaca, Red ruzica.

Official statistics do not distinguish between table grapes and wine grapes, expert opinion is that 90% of grape production is processed into wine or other alcoholic beverages. Again, expert opinion is that the area under table wine varieties is declining and that used for quality and high-quality wines as well as the table grapes is rising. In new plantations, an increasing proportion of hybrid varieties are being planted.

#### 2.1.4 Vineyard area

In the period 1999 to 2004 Serbia's total vineyard area (excluding the Autonomous Province of Kosovo and Metohija which is under UN jurisdiction) declined from 71700 hectares to 65900 (8.3%) 83% of Serbia's vineyard area is within Central Serbia and 17% in the Autonomous Province of Vojvodina. Family farms account for 91.4% of the total vineyard area. Areas under vineyards in agricultural enterprises (being privatised already or in the process of privatisation) have been reduced by 10%.

During the 1980s some 120000 hectares in 8 regions (mostly beside three rivers West Morava, South Morava and Big Morava, as well as beside Sava and Danube rivers), together with 19 sub-regions and 51 vineyard districts were designated as suitable for vine growing. However, according to the Ministry of Agriculture's Activity Programme, completion of the vineyard cadastre is not expected until the end of 2009.

Within each vineyard district vineyards are differentiated according to high-quality wines, quality wines and table wines varieties (red or white), but this is not recorded in the vineyard cadastre.

#### 2.1.5 Structure of production

88% of the vineyard area is planted with grafted vine on American stock-vine and a further 7% with domestic vine stocks, the remaining 5% are hybrids. The latter are mostly newly planted hybrids on high-yielding plantations.

The last complete *Census of Agriculture* covering vineyards was in 1969 hence there is no reliable official statistical data on the number of grape producers. Experts estimate that more than 120000 households (out of 750000 farm households) have vineyards, so their average area under vineyards is estimated at 0.5 ha. However, the vast majority are small producers with 0.1 to 0.3 ha of vineyards, whose production is mostly for their own consumption and so-called inter-farmers' trade. There are a small number of vineyards with areas of 1 to 3 ha and a very small number of farms with 3 to 8 ha of modern vineyard plantations.

A second group of grape producers is made up of small agricultural enterprises and farmers' cooperatives having up to 30 ha of vineyards, then the medium-size enterprises with 30-100 ha of vineyards and finally big enterprises with more than 100 ha (up to 1700 ha, possessed by the greatest plantation in Vrsac).

### 2.1.6 Wine yields

The yields of grape are relatively low and significantly vary between 0.45 and 1.23 kg per vine-tree. That is the consequence of small plantations, obsolete varieties, the long-term absence of investments in new vineyards or the renewal of existing ones, the low level of agro-technical measures, together with the absence of hail defence and/or of irrigation systems in some vineyard districts.

Average grape yields are much higher in Vojvodina (1.14 to 1.75 kg/vine) than the ones in Central Serbia (0.34 to 1.15 kg/vine).

Table wines are dominant in production and consumption, while the wines with geographically controlled origin are being produced in industrial wine facilities (e.g. "Rubin" – Krusevac, "NAVIP" – Beograd) or in small number or registered cellars at family farms.

### 2.1.7 Wine production

Serbia's annual wine production in Serbia has averaged 1.85 million HL over the past five years with fluctuations due to weather conditions. The dominant share of total wine production has been produced on family farms though their share varies greatly from year to year (62% to 88%).

The volume of grape processing and wine production in large socially-owned agricultural enterprises has declined by more than 40% since the 1999 war due to a combination of factors including the devastation of some vineyards and wine cooperatives and loss of confidence among grape farmers because of low prices and/ or long waiting periods for payment.

Table wines form some 60% of overall production, with quality wines another 30% while the high-quality ones amount to less than 10%. High-quality wines have a larger share of total red wine production than of white. The high-quality wines and quality wines with geographically controlled designations of origin are mostly produced by agricultural enterprises/cellars (e.g. "Rubin" – Krusevac, "NAVIP" – Beograd,) as well as a small number or registered cellars - wine-producers on family farms.

### 2.1.8 Production cost and competitiveness

Both grape growers and wine processors complain of being squeezed through disparities between their input prices for vineyard and wine production and the output prices of grapes and wine. In the context of global market competition these problems could be improved by mechanisation of production processes in viticulture, the introduction of modern technology in grape processing and wine production, improving grape and wine quality and through reducing unit production costs.

There are particular problems of high overhead and/or labour costs in the former socially-owned enterprises which are still in the process of privatisation or that have not been yet privatised and which usually have too many employees.

In addition too little attention has been paid to the marketing of Serbian wine. Hence, despite the very good quality of Serbian wine and the long tradition of grape and wine production, Serbian producers have much to do to improve their efficiency and competitiveness.

### 2.1.9 Wine exports

The volume and value of Serbian wine exports varies significantly from year to year depending on grape yields and quality. This does not provide a long-term continual and stable volume of supplies for export markets. The main export market is Bosnia and Herzegovina which takes some 65 % by volume, predominantly table wine, and the other two major markets are Germany (12%) and Austria (11%), where most exports consist of quality and high-quality wines. However, by both volume and value, imports continue to be greater than exports.

### 2.1.10. Policy issues

Serbia's policy for the wine sector is to seek to modernise and improve the efficiency of wine production through the following activities:

- Negotiations on accession of Serbia to international integrations (accession to WTO and EU plus regional free trade agreements);
- Fulfilment of conditions for utilisation of resources from EU pre-Accession funds for potential candidate countries;
- Completion of the privatisation of agricultural enterprises having significant areas under modern vine plantations as well as wine facilities that have industrial capacities for grape processing, wine production as well as other products based on wine;
- Harmonisation of Serbian viticultural and wine production legislation with that of the EU's wine CMO;
- The development of associations of small grape and wine producers linked with industrial capacities for grape processing and wine production.

The greatest challenges lie in the urgent completion of the vineyard cadastre (planned to be achieved by the end of 2009), the introduction of the wine producers' register, as well as of geographical origin control marks and more complete control of the seedling material quality, grape and wine quality.

Serbia has adopted a new *Law on Seedling Material (2005)* and has prepared a draft *Law on Wine and Other Products Made of Grape and Wine*, which is harmonised with the appropriate EU legislative. It is also in the course of drafting some implementing documentation on the new laws.

The Serbian Ministry of Agriculture financially supports from the Agrarian Budget funds the following activities:

- Establishment of new vineyard plantations (50 dinars or 0.63 € per standard category graft i.e. 100 dinars or 1.25 € per certificated graft, for new plantation between 0.5 and 50 ha and minimum 3,000 grafts per hectare, only for registered farms or agricultural enterprises); There are 130,000 registered farms in Serbia (16.9% out of 770,000);
- Support for export of grapes and wines produced in Serbia amounting to 10% of export price, for the products exported and paid in 2005;
- Introduction and certification of HACCP system into 300 food processing firms in the food sector in 2005 (up to 8,000 EURO per firm), among which the wine producers are as well;
- Promotion of exports as well as the exhibition activities of our wine producers (e.g. at the Dusseldorf Wine Fair).

## **2.2 Sugar sector**

Under normal peacetime conditions, Serbia is a net exporting country well able to satisfy the domestic demand for sugar. The Serbian sugar industry, like other sectors of Serbia's economy suffered from the political and economic changes of the 1990s. At that time and since, there have been difficulties in collecting data and monitoring trade, hence Serbian statistics have to be viewed with caution. Moreover, there was also a ban on foreign trade passed by the UN.

### 2.2.1 Sugar consumption

The total domestic sugar consumption amounts between 200000 and 240000 tonnes per annum. Of this amount around 54% is domestic consumption and the remainder is used in the industrial sector. Within the industrial sector, the greatest use is in the beverages and confectionery sectors. Current sugar consumption per head per year amounts some 32 kg, which is below that of the EU (some 38 kg). Key determinant in consumption is per capita income. In the case that Serbian consumption averaged comparable per capita levels as the EU, total annual consumption would rise to over 350000 tonnes.

### 2.2.2 Sugar import

Since 2000 Serbia has imported on average less than 50000 tonnes per year of white sugar mainly for the industrial sector and the remainder for domestic consumption. In 2004 the import of white sugar decreased to around 26500 tonnes, because of increased domestic production by nearly 50% in comparison to the previous year.

### 2.2.3 Sugar beet area

Serbia's sugar sector can be seen as an industry in transition. The sugar beet area having halved from an average of around 100000 hectares in the 1980s to around 50000 hectares by the mid 1990s has since recovered to above 60000 hectares by 2003/04. Of this total area approximately 62% is grown on the state farms and the remaining 38% on private farms though there is no significant difference in yields between the two sectors.

Sugar beet is mostly grown in the Vojvodina province in the north of Serbia. The pattern of cultivation within this area is determined by elevation and soil type. The most suitable sugar beet soils, with good moisture maintenance during the relatively dry months of July and August, are to be found in the Srem, southern Banat, and southern and central Backa regions.

The principal alternative crops in these regions are maize and soybean. Sunflower and wheat are also extensively grown because of their low input requirements and sunflower's drought tolerance.

### 2.2.4 Structure of production

The beet processing facilities are now largely in private hands and located entirely within the Vojvodina province in the north of the country. Four state-owned factories still exist but have not been utilized in the last few years. In 2004, seven factories operated and another, SFIR's Nova Crnja factory, was commissioned with a view to operating in the future.

MK Commerce is the largest processor, owning over half of the country's operational capacity and producing more than 50% of Serbia's sugar output. Hellenic sugar is the second largest

processor, with SFIR lying third. However, if SFIR brings the Nova Crnja factory back into operation, it has the potential to increase output to a level similar to that of Hellenic Sugar.

#### 2.2.5 Yields

The soil types in Serbia are chernozem and heavy black soil which provide a potential for sugar beet yield similar to yields in the EU-15. However, the average beet yields per hectare in the period 1999 to 2004 were some 37 tonnes per hectare per year, which is significantly lower than in the EU-15 (55 tonnes per hectare).

In comparison with the EU-15 in the most important measure of sugar yields the Serbian field performance is even poorer. However, it is very important to note that, during the late 1980s, Serbian sugar yields were comparable with those of Italy today, while sucrose content compared favourably with all comparison groups today.

Having in mind the soil potential and past performances, it could be concluded that Serbia has the potential to increase beet yields from current levels, probably to between 50 tonnes and 55 tonnes per hectare. It could be assumed that sucrose content could be increased to possibly 16%. A substantial improvement in on-farm technical performance would be the prerequisite for achieving such levels.

#### 2.2.6 Sugar and isoglucose production

The total sugar production capacity in Serbia is around 450000 tonnes per annum. However, sugar production has fluctuated in recent years between 115000 and 440000 tonnes.

One of the weaknesses of the sugar processing sector in Vojvodina is that a number of factories are poorly located in terms of their sugar beet supply. The best sugar beet regions, that is where sugar beet has its greatest comparative advantage relative to alternative crops, are Srem, southern Vojvodina, central/southern Backa and southern Banat.

All of MK Commerce's factories lie within these regions. SFIR's factories are poorly located in relation to these areas, while Hellenic Sugar's factories are situated on the border of these regions. As a result, SFIR and Hellenic Sugar have to haul sugar beets over relatively long distances, which increase the processing cost. Thus, the geographical location of MK Commerce's factories gives the company a competitive advantage over its competitors.

#### 2.2.7 Production cost and competitiveness

At present the industry's performance compares unfavourably with the EU-15 average both in terms of beet yield per hectare and in sugar extraction per tonne of beet, though in the late 1980s Serbian performance stood comparison with several EU-12 countries. Thus there is potential for improved performance but it would require substantial improvement in both on-farm and in factory technical performance.

Factory capacity in Serbia is currently large relative to sugar beet supply. Rationalisation to four or five modern factories should reduce unit costs to more competitive levels. However, the main determinant of the sector's future prosperity could well be its degree of access to the EU market as currently, sugar account for about 12% of total Serbian agricultural exports and is mainly to the EU.

In spite of relatively high processing cost, under the European Union Stabilization and Association agreement with the western Balkan countries that started in 2001, Serbia was able to export sugar free of tariffs and custom duties to the EU member countries.

With a rationalisation to four or five factories, Serbia's processing costs would fall by around €80-€85 from 2004/05 levels, to close to €100 per tonne. In the short/medium term, unit costs would fall given greater access to the EU market due to the higher output, which lowers unit fixed costs.

Following rationalisation, costs will be broadly similar both with and without EU access. This is because the number of factories will be reduced further to four factories without EU access, as the sector contracts to the size of the domestic market

Sucrose recovery rates are low by international standards. However, there is no reason why the investment that is now flowing into the sector should not raise performance to the levels approaching those witnessed in Hungary and the EU.

#### 2.2.8 Exports

Today, the industry has the capacity to produce around 450000 tonnes of sugar. Domestic consumption appears to be growing. This suggests the industry has, at present, the capacity to produce between 210000 and 250000 tonnes for export, depending on the volume that can be sold into the domestic market. Whether or not this sugar can be exported duty-free to the EU will have far-reaching implications for processors' future. This is because the alternative to selling this sugar in the high-priced EU market is to sell it in regional markets where it would earn a far lower price. The overwhelming majority of exports have entered the Italian market.

However, in May 2003, Serbia's privilege to export duty-free sugar to the EU was suspended because of allegations of fraud and violation of trade regulations. Following the suspension of its privilege, Serbia put in place an effective system for issuing sugar export certificates and verifying the origin of its exported sugar. In August 2004, the EU lifted the suspension and reinstated the duty-free status for Serbian sugar exports to its countries.

#### 2.2.9 Policy issues

The three key markets for Serbian sugar are the domestic market, the EU market and the world/regional market. The average selling price of Serbian sugar is determined predominantly by sales into the domestic and EU markets. The export and import of sugar is tax free. There are subsidies neither to sugar beet producers, nor to sugar factories.

Serbia has had a supply deficit in sugar for the past ten years or so, and, therefore, in normal circumstances, the price of sugar in the domestic market reflected the price of importing sugar from the EU.

However, after democratic changes in country in 2000 its economy started to recovery and there was a production growth. Moreover, Serbian producers have duty-free access to the EU sugar market, and the industry has been able to expand to produce a surplus of sugar. The export quota for Serbia to the EU for the season 2004/05 amounts 180.000 tones.

The market for sugar in the European Union is tightly regulated, and duty levels are such that imports are effectively restricted to those producers enjoying preferential access terms. The 2004/05 export parity price for sugar is some €600, per tonne. Preferential sugar exports to the EU, therefore, generate revenues of over €100 per tonne more than domestic sales at current prices.

Fundamental reform of the EU sugar regime is currently under discussion and it is accepted that the regime will have to adjust in some manner to the various pressures it now faces. For Serbia, exports under preferential terms to the EU are of great importance. The performances of the Serbian sugar sector over the next few years will be largely determined by two inter-related factors: the future level of sugar production and access to the EU market.