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1 General review

Agri-industries represent the most important economic branch in the Republic of Serbia accounting for by approximately 35% of GDP in 2005 (according to the new methodology of GDP calculation), with agricultural production at 14.5% and food processing industry 20%.

The volume of agricultural production in Serbia fell by 5.3% in 2005 compared to 2004 (which had shown record growth of 19.6%).¹ The fall was mainly due to bad weather conditions throughout the year and was also due higher input prices after VAT introduction which discouraged optimal input use. Crop production dominates gross agricultural product (58%) with livestock production at 42%. Last year the food processing industry had a growth of 4.2%.

In the Republic of Serbia, in 2005 in the crops sector, wheat production fell by 29.2% compared to 2004, sunflower by 19.8%, tobacco by 2%, potato by 0.6%, raspberry by 16.8%, plum by 45.8% and grape by 43.3%; increased production occurred in maize up 7.8%, soybean up 15.8%, sugar beet up 10.2% and apples up 5.9%. These latter crop increases resulted in supply surpluses of 2 million tonnes of maize, 20,000 tonnes of edible oil and 200,000 tonnes of sugar.

Cereals: Bad weather at the end of 2005 and beginning of 2006, the flooding of some 250,000 ha and an unusually high water table delayed winter and spring crop planting. In the autumn only 642,872 ha of cereals were sown (3% less than in 2004) – of which only 530,000 ha are under wheat (the smallest area of Serbia's most important bread grain for the past 50 years).

Industrial plants: Serbia's ten sugar refineries plan to use the output of 70,000 hectares of sugar beet in order to produce around 400,000 tonnes of sugar in 2006. This would cover domestic needs for sugar and fulfil the export quota for EU market amounting to 180,000 tonnes. At the end of April 2006 it is estimated that only some 52,000 ha had been planted of which around 40% were delayed compared to the optimal deadline, which will significantly reduced quality and yields. Some beet will be exported to Croatia, whose sugar refineries offer higher prices to the Serbian producers. Current forecasts are that there will be around 230,000 hectares of sunflowers and 160,000 hectares of soybean. Sunflower production is being contracted in 2006 at a price of 175 euro/tonne and soybean at 195 euro/tonne.

Slaughtering industry. According to MAFWM data during 2005 compared to 2004 total number of cattle in Serbia increased by 1.6% (of which number of fattening cattle was increased by 15.6%), while the pig number was increased by 1.5% (fattening ones by 8.2%). The growth in livestock number was not high given the level in 2004, but the fall in livestock numbers has finally stopped. The greatest share of support from the agrarian budget has been directed in the recent years into livestock husbandry - 67% of all approved credits by the MAFWM have been placed into this agricultural branch.

Milk. There are around 250 dairy plants in Serbia which annually purchase and process approximately 900 million litres of milk. According to data of Republic Statistical Bureau the

¹ The growth rates of agricultural production physical volume in Serbia were: -0.2% in 1999, -12.8% in 2000, 18.6% in 2001, -3.4% in 2002, -7.2% in 2003 and the record one of 19.7% in 2004, thereby repeating cycles characterized by one fruitful year and two unfruitful years.

cow milk production amounts to 1.6 billion litres, while some estimates put it up to 1.8 billion litres². Annual processing within 25 industrial and around 230 private mini dairy plants amount to around 1 billion litres of milk, which represents around 56.6% of milk production. That further means there is no change or decrease in traditionally high natural consumption and sales of dairy processed products through non-registered channels (farmers' markets). An estimate is that some changes in the milk production can be expected in 2006 having in mind the growth of imports of the high-yielding milking cows.

1.1 Major agricultural market development

Basic characteristic of Serbian agricultural and food-stuff products' market in 2005 were the following:

- Current production provides for the country's food needs for both direct consumption and the food processing industry and for some products there are sufficient surpluses to allow for exports;
- Low standard of living level and population purchasing power still prevent significant growth in demand for agricultural and foodstuff products;
- The absence of contracts for agricultural production other than sugar beet, soybean and sunflower production;
- Since 2005 MAFWM abolished the premiums for sugar beet and oilseeds but prolonged the payment of premiums for milk production.
- Compared to all previous years since 2000, 2005 saw a positive foreign trade balance in agricultural products 128 million € (exports 786 million €, imports 658 million €), the value of exports equalled 119.4% that of imports;
- Agricultural and foodstuff products accounted for 20.7% of total Serbian exports and 17.5% of total imports;
- Three group of goods dominate Serbia's agricultural exports: fruits and vegetables (33%), particularly raspberries;, cereals and their processed products (26%), particularly maize; and sugar and confectionery products (16%) – which contributed to meeting the preferential quota of 180,000 tonnes for sugar exports to the EU;
- Higher unit prices of agricultural and foodstuff products in import than in export shows that Serbia continues to export goods of lower processing level and import higher value added products;
- On the local Serbian market there is an increased network of foreign hypermarkets (Metro, Mercator, Vero, Interex) as well as the domestic ones (Delta Holding, Swisllion) and it is evident an increase of their participation in turnover of agricultural and foodstuff products' retail sale;
- There are strategic links connecting to large trading chains (Mercator - Rodic MB, Maxi – C Market – Pekabeta within structure of Delta Holding) for the sake of competitiveness improvement as well as profit maximisation;

² Data on 2002 Census show that from total number of farms in Serbia amounting to 780,000 around 500,000 farms are dealing with cattle husbandry (most of them are dealing with milk productions). For great number of farmers, particularly the small ones, milk production is the only sure monthly source of income.

- The recent privatisation of agricultural and food processing enterprises (*kombinats*) that have significant production capacities (e.g. land, farms and facilities for intensive production) and processing capacities (as e.g. dairy plants, breweries, sugar refineries, oil refineries, slaughterhouses, confectionery firms, factories of mineral water, ...) has led to concentration among a small number of vertically connected firms (such as Danube Foods Group, Delta Holding, MK Group, Agrokor, ...) which is leading to discussion about the need for eventual application of anti-monopoly measures;
- Compared to the neighbouring countries where the margin on agricultural and foodstuff products is mostly around 15%, in Serbia these margins could go even up to 39%. This caused a threat of introduction of administratively created margin limits by appropriate ministries (that has not been yet applied in the practice though some economists and businessmen argue that such a measure could conflict with market liberalisation;³
- A new bilateral *Agreement on free trade between Serbia & Montenegro and Former Yugoslav Republic of Macedonia* went into effect on 1st May 2006 which supported "an expansion of mutual trade, creation of fair conditions for competition, elimination of obstacles in mutual exchange, support of investments as well as improvement of trade with third countries";
- Discussions continue on a possible multilateral agreement on free trade between 9 countries (Albania, Former Yugoslav Republic of Macedonia, Bulgaria, Romania, Moldova, Bosnia and Herzegovina, Serbia and Montenegro, Croatia and Turkey), that will enable even faster harmonisation of standards in those regional market with the EU market standards;
- There are present the first important indicators of export increase from Serbia into Russian Federation (mostly for fresh fruits) – Serbia and Montenegro has with Russian Federation the bilateral *Agreement on free trade*, but possibilities for bigger sales of agricultural and foodstuff products from Serbia onto Russian Federation market as well as utilization of very favourable customs favours on this big food market are caused by an increase of foreign investments into the development programs of Serbian agriculture and food processing industry;
- Foreign agrarian inputs suppliers have an increased presence in Serbia, notably seed producers (KWS, Pioneer, ..), fertiliser producers (from Russian Federation, Romania, Austria, Germany, Israel, Netherlands) as well as machinery producers (John Deer, Clas,);
- Serbia and Montenegro are not using the full quota of preferential exports of 10,000 tonnes of beef to the EU: sending only 1,793 and 1,370 tonnes of beef in 2004 and 2005 respectively;
After VAT introduction, a growth of agricultural input prices in 2005 has increased production costs by approximately 40%;

³ It is important to point out that (at the beginning of 2006 an inspection from the Ministry of Trade, Tourism and services of Serbia has discovered in the sample of 13 controlled most important agricultural and foodstuff products that 8 products had maximal margin higher than 30% (e.g.: solid cheese – 30.00%; hot dogs – 33.03%; chicken meat – 33.52%; up to 38.98% for boneless pork) and that only in the case of one product within this product group the maximal margin was below 20% (pasteurized milk – 14.87%).

There is an absence of independent quality control of agricultural raw material purchase with the monopolistic privatised food processing firms having more market power than the commodity producers.

1.2 Agricultural and rural policy developments

- Subsidies for sugar beet, sunflower, wheat and other crops have been abandoned.
- Subsidies for milk have been reduced from 4.50 dinars to 4.00 dinars (0.05 €) per litre in hilly-mountainous regions and from 3.80 dinars to 3.00⁴ dinars (0.034 €) for the milk from plain regions. Also the payments have been delayed, which has already caused farmers to sell milking cows in order to repay debts.
- Fertiliser subsidies of 1,000 dinars (11€) per hectare of cultivable area are now payable only to those registered farms that submit the fiscal bill for fertilisers bought retail-sale shops. Farmers have protested that this is where fertiliser prices are at their highest and they cannot get subsidies for fertiliser bought through farmers' cooperatives by means of commercial invoice – but without fiscal bill.

In 2004, for the first time, the Ministry of agriculture included a budget for rural development, to support diversification of agriculture and the rural economy, increasing efficiency of farming, adding value through processing, providing a favourable framework for a better, a more sustainable use of available resources, providing alternative job opportunities, developing new marketing strategies and increasing the value of products.

In 2004 and 2005 the Ministry of Agriculture has supported the following rural development projects:

- Majority of the funds were allocated for reconstruction and extension of local roads, electrification, water pipelines, as well as sewerage systems. Total approved funds for these purposes amounted to 308,817,456 dinars (approximately 3.5 million €) and they have been used by 82 local communities or communes.
- Some of the funds were intended to support the diversification of rural economies through promotion of agro-eco-tourism, traditional crafts and processing – for 47 cooperatives and citizens' associations there have been approved totally 127,011,174 dinars (1.5 million €) for these purposes.
- 513 young farmers has been allocated a total of 575,291,733 dinars (6.6 million €) for implementation of such investments as the provision of irrigation systems, plastic houses, feed mixing facilities, mechanisation, silos and packaging equipment; the building material for facilities, and stable construction; plantation establishment; and purchase of livestock.

For 2006 it is the Ministry of Agricultural plans to improve these forms of support through coordination with other Ministries. The aim is to promote an inter-ministerial coordination through a governmental body for rural development.

Administrative capacity. The Ministry of Agriculture, Forestry and Water Management has set up a Sector for Agriculture and Rural Development consisting of:

- Department for rural development and advisory services,

⁴ One € = 87 Serbian Dinars.

- Section for organic agriculture, and
- Section for genetic resources.

Responsibilities include environmental and social issues and leading the agricultural extension network. The network currently in place has limited capacities in terms of staff.

System of grant scheme for 2006 is improved, although it was based on the SAPARD from the pre-accession countries in the region.

Support to rural development in 2006 is aimed at increasing primary agricultural production sustainability in the rural environment; developing the rural economy and its diversification so as to increase the sustainability of agricultural holdings; and creating effective mechanisms as well as the infrastructure for rural development support.

Beneficiaries of these funds could be:

- Farmers not older than 40 in the regions with favourable conditions for development of competitive and intensive agricultural production;
- Farmers not older than 55 in the marginal regions with natural and legal limitations for intensive agricultural production development;
- Farmers' cooperatives and associations;
- Units of local self-management.

Applicants will have to part fund the projected investments.

The objectives of this measure are:

- **Improvement of production** - investments on farms – purchase of mechanization and livestock, reconstruction of housing facilities for livestock, purchase of agricultural equipment, protection from erosion and wind creation of protective zones;
- **Improvement of the supply** - equipment and facilities for improvement of product storage and supply, certification of organic agriculture, promotion and protection of local products, support of processing and marketing;
- **Development of rural areas and promoting of activities** - activities related to maintaining of rural communities tradition, improvement of the living standard, diversification of activities which provide alternative incomes to farmers, management of water resources, education of farmers, establishment of producer groups, activities involved in protection of environment etc.
- **Development and promoting of organic production** (building of facilities for activities aiming at development of organic production, support for establishment of organic production).

These measures provide support of 30 to 60% of the total investment on condition that beneficiaries have to provide the remainder of the investment. The amount of support depends on the region where the project is undertaken (marginal and other regions). Through the rural development measures in 2006 it is planned to invest 750 million dinars (nearly 90 million euros) into different kinds of production and other activities aiming at rural advancement.

1.3 Issues related to the enlargement

In April 2005 that Serbia and Montenegro's Feasibility Study was approved, talks on the Stabilisation and Association Agreement started in the autumn of 2005, and the actual signing of the Agreement in spring at the earliest, or more likely in the autumn of the 2006 year.

2 Assessment and outlook: market integration in the cereal sector

Over the long term, maize has been the crop with the largest output value, ranging from 10% to 20% of the total Serbian agricultural output. As a contributor to total output, maize has been in first place in four out of every six years, with pig fattening in second place and in the other years the order is reversed in the classic "corn-hog cycle". Wheat, with 5 to 7% of the value of total output is in third place.

2.1 Introduction to the sector:

Total area under cereals fell in the 2000-2005 period from 48% to approximately 45% of the total cultivable area (i.e. by around 90,000 hectares). The reduction has been mainly in the area planted to wheat, the second major crop, whilst the area of the major crop –maize – has remained fairly constant. At the same time there have been increased areas of industrial crops, fodder crops and vegetables as their production is more profit able than cereals.

After the democratic changes in Serbia in 2000, taxes on inputs for agricultural production were abolished as well as of taxes on basic agricultural and foodstuff products. Those measures were aimed at reducing agricultural products' production costs and increasing consumption of basic foodstuffs. However, on 1st January 2005 the Government introduced VAT at a standard rate of 18% and a lower rate of 8% on agricultural outputs and inputs. This raised the prices of purchased inputs such as seeds fertilisers, chemicals for plant protection and breeding animals by 8% and the price of fuel and machinery by 18%.

As the cereal output prices have mostly remained unchanged in the 2000-2005 period, the areas under less profitable cereals, notably wheat and barley, have fallen along with reduced bought-in inputs for their production.

2.2 Expert views on infrastructures (storage capacity and transportation)

A slight increase of the maize area has been seen, but not on large farms, where maize occupies less than 10% of cultivable areas. Small farms are increasing their maize area because maize production is much more profitable than other cereals. Maize is also the most important component of concentrate mixtures for livestock feed and that is why the small farms, which usually have small stable capacities, could relatively easily start cattle fattening. In addition, they have storage capacities for the harvested maize, so they can store and sell them in the April-September period when market prices are relatively high.

The unfavourable position of wheat producers in 2005 was partly improved by the Ministry of Agriculture approving after harvest a subsidy for the wheat producers amounting to 5,000 dinars (some 60 €) per hectare of sown wheat. Also, for the first time, a subsidy of 700 dinars (some 8 €) per ton was provided for storage of wheat grain in the public storages. This

measure was aiming at improving the small farmers' position as they usually do not have grain storage facilities, so have to sell their grain immediately after harvest when the cereal price is at its lowest. Subsidised grain storage gives small farmers the possibility of storing to sell their cereals when prices are higher. The subsidies can only be claimed by registered small farms, some 150,000 farms out of a total of around 780,000 small farms in Serbia.

2.3 Use of Inputs

Machinery: Before 2001, the Republic Bureau of Statistics (RBS) had recorded numbers of agricultural machinery in every other year, but the numbers have not been collected since 2001 because of a change in the method of reporting on registered agricultural machines to a new system that does not function well.

According to RBS data from 2001 there were 404,100 four-wheel tractors in Serbia, of which 98% was in property of small farms, while the rest was in property of still unprivatised socially-owned enterprises and farmers' cooperatives. Domestic production is 1,800-3,000 tractors per year and that amounts to only 0.6% of the total tractor number. Domestic production, specialised for small farms, does not provide renewal of exhausted tractors.

According to RBS data total number of combines was 25,418 in 2001, of which 80% were combines for cereals and 20% for other crops (e.g. for sugar beet, preparation of silage, vegetable harvest). Small farms have 80% of cereal combines, mostly the single-furrow and two-furrow maize pickers, whose number was 35,214 in 2001.

Import liberalisation resulted in the share of imported machines increasing from year to year. (However, official data on the number of imported tractors and combines can only be obtained by paying a fee for the information to the RBS.)

Greater mechanisation has occurred in the last few years for several reasons, partly because of more cereals production on big farms, where production is fully mechanised. Mechanisation on small farms has also risen as the markets for new and second-hand machines have been liberalised, resulting in increased supply and lower prices. Furthermore, the development of leasing and commercial credits has made mechanisation more easily accessible. State subsidies of 30% of the purchase price of certain kinds of new machinery coupled with measures to facilitate short-term and long-term credit have also encouraged machinery purchases. Finally, the policy of agricultural subsidies, the stimulation of structural changes, and support for rural development have all combined to make agricultural production more attractive

Seeds: Serbia is an important and acknowledged producer of the seed wheat (*The Institute for Crop and Vegetable Growing – Novi Sad, The Institute for Cereals – Kragujevac, The Institute for Agrotechnological Researches - Zaječar*) as well as of seed maize (*The Institute for Maize "Zemun Polje" – Zemun, The Institute for Crop and Vegetable Growing – Novi Sad, PKB Agroekonomik - Belgrade*), whose production of seed wheat and maize satisfy domestic needs and relatively large quantities of this production is exported.

Serbian wheat seed is used exclusively and half of the total wheat and barley area is sown with certified seed. Large farms use certified seeds only, while small farmers tend to buy certified seed in one year and use seeds saved from their own production in the subsequent year.

Liberalisation of seed imports since 2000, has led to foreign seed producers gaining a share of the Serbian market, notably in maize seed and sunflower seed. Almost all maize production uses certified seed, of which around 95% is produced in domestic institutes, while the rest of 5% by the *Pioneer* and *KWS* hybrids.

Fertiliser: Total annual consumption of all kinds of fertilisers in Serbia amounts to approximately 712,000 tonnes, i.e. around 73 kilograms of active substance per hectare of cultivable area. In the structure of fertiliser consumption the greatest share have nitrogenous fertilisers (around 66%), while the phosphorous and potash ones participate by 17% each. Recently the use of fertilisers has increased from 530,000 tonnes in 2000 to 896,000 tonnes in 2004. However, in 2005 it dropped to 751,000 tonnes and is expected to fall further in 2006 because of high fertiliser prices in relation to agricultural output prices.

Pesticides: The large farms are the major users of plant protection products and apply those using modern sprayers. On the small farms pesticides tend to be used only on cash crops but in recent years smaller farmers have also begun to equip with modern sprayers.

Storage and Sales of Cereals: In Serbia there are around 260 big stores with a total capacity of 3.8 million tonnes of grain, of which 3.4 million tonnes are silos, while the rest of 400,000 tonnes are floor storage. Silos are mostly made of reinforced concrete and their capacity is for approximately 2.7 million tonnes, while the rest of 700,000 tonnes are the metal ones. The storage owners are mostly agricultural and agro-industrial *kombinats* (enterprises) or grain and milling enterprises and some farmers' cooperatives. There are still few producers' associations in Serbia that have significant cereal storage capacities.

Up to 2004 the Directorate for Stock Reserves of the Republic of Serbia had a significant role in the wheat storage business. The Directorate bought wheat from the producers for the strategic reserves and functioned as the government stock-keeper. The Directorate intervened in the case of market disturbances, most frequently because of flour and bread price increases, by selling quantities of wheat at below the market price. The strategic maize reserves bought by Directorate in the period of lowest prices (October- November) allowed for intervention in the case of market shortage. However, since 2005 cereal market liberalisation has reduced the Directorate's importance as the public stock-keeper.

2.4 Outlook for Cereals

Short Term: In the short-term a fall in wheat production is expected due to reduced planting in the 2005/06 autumn.

Long Term: In the longer-term, small wheat producers are pessimistic, because of unfavourable input and output price movements coupled with import liberalisation and unfair competition from subsidised wheat production in other countries. If the fall in the wheat area continues, Serbia could become a net importer of wheat instead of a net exporter. Maize production is expected to continue at present levels as this crop is mainly grown for animal feed.

However, if diesel and gas price levels continue to increase, escalating costs of using machinery and rising fertiliser prices could lead to a reduction in the cultivated arable area.

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Producers are also concerned at the possible consequences of the forthcoming trade negotiations with WTO.

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