

# CRS Report for Congress

## Serbia and Montenegro: Background and U.S. Policy

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nae redacted  
Specialist in European Affairs  
Foreign Affairs, Defense, and Trade Division



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## Summary

Serbian strongman Slobodan Milosevic's long reign came to an end in October 2000, when he was deposed from power by a popular revolt after he refused to concede defeat in an election for the post of President of the Federal Republic of Yugoslavia (FRY) won by his opponent, Vojislav Kostunica. The new government suffered a great blow in March 2003, when Serbian Prime Minister Zoran Djindjic was murdered by organized crime figures linked to the Serbian security apparatus. Organized crime, extremists within the Serbian military and security apparatus, and the links between them continue to pose a threat to Serbia's democratic development.

On December 28, 2003, the extreme nationalist Serbian Radical Party won a stunning victory in early Serbian parliamentary elections, but fell short of a majority. In March 2004, a minority government of democratic parties formed a government without the Radicals. However, the government depends on the parliamentary support of the Socialists (Milosevic's former party), who are not in the government but are in a position to extract concessions from it. Democratic forces in Serbia received a boost from Serbian presidential elections in June 2004, which resulted in a victory for Boris Tadic, a pro-Western, pro-reform figure over a Radical Party candidate.

In a years-long confrontation with Milosevic, Montenegrin leader Milo Djukanovic seized control of virtually all levers of federal power on the republic's territory. He sought to rapidly achieve an independent Montenegro, but opposition from the United States, European Union and Russia stymied these efforts. After a largely unsuccessful three-year decentralized union with Serbia, Montenegro voted for independence in a referendum held on May 21, 2006. Montenegro's independence has been recognized by Serbia, the United States, the European Union, and other countries.

The United States and other Western countries have sought to encourage Serbia and Montenegro's integration into Euro-Atlantic institutions. However, these efforts have been hampered by controversy over the future status of Serbia's Kosovo province, Serbia's failure to fully cooperate with the Yugoslavia war crimes tribunal (in particular its failure to arrest former Bosnian Serb army chief Ratko Mladic), and Serbia's fitful progress in such areas as rule of law and military and security sector reform.

Since Milosevic's downfall, Congress has appropriated significant amounts of aid to Serbia and Montenegro to promote reforms. In each fiscal year from FY2001 through FY2006, Congress conditioned U.S. aid to Serbia on a certification by the President that a series of conditions had been met by Serbia, above all cooperation with the Yugoslav war crimes tribunal. The House has passed such a certification provision in its version of the FY2007 foreign aid bill (H.R. 5522). This report will be updated as events warrant.

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# Serbia and Montenegro: Background and U.S. Policy

## Political Background

Despite defeats in wars in Croatia, Bosnia and Kosovo, international isolation and the impoverishment of his people, Serbian strongman Slobodan Milosevic remained in power for more than a decade. He did this by maintaining tight control over key institutions (such as the police, army, judiciary and most of the media) as well as much of the economy. He retained a reservoir of support among some sectors of the population, such as the elderly and those living in rural areas, in part by appealing to Serbian nationalism. His reign came to an end on October 5, 2000, when he was deposed from power by a popular revolt after he refused to concede defeat in an election for the post of President of the Federal Republic of Yugoslavia (FRY) won by his opponent, Vojislav Kostunica on September 24, 2000.<sup>1</sup> Milosevic's party, the Socialist Party of Serbia (SPS) was also trounced in simultaneous elections to the federal parliament and local governments.

### Serbia and Montenegro at a Glance

In February 2003, the Federal Republic of Yugoslavia (FRY) was replaced by a loose union of the FRY's two republics simply called "Serbia and Montenegro." (Before Milosevic's rise to power, Serbia had two autonomous provinces on its territory, Vojvodina and Kosovo, but Milosevic eliminated many of their powers. Currently Vojvodina retains some elements of autonomy and Kosovo is under U.N. administration.) After Montenegro opted for independence in May 2006, the union broke up, and each republic is now a fully independent country.

**Area:** Serbia (including Kosovo) 88,361 sq. km. Montenegro 13,812 sq. km.

**Population:** Serbia 7.82 million (excluding Kosovo), Montenegro 0.62 million, and Kosovo 2 million (est.).

**Source:** The Statesman's Yearbook 2001.

The victor in the election was a coalition of often-feuding opposition parties called the Democratic Opposition of Serbia (DOS). The DOS agreed on a joint slate

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<sup>1</sup> For detailed accounts of the events leading up to Milosevic's fall, see Steven Erlanger and Roger Cohen, "How Yugoslavia Won its Fight For Freedom," *New York Times*, October 15, 2000, 1; and R. Jeffrey Smith, "How Milosevic Lost His Grip," *Washington Post*, October 14, 2000, 1.

of candidates for the federal parliament and local elections. They named Vojislav Kostunica as their joint candidate to run against Milosevic for the federal Presidency. Kostunica's main advantages, according to many observers, were a reputation for honesty and his long-standing, unwavering opposition to Milosevic. Kostunica, a former law professor, sharply criticized the Milosevic regime's cynical manipulation of the law and legal system, as well as the often lawless behavior of those close to the regime. Kostunica holds strongly nationalist views. He has been a fierce critic of United States and NATO policy in Kosovo and Bosnia. This may also have made him popular with many Serbs. After their victory in federal and local levels, the DOS swept to further victories in elections for the Serbian parliament on December 23, 2000. On January 25, 2001, the parliament approved a DOS government led by Prime Minister Zoran Djindjic.

However, soon after the DOS took power, tensions arose between supporters of FRY President Kostunica and Serbian Prime Minister Djindjic. These conflicts slowed reforms and disillusioned many Serbs, who once had high hopes that Milosevic's overthrow would lead to a dramatic improvement in their living standards. One key subject of dispute was cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY). On June 28, 2001, the Serbian government transferred Milosevic to the ICTY to face war crimes charges. Serbian Prime Minister Zoran Djindjic defended the transfer of Slobodan Milosevic and other indictees, saying they were needed so that the FRY could receive vitally-needed international aid. Kostunica condemned the transfer of Milosevic as illegal and claimed that he had not been informed of the move beforehand. The DSS left the Serbian government in August 2001, causing the effective breakup of the DOS.

The DOS government received another blow on March 12, 2003, when Djindjic was assassinated by two gunmen as he got out of his car in front of the Serbian cabinet office. Milorad Ulemek (also known as "Legija"), a Serbian organized crime figure who once served in the Serbian security apparatus, is on trial for ordering the murder. He has already been convicted of the 2000 murder of an opposition leader on the order of the Milosevic regime and the attempted murder of another. Organized crime, extremists within the Serbian military and security apparatus, and the links between them continue to pose a threat to Serbia's democratic development and Euro-Atlantic integration.

## **Current Political Situation in Serbia**

The instability of the ruling DOS coalition led the Serbian government to call early parliamentary elections on December 28, 2003. The results reflected public disillusionment with the performance of the previous government and resurgent nationalism in Serbia. By far the largest party in the 250-seat parliament is the Serbian Radical Party, which won 82 seats. Milosevic's Socialist Party of Serbia won 22 seats. Democratically-oriented parties won the remaining seats. Kostunica's Democratic Party of Serbia (DSS) won 53 seats, the Democratic Party won 37 seats, and the G-17 Plus party won 34 seats. The monarchist and moderate nationalist Serbian Renewal Movement, in coalition with the New Serbia party, won 22 seats.

Kostunica assembled a minority government of democratic parties, consisting of the DSS, G17 Plus, and the SPO/NS. The DSS received the interior and justice ministry posts, which are key in the fight against organized crime and corruption. G17 Plus plays an important role in economic affairs. The parliament approved the new Serbian government on March 3, 2004. The most controversial aspect of the Serbian government is its dependence on support from the SPS, which does not have ministers in the government but provides it with a majority in parliament. In justifying his overtures to the Socialists, Kostunica asserted that they have reformed themselves since they were in power under Milosevic, a claim that many analysts would dispute. Critics have charged that the government has had to make concessions to the Socialists on several issues in order to remain in power.

On June 13, 2004, Serbia held a presidential election. Although the Serbian presidency is not a powerful post, analysts viewed the election as a key indication of Serbia's democratic development and orientation toward Euro-Atlantic institutions. A victory for the candidate of the extreme nationalist Radical Party, Tomislav Nikolic, would have been viewed as a serious setback for Serbia's path toward integration with Western institutions. Nikolic was opposed by Democratic Party leader Boris Tadic and Dragan Marsicanin of the DSS. In the first round of the vote, Nikolic won 30.6% of the vote. Tadic took second place with 27.37%. In a surprise result, wealthy businessman Dragoljub Karic won 18.23%. Karic, a prominent business figure in the Milosevic era, ran on a populist program. In a blow to the DSS and the government, their candidate, Dragan Marsicanin, received a mere 13.3% of the vote. In the June 27 runoff between the two top first-round finishers, Tadic beat Nikolic 53.53% to 45.1%. Tadic's victory was greeted with relief by Western governments. These results confirmed the growing strength of Tadic's pro-Western Democratic Party but also continued strong support for the Radicals.

New parliamentary elections must be held by the end of 2007, but many observers believe early elections could take place this year. The current government is weak but continues to hang on, partly because smaller parties in it know that they may lose all of their seats in parliament when new elections are held. The weakness of the government also appears to suit the Radicals and Socialists, who have not yet sought to overturn it. However, events that may occur later this year may destabilize the government. These could include a Kosovo settlement that results in Kosovo's independence; the transfer of indicted war criminal Ratko Mladic to the International Criminal Tribunal for the Former Yugoslavia; or scandals over privatization or other issues.

Experts disagree on their predictions for the outcome of possible early elections. According to public opinion polls, the Radicals remain the most popular single party in Serbia by a wide margin. However, they may not be able to form a majority on their own or with the Socialists. On the other hand, a nationalist backlash over Kosovo or other issues could put the Radicals and Socialists over the top. The international community would likely strongly disapprove of the participation of the Radicals in a Serbian government. An alternative could be for the DS, DSS, and other democratic parties to form a government, but continuing animosities among their leaders could make this difficult.

### Major Political Parties and Groups in Serbia

**Democratic Party (DS):** The DS was the largest party in the 2001-2003 democratic coalition government. It established a reputation for pro-Western pragmatism under its former leader, Prime Minister Zoran Djindjic. This reputation also hurt the party among some Serbs, who saw it as opportunistic, riddled with corruption, and too eager to appease the West. Djindjic was assassinated in March 2003 by organized crime figures associated with the former Milosevic regime. It suffered a substantial decline in support in the December 2003 elections but began to recover its strength when it went into opposition in 2004. Its popularity was boosted by the election of its leader, former Defense Minister Boris Tadic, as Serbian president in June 2004.

**Democratic Party of Serbia (DSS):** The DSS is led by Vojislav Kostunica, formerly Yugoslav President and now Prime Minister of Serbia. Like other democratic parties, the DSS favors democracy, the rule of law (a particular interest of Kostunica's), and free market reform, but has a markedly nationalist orientation. It was highly critical of the decision to transfer Milosevic to war crimes tribunal in June 2001 and has continued to strongly criticize the tribunal. The DSS plays the leading role in the current Serbian government, established in March 2004. Its popularity has fallen substantially since it has taken a leading role in the government.

**G-17 Plus:** Formerly a non-partisan economic reform group, G-17 Plus registered as a political party in early 2003. It won 34 seats in the December 28, 2003 parliamentary elections. It is perhaps the most pro-Western and pro-economic reform force in the government, where it holds key posts in the government dealing with the economy. However, its strength has declined as the government's popularity has decreased and it may not win seats when new elections are held.

**Serbian Radical Party (SRS):** An extreme nationalist party, led by Vojislav Seselj, who is now facing war crimes charges at Yugoslav war crimes tribunal in The Hague. Although ostensibly anti-Communist, the SRS held posts in the Milosevic regime, which cost the SRS dearly in the 2000 elections. However, the SRS surged in popularity as the pro-Western and pro-reform government's fortunes waned. The SRS condemned cooperation with the war crimes tribunal, government corruption scandals, and poor living standards, and slightly moderated its warlike, anti-Western rhetoric. The SRS won a spectacular victory in the December 2003 elections, becoming by far the largest party in the Serbian parliament. However, it did not win a majority on its own and is viewed as a pariah by democratic parties, and is therefore in opposition. Nevertheless, it remains the most popular party in Serbia by a significant margin.

**Serbian Renewal Movement (SPO)/New Serbia:** The SPO is a democratically-oriented, nationalist, pro-monarchist party, led by Serbia and Montenegro Foreign Minister Vuk Draskovic, who has had a reputation for political unpredictability. It formed an electoral coalition with a smaller group called New Serbia. This group could find it difficult to meet the vote threshold to receive seats when new elections are held.

**Socialist Party of Serbia (SPS):** The SPS is the successor to the Serbian branch of the Yugoslav Communist party. Under the leadership of Slobodan Milosevic, the party used nationalism to dominate Serbian politics from the late 1980s until its defeat in the 2000 elections. The SPS was further weakened by Milosevic's transfer to the Yugoslav war crimes tribunal in June 2001. The SPS won 22 seats in the December 2003 elections, even fewer than in 2000. It is not in the government, but its support is crucial for the government to have a majority in parliament.

## Political Situation in Montenegro

Since 1997, Montenegro has been controlled by an anti-Milosevic faction of the local Socialist Party led by Milo Djukanovic. In October 1997, Djukanovic was elected President of Montenegro. As Djukanovic consolidated his grip on power in Montenegro, a cold war developed between Montenegrin leaders and the Milosevic regime. Milosevic did not allow Montenegro to participate in setting federal policies. For his part, Djukanovic moved to seize control of virtually all of the levers of power in Montenegro. Djukanovic successfully sought relief from Western sanctions against the FRY and received Western aid to boost Montenegro's economy.

After Milosevic's fall, efforts by Montenegrin leaders to push forward with independence from Yugoslavia were stalled by international opposition, particularly from the European Union. In addition to their concerns about the impact Montenegrin independence might have on the situation in Serbia and Montenegro, EU officials were also worried that the collapse of Yugoslavia could hurt the chances of keeping Kosovo as part of the Serbia and Montenegro union.

On March 14, 2002, EU foreign policy chief Javier Solana brokered an agreement between Serbia and Montenegro on restructuring the relationship between the two republics. The FRY was formally abolished and the country was renamed "Serbia and Montenegro." The "union of states" would have a popularly elected parliament, a president chosen by the parliament, and a government. It would deal with foreign affairs, defense, international economic relations, economic relations between the republics, and the protection of human and minority rights. The two republics would attempt to reform and harmonize their economies in line with EU standards. The agreement allowed either state to declare independence after three years. The agreement asserts that Serbia would inherit the FRY's sovereignty over Kosovo as laid out in U.N. Security Council 1244. In February 2003, the Federal Republic of Yugoslavia was formally dissolved and "Serbia and Montenegro" came into being as the new joint state.<sup>2</sup>

On October 20, 2002, Montenegro held parliamentary elections. A DPS-led coalition won an absolute majority of 39 of the 75 seats in the parliament. An SNP-led bloc won 30 seats, and the Liberals won 4. Presidential elections were scheduled for December 22, 2002. Fearing an opposition boycott which could depress turnout and therefore invalidate the vote, Djukanovic resigned as President on November 26, 2002 and was elected to the post of Prime Minister by the parliament. Djukanovic's concerns about the presidential vote proved correct when the results of the December 22 vote were invalidated due to low turnout. After a repeat presidential election failed for the same reason in February 2003, former Prime Minister and Djukanovic supporter Filip Vujanovic was elected as President when a third election was held in May 2003.

Observers have noted that Montenegro is a small republic with few industries and resources, it is highly dependent on tourism, trade and, allegedly, crime. Since

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<sup>2</sup> For more on the Serbia and Montenegro union, see CRS Report RS21568, *Serbia and Montenegro Union: Prospects and Policy Implications*, by (name redacted).

coming to power, Djukanovic and other Montenegrin leaders been accused of complicity with smuggling operations, trafficking in persons, and other organized crime activities, sometimes in cooperation with the Italian Mafia figures. Italian police investigated Djukanovic's possible role in a long-standing cigarette-smuggling operation. Montenegrin leaders claim these charges of criminal conduct by top-ranking European officials have been fabricated by domestic opponents and some European countries to undermine Montenegrin efforts to secure independence.

On May 21, 2006, Montenegro held a referendum on independence from the Serbia and Montenegro union. Voters opted by a majority of 55.5% for independence, just above the 55% threshold set by the government and the European Union for the referendum's success. Turnout for the vote was 87%. International election observers from Organization for Security and Cooperation in Europe (OSCE) said that the vote was held in compliance with OSCE and other international democratic standards. In response, Serbia declared itself an independent state on June 5 and formally recognized Montenegro's independence on June 15. The two countries will now have to agree on a division of joint debts and property. Serbia inherits the union's membership in international organizations, while Montenegro will have to apply for membership to them as a new country.

#### **Major Political Parties in Montenegro**

**Democratic Party of Socialists (DPS):** The largest party in Montenegro, the DPS is the successor to the Montenegrin sister party of the Socialist Party of Serbia. In 1997, Milo Djukanovic, its leader, broke with Milosevic, taking most of the party with him. Although comprised of former Communists, the DPS espouses support democracy, free market reform and Euro-Atlantic integration. It has been beset by charges of corruption.

**Liberal Alliance of Montenegro:** A small opposition political group that strongly supports Montenegrin independence, political and economic reform, and a pro-Western foreign policy. It criticizes the DPS for its Communist past, its lack of commitment to a truly democratic Montenegro, and charges that it has manipulated the economy for the personal gain of Djukanovic and his cronies. However, an alliance with the Socialist People's Party in 2002 laid it open to charges of opportunism.

**People's Party of Montenegro (PP):** Like the DPS, the PP favors political and economic reform and closer ties with the West. However, it is more strongly in favor with closer ties with Serbia than the DPS. The PP was a member of the governing coalition with the DPS until December 2001, when it quit the government in protest against a DPS plan for Montenegro's independence.

**Social Democratic Party (SDP):** A center-left party that shares similar domestic and foreign policy goals with the DPS. It strongly favors independence.

**Socialist People's Party (SNP):** The SNP was formed from the minority faction of the former Yugoslav communist party in Montenegro that remained loyal to Milosevic. It strongly favors close ties with Serbia and opposes independence.

## Kosovo and Southern Serbia

Kosovo was an autonomous province within Serbia until 1990, when its autonomy was eliminated by Milosevic. The move provoked the province's ethnic Albanian majority to non-violent resistance then, by 1998, armed revolt. In order to put a halt to the conflict (including atrocities by Serbian forces) and restore the province's autonomy, the United States and other NATO countries launched an campaign of air strikes against Serbia between March and June 1999. In June 1999, Milosevic agreed to withdraw his forces from Kosovo, permitting a NATO-led peacekeeping force to be deployed. Under the terms of U.N. Security Council Resolution 1244, Kosovo is governed by a U.N. Mission in Kosovo (UNMIK), until an autonomous Kosovo government can run the province itself. UNSC 1244 does not say what Kosovo's final status should be, but supports the territorial integrity of the FRY (which was replaced by the Serbia and Montenegro union in 2003).<sup>3</sup>

U.N-brokered talks between the Kosovo and Serbian governments on the future status of the province began in early 2006, and the United States is strongly pushing for the talks to be concluded at the end of 2006. The largely ethnic Albanian Kosovo government is seeking independence for the province, which the Serbian government strongly rejects. This view is backed by an all-party consensus in the Serbian parliament. Serbian leaders have encapsulated their current position on status with the phrase "more than autonomy, but less than independence." Serbia has also put forward a decentralization plan for Kosovo. The plan would set up autonomous Serb regions in northern Kosovo and other Serbian-majority enclaves. Serbian-majority areas in Kosovo would be controlled by local Serb authorities, with their own police, and would be linked with each other and with Serbia. Ethnic Albanian authorities would control the rest of the province. Such a plan would have the benefit, from Belgrade's point of view, of consolidating its control over northern Kosovo, where most Serbs in the province now live, and where important economic assets, such as the Trepca mining complex, are found. Ethnic Albanian leaders strongly oppose the idea for these very reasons.

To a certain extent, the Serbian plan seeks to strengthen and ratify the existing situation in northern Kosovo. International officials and ethnic Albanians have criticized Serbia for supporting "parallel structures" that cement its control over Serb-majority areas at the expense of UNMIK's authority. International officials have also criticized the Serbian government for (successfully) calling on Kosovo Serbs to boycott Kosovo government institutions. They have noted that such a move isolates Kosovo Serbs at a time when UNMIK is devolving many of its powers to the Kosovo government and Kosovo's future status is being determined.

Some observers have speculated that Serbia's hard-line stance may be a negotiating tactic, with a possible fall-back position that would try to secure a partition of Kosovo, with northern Kosovo formally becoming part of Serbia and the rest becoming independent. However, the United States and other members of the Contact Group have ruled out a partition of Kosovo. Serbian leaders may also seek

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<sup>3</sup> For more on Kosovo, see CRS Report RL31053, *Kosovo and U.S. Policy*, by (name redacted) and (name redacted).

or be offered other forms of compensation, such as easier terms for NATO and EU membership, or at least increased aid from these institutions and their member countries. Serbian experts realize that such concessions, even if offered by the international community, may lack credibility due to “enlargement fatigue” in many European Union countries, among other factors.<sup>4</sup> Moreover, Serbian experts warn that the current political situation in Serbia may make any public concessions on its part difficult, given the weakness of the Serbian government and continued strength of the Radicals. There are concerns among Western observers that if the international community recognizes Kosovo’s independence at the end of this year, Serbia, acting overtly or covertly, could assist Serbs in northern Kosovo in breaking away from the new state, perhaps resulting in violence.

With the help of the international community, Serbia had success in defusing an insurgency in ethnic-Albanian inhabited areas of southern Serbia comprising the of municipalities of Presevo, Medvedja and Bujanovac. In March-May 2001, NATO troops in Kosovo permitted the phased reintroduction of Yugoslav forces into a demilitarized zone bordering Kosovo that ethnic Albanian guerrillas had used as a springboard for attacks on Serbian territory. Under pressure from the international community, the guerrillas disbanded in May 2001. Western countries pressed Serbia to seek a peaceful settlement to the conflict by dealing with some of its underlying causes, including the ethnic balance of local police and the economic situation in the area.

In February 2001, Serbian put forward a peace plan for the region. The plan called for boosting the participation of ethnic Albanians in local government and police, with help from the Organization for Security and Cooperation in Europe. Local elections were held in July 2002 in the region. Ethnic Albanian parties now control the local governments of Presevo and Bujanovac, while Serb groups control Medvedja. However, the problems in the area are not completely solved. Some ethnic Albanians complain of discrimination, and occasional violence continues. In response to a boycott call by local ethnic Albanian leaders, almost no ethnic Albanians voted in the Serbian parliamentary elections in December 2003. Local leaders said that the Serbian election law made no provision for setting aside seats for ethnic minorities who cannot meet the requirement of winning 5% of the vote to enter the parliament. Final status talks in Kosovo could have an impact on the stability of southern Serbia. Some local ethnic Albanian leaders have called for their region to be joined to Kosovo, if Kosovo becomes an independent state.

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<sup>4</sup> Discussions with experts on Serbia, October 2005.

## Economic Situation

The democratic leadership in Belgrade faced daunting economic challenges when it took over from the Milosevic regime in 2000. The FRY's economy suffered from years of economic mismanagement, economic isolation and the lingering effects of NATO air strikes in 1999. Many key enterprises and banks were controlled by regime cronies who managed them poorly and stole large sums from them. According to FRY officials, Serbia's Gross Domestic Product (GDP) in 1999 was only 45% of its 1990 level. Unemployment was about 35% in 2000. Conflicts in the former Yugoslavia left the FRY with over 800,000 refugees and displaced persons to care for, or about 10% of the country's population. In the final year of his rule, Milosevic increased the money supply in order to fund reconstruction projects after the Kosovo war, fueling inflation and the depreciation of the dinar, Serbia's currency. The inflation rate for 2000 was 70%. The country suffered from high levels of internal and external indebtedness. Budget deficits at all levels of government, including pension and other social welfare arrears, amounted to 8-10% of GDP. There was a tangle of bad bank debts and interenterprise arrears, amounting to 80% of GDP. There was also an external debt of \$11.6 billion, or about 140% of GDP.<sup>5</sup>

Since 2001, the Serbian government embarked on a comprehensive economic reform program. They have conducted prudent fiscal and monetary policies that reduced inflation. The fiscal and budgetary systems are being overhauled to make them fairer and more transparent. The government ran a consolidated budget surplus of 1.6% of GDP in 2005. The country's foreign trade regime has been liberalized. Reform of the banking sector has begun, and foreign investment in Serbian banks is growing rapidly. Serbia has moved to privatize some "socially-owned" firms, but many still need to be restructured and sold off. A particularly important and difficult example is the Serbian state oil firm NIS. A series of corruption scandals have marred privatization efforts. Nevertheless, foreign direct investment (FDI) has increased rapidly. Serbia and Montenegro took in \$1.48 billion in net FDI in 2005, a 50% increase when compared to the previous year.

Serbia and Montenegro has experienced rapid economic growth in recent years. Gross Domestic Product rose by 6.2% in 2005 and is expected to grow by 5.0% in 2006. Real monthly wages increased 11.5% year-on-year in February 2006. On the other hand, consumer price inflation remains substantial, at 16.6% year-on-year at the end of 2005. Unemployment remains very high, at 32.6% of the workforce in 2005. As large companies are restructured, more people are losing their jobs, although the government has made progress in decreasing regulatory red tape and simplifying labor laws in order to stimulate job growth among small and medium-sized businesses. Poverty remains a problem. In 2003, the World Bank estimated that 10% of the population of Serbia and Montenegro was under the poverty line, defined as 60 Euros (about \$73) a month.

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<sup>5</sup> Paper presented by FRY Deputy Prime Minister Miroljub Labus at December 12, 2000, donor coordination conference, available from the EU/World Bank website at [<http://www.seerecon.org>].

Serbia and Montenegro's economic policies have been supported by the International Monetary Fund and other international financial institutions. In May 2002, the IMF extended a three-year, \$889 million loan to Serbia and Montenegro, after disbursing the final part of a \$249 million standby loan offered in 2001. The IMF has urged Serbia and Montenegro to push forward with the restructuring and privatization of "socially-owned" firms, cut public spending, and reverse the recent spike in inflation. The loan program was completed in early 2006. It is unclear whether Serbia will seek another IMF loan, given the improved state of its external finances, although it may do so to secure an international imprimatur for its reforms so as to encourage foreign investment. Serbia and Montenegro has made substantial progress in reducing its foreign debt, due in part to debt forgiveness deals with the Paris Club in 2002 and the London Club in 2004.

Under Djukanovic, Montenegro pursued a separate economic policy from Serbia during the Milosevic period. Its switch to the Deutschmark (and later the Euro) as its currency limited the damage of Milosevic's lax monetary policies. It has pursued sound fiscal and monetary policies. Inflation remains lower than in Serbia, at 1.8% in 2005. Montenegro's real GDP grew by 4.1% in 2005. However, the republic's few industries need extensive restructuring, and its economy is heavily dependent on tourism and on trade with Serbia and foreign countries. Privatization has accelerated in the past year, spurring large inflows of foreign direct investment. Nevertheless, a few big firms remain to be sold off. Some have complained about corruption in the privatization process.<sup>6</sup>

## **Relations with the European Union and NATO**

### **European Union**

Eventual membership in the European Union is a key objective of the foreign policies of Serbia and Montenegro. The EU has committed itself to admitting Serbia and Montenegro when they are ready. However, the path to membership may be a long and difficult one. In October 2005, the EU announced that it would begin negotiations with Serbia and Montenegro on a Stabilization and Association Agreement (SAA). The agreement would provide a framework for enhanced cooperation between the EU and Serbia and Montenegro in a variety of fields, including the harmonization of local laws with EU standards, with the perspective of EU membership.

Although the European Union has not conditioned its aid to Serbia on war crimes cooperation, EU officials have made clear to Serbian leaders that a closer relationship with the EU, including concluding an SAA, requires Serbian cooperation with the ICTY. Other conditions include progress in political and economic reforms, especially rule of law and reform of the military and security sector. Although it is

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<sup>6</sup> Global Insight report on Serbia and Montenegro [<http://www.globalinsight.com>], January 2006; Economist Intelligence Unit Country Report on Serbia and Montenegro, June 2006; documents from the Donor Coordination Meeting for Serbia and Montenegro, November 18, 2003, which can be found at [<http://www.seerecon.org>].

not a formal condition for an SAA, the talks could be stalled if Serbia strongly opposes a possible EU-supported solution to the Kosovo status issue. In May 2006, the EU suspended SAA talks because of Serbia's failure to turn indicted war criminal Ratko Mladic over to the ICTY.

Serbia and Montenegro have enjoyed preferential trading status with the EU since 2001. For 2005 and 2006 combined, the EU has budgeted 89 million Euro in aid for Serbia, 100 million for Montenegro, and 90 million for the Serbia and Montenegro union government.<sup>7</sup>

EU foreign policy chief Javier Solana brokered the March 2002 agreement to set up the union of Serbia and Montenegro. Although the agreement permits either republic to leave the union within three years, EU officials at first pressed the two republics to stay together and to more closely align their economic policies, warning that such integration would be necessary if Serbia and Montenegro wished to secure an SAA in the near future or join the European Union in the longer term. When Montenegrin leaders remained firm in their intention to hold a referendum on independence, the EU pushed for the threshold for the success of the referendum to be higher than a simple majority. Montenegro agreed to a 55% threshold, and when the referendum was approved on May 21, 2006, the EU pledged to respect the result. EU officials say they will open separate SAA talks with Montenegro, which they say could be concluded by the end of 2006.

## NATO

In June 2003, Serbia and Montenegro made a formal request to join NATO's Partnership for Peace (PFP) program. The United States and NATO have set the arrest of Ratko Mladic as the remaining obstacle to PFP membership for Serbia and Montenegro. Leaders in Serbia and Montenegro say they want to join PFP in order to secure Western aid and advice in reforming their armed forces, including the establishment of full civilian control.

Since 2003, Serbia and Montenegro has taken steps to reform its armed forces, including by putting the General Staff and intelligence and security agencies under the control of the civilian Minister of Defense. Hundreds of high-ranking officers from the Milosevic era were retired or dismissed. Other needed changes include redrafting defense and national security strategies, and restructuring and reducing the size of the armed forces along lines suggested for NATO candidate states. Efforts must also be made to reform the country's intelligence agencies. Serbia and Montenegro does not have troops deployed to Iraq as part of the U.S.-led coalition there or in Afghanistan. As a result of Montenegro's independence in May 2006, Serbia and Montenegro's armed forces will be divided between the two republics, and each will seek to join PFP independently.

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<sup>7</sup> EU Commission Enlargement website, [[http://europa.eu.int/comm/enlargement/cards/financial\\_en.htm](http://europa.eu.int/comm/enlargement/cards/financial_en.htm)].

## **U.S. Policy**

In its policy toward Serbia and Montenegro, the Administration has supported the country's democratic transition and integration into Euro-Atlantic institutions. However, the United States has continued to insist that Belgrade meet its international obligations, including to the International Criminal Tribunal for the Former Yugoslavia (ICTY). The Administration has advocated Serbia and Montenegro's membership in NATO's Partnership for Peace, if it delivers ICTY indictee Ratko Mladic to the Tribunal. On May 7, 2003, President Bush signed a presidential determination that permits Serbia and Montenegro to receive U.S. defense articles, services, and assistance.

The United States backed EU efforts that produced the Serbia and Montenegro union in 2003 that replaced the Federal Republic of Yugoslavia. In testimony before the Senate Foreign Relations Committee on November 8, 2005, Undersecretary of State Nicholas Burns said that the United States did not oppose the Montenegrin government's efforts to hold an independence referendum but warned that the referendum must be held peacefully and as the result of a process that "all sides" accept as legitimate. He added that the main U.S. goal in the region is "reform and progress toward Europe for both Serbia and Montenegro, in or outside the state union." On May 23, a State Department spokesman said the United States applauded "the peaceful, democratic and transparent manner" in which the May 21 independence referendum was conducted. On June 13, 2006, the United States recognized Montenegro as an independent country.

### **Cooperation with the War Crimes Tribunal**

The fate of Milosevic and other persons indicted by ICTY has been a controversial issue in Serbia's relations with the United States. In each of the past six fiscal years (FY2001-FY2006), Congress has conditioned U.S. aid to Serbia after a certain date in the Spring of that year on a presidential certification that Serbia has met certain conditions, especially cooperation with the ICTY. The provisions also recommended that U.S. support for loans to the FRY be conditioned on the certification. U.S. conditions on aid to Serbia may have had a significant impact on Serbian cooperation with the Tribunal. Since the coming to power of Serbian democrats in late 2000, Serbian cooperation with the ICTY has followed a similar pattern each year: Serbia delivers several indictees to the Tribunal just before or, at most, a few weeks after the certification deadline. The Administration makes the certification as required by the legislation, and urges Serbia to do more. However, Serbian cooperation then slows, with Serbian leaders claiming that political and legal obstacles preclude greater efforts. Nevertheless, more indictees are delivered as the next deadline for certification approaches, and so on.

Of the six remaining fugitives sought by the ICTY, Tribunal chief prosecutor Del Ponte has said that Mladic and three others are in Serbia. Del Ponte added that Serbia also has main responsibility to transfer Karadzic, whose current whereabouts are unknown, and another indictee who has fled to Russia, due to Serbia's links with

both persons.<sup>8</sup> In January 2006, the Serbian government admitted that Mladic had been drawing a Serbian Army pension as late as mid-November 2005.

## **U.S. Aid**

Due to U.S. and international sanctions on the FRY, the United States provided little aid to Serbia and Montenegro before FY1999. From FY1999 through FY2001, the United States obligated \$136.8 million in aid to Serbia and \$137.9 million in aid to Montenegro. An additional \$133.5 million was allocated to the FRY as a whole for the same period.<sup>9</sup> The Administration provided \$106.7 million in SEED funding for Serbia in FY2002 and \$60 million for Montenegro. The Administration allocated \$110 million for Serbia for FY2003 and \$25 million for Montenegro. It budgeted \$95 million in aid for Serbia in FY2004 and \$18 million for Montenegro. The FY2005 foreign aid measure (P.L. 108-447) provided \$73.6 million for Serbia and \$20 million for Montenegro. The FY2006 foreign aid bill contains \$70 million in aid for Serbia and \$15 million for Montenegro. The committee report for the House-passed version of the FY2007 foreign aid bill (H.R. 5522) recommended \$60 million in funding for Serbia and \$10 million for Montenegro.

SEED aid is being used to help Serbia and Montenegro establish a free market economy. U.S. aid provides advice on restructuring the banking sector, privatization, tax reform, WTO accession, fighting financial crime, and providing credit facilities to help small business and develop a mortgage market. Other SEED aid is aimed at strengthening democratic institutions and civil society in the two republics, including by supporting the development of effective local governments.<sup>10</sup> Other U.S. aid is targeted at strengthening Serbia and Montenegro's exports and border controls.

## **Congressional Response**

During Milosevic's reign, congressional action on the FRY focused on codifying and tightening sanctions against Serbia and denying it most aid, while providing significant assistance to Montenegro and some democratization assistance for Serbia. As in previous years, the House and Senate-passed versions of the FY2001 foreign operations appropriations bills included provisions that would have implemented these objectives. However, Milosevic's removal from power intervened during conference deliberations on the bill (H.R. 4811). The measure, signed by the President on November 6, 2000 (P.L. 106-429), provided \$600 million for central and eastern Europe in Support for East European Democracy Act (SEED) funds. An additional \$75.825 million in emergency supplemental funding was earmarked for Serbia, Montenegro and Croatia combined.

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<sup>8</sup> For a transcript of Del Ponte's remarks to the Security Council, see the ICTY website, [<http://www.un.org/icty>].

<sup>9</sup> USAID, U.S. Overseas Loans and Grants, July 1, 1945-September 30, 2001.

<sup>10</sup> USAID Budget Justification to the Congress, Fiscal Year 2006, Annex III Europe and Eurasia.

From the funds in the bill, the Administration was permitted to provide up to \$100 million for Serbia. The bill did not include an earmark for Montenegro, but the conference report says that Montenegro “should” receive \$89 million. Section 594 of the measure added the condition that no funds from the bill can be made available for Serbia after March 31, 2001 unless the President certifies that Serbia is “(1) cooperating with the International Criminal Tribunal for Yugoslavia including access for investigators, the provision of documents, and the surrender and transfer of indictees or assistance in their apprehension; (2) taking steps that are consistent with the Dayton Accords to end Serbian financial, political, security and other support which has served to maintain separate Republika Srpska institutions; and (3) taking steps to implement policies which reflect a respect for minority rights and the rule of law.”

The law said that the United States should support the membership of the FRY to regional and international organizations subject to a certification by the President that the FRY has applied for membership on the same basis of other former Yugoslav republics, and has taken steps to settle issues related to state liabilities, assets and property. It also said that after March 31, 2001, the United States should instruct its representatives to international financial institutions to support loans to the FRY subject to the conditions in the Presidential certification on aid to outlined above (Section 594). The section did not apply to Kosovo, Montenegro, humanitarian aid or assistance to promote democracy in municipalities.

Another section of the law also prohibited any aid to countries that harbor war criminals, although this provision could be waived by the Secretary of State if he provides a determination to Congress that such aid supports the implementation of the Bosnian peace accords (Section 563).

Members of Congress hailed the transfer of Milosevic to the ICTY on June 28, 2001. On June 29, Senators McConnell and Leahy introduced S.Res. 122. The resolution praised Prime Minister Djindjic and other Serbian leaders for their “courage” in transferring Milosevic and called on them to continue to transfer indictees to the ICTY and to release all political prisoners from Serbian jails. It expressed the sense of the Senate that the United States should continue to provide aid to the FRY to support economic, political and legal reforms there. The resolution was adopted by unanimous consent on July 18, 2001.

FY2002 foreign appropriations legislation (P.L. 107-115) contained the same conditions on aid to Serbia as in FY2001. The Administration made the certification on May 21, 2002. Secretary of State Colin Powell pointed to the passage of the war crimes cooperation law and the surrender of several indictees over the previous few weeks, as well as the release of ethnic Albanian prisoners from Serbia in March 2002 as justification for the move. Secretary Powell also said that, in the wake of the certification, the Administration favored working with Congress to restore Normal Trade Relations (NTR) status for the FRY.

The FY2003 foreign aid appropriations measure was included as part of the Consolidated Appropriations Resolution for FY2003 (P.L. 108-7). The bill contained certification provisions on aid to Serbia similar to the FY2001 and FY2002 bills, and required the President to make the certification by June 15, 2003. Secretary of State

Powell made the certification on June 15, but noted that Serbia and Montenegro still need to give their full cooperation to the ICTY, including the transfer of Mladic and Karadzic.

On March 5, 2003, the House passed H.R. 1047, which, among other provisions, would permit the President to restore Normal Trade Relations (NTR) status to Serbia and Montenegro, notwithstanding the provisions of P.L. 102-420. P.L. 102-420 imposed conditions on restoring NTR to the FRY, including a Presidential certification that the FRY had ceased armed conflict with other peoples of the former Yugoslavia, agreed to respect the borders of the former Yugoslav states, and ended support to Bosnian Serb forces. In 2002, the House passed a similar measure in H.R. 5385, but the Senate did not consider a companion version before the adjournment of the 107<sup>th</sup> Congress.

The House passed H.Res. 149 on April 9, 2003. The resolution offered condolences to the people of Serbia and the family of Zoran Djindjic; noted that implementing reforms and cooperating with the International Criminal Tribunal for the former Yugoslavia must continue despite the "significant risks" they pose for the leadership of Serbia and Montenegro; and that the United States should continue to support the reforms started by Djindjic, including the fight against organized crime and corruption.

On November 4, 2003, the Administration restored Serbia and Montenegro's Normal Trade Relations (NTR) with the United States. The FRY's NTR status was suspended in 1992, in response to its role in the war in Bosnia, according to the terms of P.L. 102-420 (106 Stat. 2149). The legislation permits the Administration to restore NTR to Serbia and Montenegro if the President certifies that the FRY had ceased armed conflict with other peoples of the former Yugoslavia, agreed to respect the borders of the former Yugoslav states, and ended support to Bosnian Serb forces. Administration officials say the move was made in response to the improved situation in Serbia, especially in defense reform and cutting links between the Serbian and Bosnian Serb armed forces. In June 2005, the Administration granted duty-free treatment to some products from Serbia and Montenegro under the Generalized System of Preferences (GSP).

The FY2004 foreign aid appropriations bill was added to an omnibus appropriations bill (H.R. 2673). The bill contains the certification process as in FY2001-FY2003, but tightens the provisions by specifically naming the transfer of Ratko Mladic as one of the steps Serbia must take to cooperate with the ICTY. The deadline for the certification was March 31, 2004. The Administration declined to make the certification, resulting in the suspension of about \$16 million in U.S. aid to Serbia. The FY2005 foreign aid appropriations were incorporated into an omnibus spending bill (P.L. 107-447). It contains the same certification process as the FY2004 bill, but with a certification deadline of May 31, 2005. The conference report deleted a Senate provision to deduct from U.S. aid to Serbia an amount equal to Serbian government aid to indicted war criminals.

The FY2006 foreign operations appropriations bill (H.R. 3057) was approved by the House on November 4 and the Senate on November 10. It was signed by the President on November 14, 2006 (P.L. 109-102). Section 563 contains the Serbian

aid conditions. The provision conditioned U.S. aid to Serbia after May 31, 2006, on “(1) cooperating with the International Criminal Tribunal for Yugoslavia, including access for investigators, the provision of documents, and the surrender and transfer of indictees or assistance in their apprehension, including making all practicable efforts to apprehend and transfer Ratko Mladic and Radovan Karadzic, unless the Secretary of State determines and reports to the Committees on Appropriations that these individuals are no longer residing in Serbia; (2) taking steps that are consistent with the Dayton Accords to end Serbian financial, political, security and other support which has served to maintain separate Republika Srpska institutions; and (3) taking steps to implement policies which reflect a respect for minority rights and the rule of law.” It says the Administration “should” vote for loans and aid for Serbia and Montenegro from international financial institutions after May 31, 2006, if the certification is made. The aid conditions do not apply to Montenegro, Kosovo, humanitarian aid, or assistance to promote democracy.

The provision specifically names Karadzic as well as Mladic as persons Serbia should detain. Second, it allows the Administration to issue a certification even if the two men are not transferred, if it determines that the two are not living in Serbia. (The exact whereabouts of the two men are uncertain. The Serbian government has admitted that Mladic was living in Serbia until very recently, but claims it does not know where he is now. Most observers believe that Mladic has been assisted in hiding by former and serving military and security officials. Most speculation on Karadzic’s location, at least in the past, placed him in Bosnia.)

On May 31, 2006, the Administration, in compliance with the certification provision in the FY2006 foreign operations appropriations bill, suspended \$7 million in U.S. aid to Serbia, due to its failure to cooperate with the ICTY.

On June 9, 2006, the House passed H.R. 5522, the FY2007 foreign operations appropriations bill. The bill contains the same certification provisions as the FY2006 bill. However, it no longer specifically names Karadzic as a person Serbia should detain but retains the mention of Mladic.

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