



## **INTERNATIONAL CONFERENCE ON PRIVATIZATION OF SOEs AND THE REFORM OF UTILITIES IN KOSOVA**

Prishtina, June 27-29, 2002

## **SOCIALLY OWNED ENTERPRISES AND THEIR PRIVATIZATION**

**Research Report  
June 20, 2002**

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## **CASE STUDIES OF SOES – SEPARATE VOLUME**

- 1.Kosova Electric Power Company
- 2.Post and Telecommunications of Kosova
- 3.Trepca
- 4.Ferronikel
- 5.Mirusha
- 6.Fructus
- 7.Agro-industrial Combine 'Kosova-Export'

## **Summary of the Main Findings of the Survey**

In February 2002, Riinvest carried out a research survey and study of 193 Socially Owned Enterprises (SOEs) similar to the survey conducted in October 2000. The main findings of the survey are presented below.

(1) The majority of the surveyed enterprises (55%) have more than 100 employees; 21% have 51-100 employees; and 24% have less than 50 employees.

(2) The legal status of the SOEs has remained the same as in the previous year.

(3) The main changes in economic activities compared to the previous year are as follows:

- About 86.0 % of the surveyed enterprises are active signifying no change.
- The number of active employees has fallen by 12.1%, whereas the number of employees receiving stipend but not working currently has fallen by 8.6%.
- Sales are mainly realized in the domestic market (91.3%) and remaining are exports (8.7%) that have increased from 1%.
- There has been an increase in turnover by 66.3%.
- The capacity utilization has increased from 35.0% to 41.8%. The highest increases in capacity utilization occurred in the transport sector (66.4%), in services (64.9%) and in construction (47.9%).
- The average monthly salary per employee has increased from 215 DM to 282 DM, a rise of 31.2%.

(4) The main obstacles to business as perceived by the management of the surveyed enterprises comprise shortage of working capital, obsolete technology, delays in ownership transformation/privatization, lack of market, inappropriate legal and institutional environment and an inadequate tax policy.

(5) The fixed assets of these enterprises are estimated to be valued at 3,602 million DM (a decrease of 19.4% compared to previous year). Based on the estimation by the management of these enterprises the fixed assets comprise machinery and equipment (24.2%), premises (38.4%) and land (37.4%).

(6) Almost all enterprises cited an inappropriate personnel structure as one of their main problems. From the composition of employees it is evident that the ratio of older employees is high comprising 64% of employees over 41 years, 29% between 31 year to 40 years and remaining 7% between 21 years to 30 years. Moreover, these enterprises have an unsuitable structure of educational qualification of managerial staff comprising 52 % having a university degree, 18% having a high school degree and 30% having secondary school certificate or other qualification. There is no change in the managerial and organizational structure of the SOEs as compared to the previous year.

(7) Financial performance has been affected by constraints in the legal status of these enterprises, the business environment and the structure of fixed and human capital. A

decrease in the share of raw materials and finished goods in the overall composition of stocks has led to an increase in cash and improved liquidity.

(8) The value of investments was 58.0 million DM, an increase of 52.6% compared to the previous year, but these investments are far less than needed to stabilize the economic activities of SOEs. The sources of investment are as follows: donations (51.2%), internal cash generation (20.9%), banks and other credit institutions (12.0%) and remaining from other sources (16%). The unclear legal status and other obstacles limit the possibilities for SOEs to attract new and favorable investment sources.

(9) Attitudes in favor of privatization have strengthened. Most of the surveyed enterprises are strongly in favor of privatization (increase from 79% to 87%). However, commercialization as a method of reactivating SOEs lacks support in these enterprises (13.5% of enterprises were in favor of commercialization in the previous year while only 2.6% felt the same way in 2001). The survey indicates that employees are interested in receiving free shares (63.2%), in buying shares at a reduced price (55.9 %), however there was not much interest in buying shares at market prices (24.2%). Managers of SOEs are willing to participate in the privatization process that would include a mixture of all three forms.

(10) Dislike for taxes is evident, with only 23% of the surveyed enterprises considering that they are acceptable; while excise duties are acceptable for 25% of enterprises. There is a moderate willingness to pay taxes, although reasons to avoid paying taxes were given as “high taxes and insufficient control”.

The table below shows the main characteristics of surveyed SOEs.

**Table 1. Main characteristics of surveyed SOEs**

|  |                                |
|--|--------------------------------|
| 1. Number of SOEs surveyed<br>- in Industry  | 193<br>107                     |
| 2. Active enterprises<br>- in Industry   | 166<br>85                      |
| 3. Number of registered workers<br>- Number of active workers  | 41,207<br>21,689               |
| 4. Workers age structure in years (%)<br>- 20 – 30<br>- 31 – 40<br>- 41 and over   | 7<br>29<br>64                  |
| 5. The value of fixed assets (in million DM)<br>- The value of equipment<br>- The value of buildings<br>- The value of land        | 3,602<br>871<br>1,384<br>1,347 |
| 6. Claims and liabilities<br>- The value of claims reported (in million DM)<br>- The value of liabilities reported (in million DM) | 41.3<br>22.2                   |

## I. INTRODUCTION

In the post war period the Riinvest Institute has been actively engaged in research activities in connection with the reactivation and privatization of socially owned enterprises (SOEs). Research activities and consultancy have been undertaken by Riinvest through the following projects:

- International Seminar: Post War Reconstruction of Kosova (July 1999),
- International Conference: Post War Reconstruction of Kosova – Strategy and Policies (January 2000),
- Setting up 18 Task Forces to examine the post war situation in key sectors of the economy and assess the damage caused by the war (1999),
- The survey of 192 SOEs year 2000 and 193 year 2001 and
- International Roundtable Forum: Socially Owned Enterprises and their Privatization/ Transformation (March 2001).

Many of the above activities have been undertaken as part of the two-year project, namely, “Promoting Economic Development through Civil Society” which is implemented in partnership with Center for International Private Enterprise (CIPE), Washington D.C. and supported by USAID. Within this project, the Riinvest Institute has organized wide debates, involving many sections of society, in order to stimulate the privatization process in Kosova. The civil society, the business community, independent research institutions, political parties, local government institutions and also SOEs have been involved in these debates.

During the last three years the UNMIK administration has tried to develop the best method of transforming SOEs, but the results of these efforts have been modest. The dilemma of and the attitude towards social ownership in Kosova and the rights and the sphere of competency of the management of SOEs have been amongst the main obstacles in the process of transformation. Therefore, privatization reforms have not been passed in Kosova and no real change has taken place.

In April 2002, Pillar IV of UNMIK and the DTI proposed the Regulation for Kosova Trust Agency, which created possibilities for the restructuring and privatization of SOEs. However, the Regulation has failed to address many important issues that need to be considered and solved in order to create the basic public support and social consensus necessary for the implementation of the Regulation. The International Conference on Privatization of SOEs and the Reform of Public Utilities (June 27 to 29, 2002) is a timely opportunity to develop an active debate and to recommend actions to overcome problems in starting the privatization process. In addition to this Report, case studies of seven public enterprises, namely, Kosova Electric Power Co. (KEK), Post and Telecommunications of Kosova (PTK), Trepca, Ferronikel, Mirusha, Fructus and Agro-Industrial Combine “Kosova-Export” are presented at the Conference.

## **1.1. The objective of the report**

The main objective of this Report is to present, at the Conference, the current situation of SOEs and to identify changes that have taken place in the operation of SOEs during the last two years. Other objectives are:

- To enrich our knowledge of these enterprises by investigating the most recent situation regarding their economic activities and financial situation,
- To provide essential information on the current conditions for business and the obstacles faced by SOEs,
- To present the attitude of the business community towards the privatization process, and
- To encourage a wide ranging debate amongst the democratically elected institutions of Kosova, UNMIK and the civil society in order to create the necessary preconditions for a successful privatization process.

## **Research methodology**

The report is based on a survey of 193 SOEs carried out in February 2002 in cooperation with the Central Fiscal Authority (CFA). Meetings and talks with the DTI, the Ministry for Trade and Industry, CFA and the Public Utilities Regulatory Unit, as well as discussions in the Riinvest Business Advisory Board and the study report presented at the International Roundtable Forum (Riinvest, June 2001), were also used to prepare this Report.

## **Sample**

The survey sample included almost all SOEs from the previous survey in 2000. However, large enterprises such as Trepca and Ferronikeli, public enterprises such as KEK and PTK, agro-industrial enterprises and public utility enterprises at municipal level are not included in the sample. The sample consists of 193 SOEs, which amounts to 55% of the overall total of 350 active and non-active SOEs. Enterprises included in this survey have priority in the privatization process because of their size and importance. Enterprises from Gjakova, which had transformed themselves into joint stock companies according to the ex-Yugoslav law of 1989, are also included in the survey sample. The survey includes SOEs from the following sectors:

- (i) industry (food processing, metal processing and electrical equipment, chemicals, paper and plastic processing, textile and leather, wood processing, printing and rubber),
- (ii) construction,
- (iii) trade,
- (iv) agriculture,
- (v) tourism,
- (vi) services,
- (vii) transport, and
- (viii) others.

The survey has been carried out in all municipalities in Kosova. The structure of the sample in terms of the number of enterprises in each of the seven regions is as follows: Prishtina (26.4%), Gjakova (11.4 %), Peja (17.6 %), Prizren (16.1 %), Gjilan (9.3 %), Ferizaj (9.8 %), and Mitrovica (9.3 %).<sup>1</sup>

## **Questionnaire**

The questionnaire used for the data collection was compiled in cooperation with the Central Fiscal Authority (CFA) and is almost the same as the questionnaire used in the survey of the previous year. It contains the following sections:

- Production activities,
- Capacity utilization,
- Turnover,
- Expenses and profits,
- Personnel and changes in management,
- Obstacles to business,
- Fixed assets,
- Investment,
- Accounts,
- Claims and liabilities,
- Taxes and privatization.

The survey was administered in the field by 20 senior students at the Faculty of Economics, most of whom had participated in the previous survey. This task was completed within two weeks followed by another two weeks of data entry and rechecking the answers in the questionnaires. The field control covered about 10% of the survey sample. The survey was carried out by personal contact and an interview with the management of the SOEs, mainly with directors or financial directors/managers. A willingness to participate in the survey was evident at almost all of the surveyed companies. However, despite several requests, the Cement Factory in Elez Han, first company commercialized by the DTI, declined to cooperate and participate in the survey and preparation of case study.

## **1.2. Contents**

The structure of the report is as follows:

- Summary of the main findings of the survey
- Introduction
- Characteristics of the business activities of SOEs 2000 – 2001 (capacities, financial indicators/performance, personnel and management issues)
- Obstacles to business
- Changes in fixed assets

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<sup>1</sup> The numbers in brackets indicate the proportion of the sample in each municipality.

- Attitudes towards privatization and tax policy
- Current issues relating to the privatization of SOEs, with a focus on the Regulation for the Kosova Trust Agency.

Appendices include:

- The Riinvest Position Paper on the privatization of SOEs (International Roundtable Forum, Prishtina, 2001)
- An overview of the process of commercialization of SOEs

Case studies of SOEs:

Riinvest and CFA have jointly carried out studies of the status of some SOEs. A separate volume presents them as case studies and includes the following SOEs:

1. Kosova Electric Power Company
2. Post and Telecommunications of Kosova
3. Trepca
4. Ferronikel
5. Mirusha
6. Fructus
7. Agro-industrial Combine 'Kosova-Export'

## 2. ECONOMIC ACTIVITY OF SOEs DURING THE 1999 – 2001 PERIOD

### 2.1. Level of activity and capacity utilization

During the period 1999 – 2001 SOEs received inadequate support and the institutional environment was unfavorable for them. The situation can be described by the following:

- Problems arising from the undefined status of social ownership and the legal status of these enterprises,
- Modest results from commercialization as a method of revitalizing SOEs,
- Limited access to sources of credit,
- A reluctance to start implementing the privatization process,
- Disputes between central and local government institutions regarding the appointment of the managerial staff of SOEs.

These conditions had a strong adverse effect on the economic activity and market environment for SOEs. As a result, SOEs have made only a modest contribution to the reconstruction process of the country.

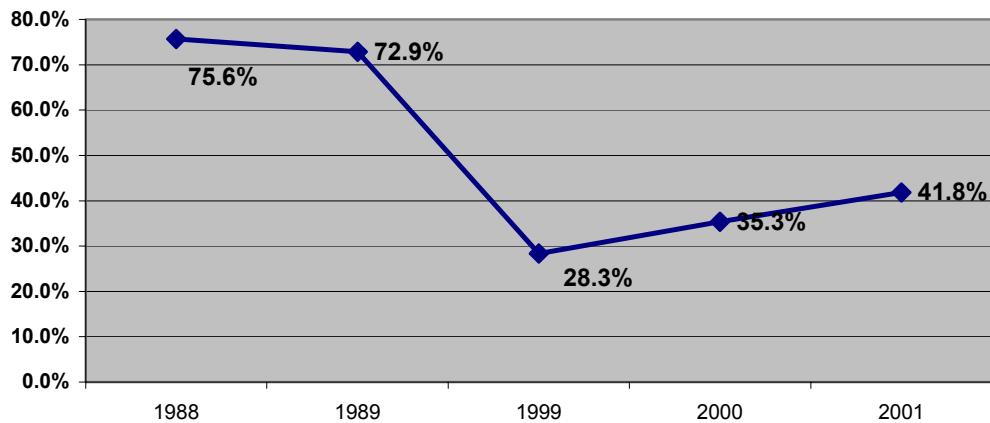
Table 2: Overview of Economic Activity

| <b>Description</b>                         | <b>1999</b> | <b>2000</b> | <b>2001</b> |
|--|-------------|-------------|-------------|
| Active SOEs (percentage of the total SOEs) | 55-60%      | 86.0%       | 86.0%       |
| Capacity utilization                       | 28%         | 35.0%       | 41.8%       |
| Turnover increase in %                     | -           | 34.4%       | 66.2 %      |
| Number of active employees                 | 18,171      | 24,662      | 21,689      |
| Number of registered employees*            | 36,023      | 44,203      | 41,207      |
| Average monthly salary                     | -           | 215 DM      | 282 DM      |

\* This refers to the total number of employees on companies' books

Based on an estimate, around 55-60% of the total number of SOEs was active in 1999, whereas during 2000 and 2001 the percentage of active enterprises increased to 86%. If we analyze active enterprises by sector then we will find that the trade sector, paper industry, chemical industry, wood processing industry, services, and construction have the highest proportion of active enterprises in the total number of enterprises in the respective sectors.

## Level of capacity utilization



After the big drop in capacity utilization during the period of Serbian control, we have witnessed a steady increase in the level of capacity utilization in each subsequent year since 1999 – from 28.3% in 1999 to 35% in 2000 and 41.8% in 2001. Sectors with the highest level of capacity utilization are transport (66.4%), services (64.9%), hotels and tourism (54.0%), and the agro-processing industry (48.3%). Low levels of capacity utilization are noticeable in processing industries such as: the textile industry (14.0%), wood processing industry (25.0%), plastic processing industry (27.5%), and electric equipment (25.0%). It can be clearly seen that the activities of SOEs were mainly in sectors related to the reconstruction process of Kosova (construction, transport and services). The low level of activity in other sectors demonstrates the lack of necessary investment and working capital in SOEs, as well as the difficulties of improving current market position and penetrating new markets.

## 2.2 Financial performance

According to the responses of the surveyed enterprises, the turnover of SOEs in 2001 has increased by 66.3 % compared to that of the previous year (from 172.2 million DM in 2000 to 286.3 million DM in 2001).

Table 3: Turnover and costs

|   | Description | Amount in DM-2000 | Amount in DM-2001 | % increase |
|---|-------------|-------------------|-------------------|------------|
| 1 | Turnover    | 172,243,394       | 286,284,121       | 66.2%      |
| 2 | Costs*      | 97,435,077        | 194,629,982       | 99.7%      |

\* The costs exclude labor costs.

The level of turnover of SOEs in industrial sectors has been below the average for the sample. About 55% of surveyed enterprises are in industrial sectors, whereas they amount to 54% of the total turnover. With regard to enterprises in services, which make up 12% of the sample, their share of the total turnover is 19.6%; with hotels and tourism only 6.7% of enterprises but 9% of total turnover; and construction 8.3% of enterprises and 8.9% of total turnover. The survey demonstrates that ‘above average’ turnover

increase is observed in services and in some industrial sectors (wood processing, metal processing and agro-industries).

Agro-industrial enterprises make up 20% of surveyed enterprises and 23% of total turnover. The textile industry is in a far worse position, with 5.2% of the total number of enterprises and contributing only 1.7% of the total turnover. The metal processing industry is in a similar position, where 15.6% of enterprises produce only 10.7% of the total turnover.

### 2.2.1 Costs

The negative trend in the business activities of SOEs can also be seen from other indicators: an increase in production costs by 99.7% compared to a year ago, much more than the increase in turnover (66.2%). In 2000, about 56.5% of turnover consisted of costs of sales and in 2001 this went up to 68%. Following the old accounting procedures, costs do not include salaries. According to the survey, the average costs increase was in the sectors: services and some industrial sectors that had also higher increase in the turnover. A higher disproportion (negative gap) between the increase of turnover and costs is reported in sectors: services, hotels and restaurants, agro-industry and metal processing.

### 2.2.2 Salaries

There was a significant increase in salaries in 2001. The average monthly salary went up from 215 DM to 282 DM (an increase of 31.2%). The average monthly salary in SOEs is 47% of that in the private sector.

### 2.2.3 Profit/Loss

The number of enterprises that have made a profit in 2001 decreased to 93 from 118 enterprises in 2000. The total profit of these 93 enterprises in 2001 amounted to 21.8 million DM that was 7.6% of the total turnover of DM 286.3 million while the total losses incurred in 2001 by 51 enterprises amounted to 9.1 million DM that was 3% of the total turnover of DM 286.3 million.

### 2.2.4. Working capital

An improvement in the structure of working capital in 2001 can be observed. The structure of working capital and the respective total amounts for 2000 and 2001 are presented in the following table.

Table 4. Structure of stocks

|                   | 2000      | 2001      |
|-------------------|-----------|-----------|
| Description       | Structure | Structure |
| Raw material      | 44.6%     | 25.5%     |
| Stocks            | 27.0%     | 8.2%      |
| Claims            | 18.9%     | 8.8%      |
| Financial Capital | 9.5%      | 57.5%     |
| Total             | 100.0%    | 100.0%    |

The shares of final products and raw materials in the working capital have decreased from 27% and 44.6% respectively to 8.2% and 25.5%. Instead, the share of cash in enterprises' working capital has increased substantially. The setting up of the banking system has helped to smoothen, improve and make the payment system easier. About 80% of surveyed SOEs have opened bank accounts, almost all capital that is in cash is held in bank accounts and some 44% of all payments are executed through bank accounts.

#### 2.2.5. Claims and Liabilities

In 2001 the number of enterprises with claims against other partners increased by 8.5%. Also, the value of claims rose from 38.1 million DM in 2000 to 41.2 million DM in 2001. Around 36% of the total amount of claims belongs to industrial enterprises, followed by the trade and service sectors.

Table 5: Claims in 2001

|   | Activity                       | No. of surveyed enterprises | No. of enterprises reporting claims | Sector's share in the total reported claims (%) |
|---|--------------------------------|-----------------------------|-------------------------------------|---|
| A | Industry                       | 107                         | 51                                  | 35.6  |
| B | Services                       | 24                          | 12                                  | 13.0  |
| C | Construction                   | 16                          | 7                                   | 4.8   |
| D | Trade                          | 5                           | 4                                   | 21.4  |
| E | Transport                      | 8                           | 5                                   | 3.6   |
| F | Hotels/restaurants and tourism | 13                          | 6                                   | 1.9   |
| G | Others                         | 20                          | 8                                   | 19.7  |
|   | Total                          | 193                         | 93                                  | 100.0   |

On the other hand, the number of enterprises with liabilities remained almost the same as in the previous year, and the amount of liabilities towards business partners decreased from 75.7 million DM in 2000 to 21.1 million DM in 2001. This was influenced by a decrease in the liabilities of industrial enterprises from 72.1 million DM to 15.4 million DM in 2001. In general, this change determined the whole movement of liabilities. The increase in liabilities was observed in the trade and service sectors as well as in the transport sector.

Table 6: Liabilities in 2001

|   | Activity                        | No. of surveyed enterprises | No. of enterprises that have had reporting liabilities | Sector's share in reported amount of liabilities |
|---|---------------------------------|-----------------------------|--|--|
| A | Industry                        | 107                         | 46   | 69.6   |
| B | Services                        | 24                          | 7  | 10.0   |
| C | Construction                    | 16                          | 4  | 2.3  |
| D | Trade                           | 5                           | 3  | 0.3  |
| E | Transport                       | 8                           | 5  | 12.4   |
| F | Hotels, restaurants and tourism | 13                          | 5  | 1.4  |
| G | Others                          | 20                          | 3  | 4.1  |
|   | Total                           | 193                         | 73   | 100.0  |

#### 2.2.6. Management and Personnel

The number of active workers in these enterprises has fallen in 2001, compared to 2000, by about 3,000 workers (around 12%), whereas the number of unpaid workers has risen slightly (this includes workers who still have some relation to the company). There are 114 large enterprises employing over 100 workers, together employing 60% of the total workers.

Table 7: Personnel

| Description                                   | No. of workers 2000 | %     | No. of workers 2001 | %     |
|---|---------------------|-------|---------------------|-------|
| Active workers                                | 24,662              | 55.8  | 21,689              | 52.6  |
| Workers who receive a stipend but do not work | 3,315               | 7.5   | 3,033               | 7.4   |
| Unpaid registered workers                     | 16,226              | 36.7  | 16,485              | 40.0  |
| Total   | 44,203              | 100.0 | 41,207              | 100.0 |

Table 8: Changes in managerial staff during the year 2001

|                    | No. of enterprises | %     |
|--------------------|--------------------|-------|
| Without changes    | 108                | 56.0  |
| Partial changes    | 51                 | 26.4  |
| Completely changed | 18                 | 9.3   |
| Without answers    | 16                 | 8.3   |
| Total              | 193                | 100.0 |

The number of managerial staff in these enterprises has decreased from 1,924 in 2000 to 1,480 in 2001. The category of well-qualified workers was mainly reduced, with other categories being reduced a little. The reasons for this reduction can be found in the very low level of wages. This may have a negative effect on future activities. In more than half of the surveyed enterprises, managerial staff have not been changed; have been

partially changed in 26.4% of the cases and in only 9.3% of enterprises have the managerial staff changed completely.

Table 9: Managerial qualification structure

| Qualification | No. of enterprises | %     |
|---------------|--------------------|-------|
| Faculty       | 770                | 52.0  |
| High          | 272                | 18.4  |
| Secondary     | 339                | 22.9  |
| Others        | 99                 | 6.7   |
| Total         | 1,480              | 100.0 |

The age structure of workers in the SOEs has worsened. While the number of workers in the 20 to 40 year age group has fallen, the number of workers older than 40 has risen sharply. Table 10 shows the age structure of employees in the sample enterprises.

Table 10: Employment according to the group ages – 2001

| Group-ages | %     |
|------------|-------|
| 20 – 30    | 7.2   |
| 31 – 40    | 29.0  |
| 41 – 55    | 51.9  |
| Over 55    | 11.9  |
| Total      | 100.0 |

### 2.2.7. Market

In the past, SOEs were the main generators of exports. Besides the suppression of export activities for the last 10 years, these enterprises are currently faced with a shortage of financial sources for the re-establishment and stabilisation of their activities. Under these circumstances all efforts are focused on the distribution and sale of products in the domestic market. Re-entry into former markets (the ex-Yugoslav market and other foreign markets) is hindered by the factors mentioned in section 3.

Table 11: SOEs' markets

|                    | 2000 (%) | 2001 (%) |
|--------------------|----------|----------|
| Domestic market    | 98.9     | 91.3     |
| Ex-Yugoslav market | 0.3      | 2.4      |
| Foreign market     | 0.7      | 6.3      |
| Total              | 100.0    | 100.0    |

Currently, the domestic market is undergoing changes due to the reconstruction activities. Because of the lack of domestic production there is a huge amount of imported products with complete liberalization of imports. Under this fierce competition it is difficult for the SOEs to sell their products, even though, according to the survey, it appears that the domestic market is the biggest customer of the products and services of SOEs. Around 99% of products and services were sold in the domestic market in 2000, whereas in 2001 it was around 91 %. The increase in exports is obvious; the export share of the total sales of surveyed companies was 8.7% in 2001 compared to 1.0% in 2000. The value of

exports was 1.9 million DM for 2000, and 20.1 million DM in 2001. The main exporters were “Balkan” (conveyor belts), Tobacco Factory (Gjilan), Radiator Factory (Gjilan), Eurometali (Ferizaj) and Shock Absorbers (Prishtina).

### **3. MAIN BARRIERS TO BUSINESS ACTIVITIES**

SOEs, as well other businesses, face many different obstacles in their business, ranging from institutional ones to those of an internal, managerial nature. Besides the already mentioned hurdles in the general context, there are also some specific problems. These specific barriers originate from the undefined legal status of these enterprises, which makes it very difficult for them to gain access to the financial markets. From the answers obtained from the 193 SOEs, the obstacles were ranked in the following order:

- A shortage of working capital
- Old technology
- Delays in privatization
- Insufficient market
- Legal and institutional environment
- Inappropriate (and unhelpful) taxes
- Others

3.1 Shortage of working capital was cited as the most serious barrier to economic activity by SOEs. These enterprises have very limited access to financial sources, and consequently face many problems in the financing of current activities and capital investment. The survey shows that working capital is insufficient to establish a sustainable business. 48% of respondents claim that lack of working capital is a very serious problem, 30.5% consider it a moderate problem while 18.6% state it is only a small problem. As the survey indicates, the stocks of raw materials and finished goods were transformed into liquid capital, but not enough to enhance and increase economic activity.

3.2 Obsolete technology of SOEs originates from the lack of capital investment in the last 10 years. The existing technology can be considered as a huge handicap for the future development of their activities under conditions of a market economy. Asset depreciation varies from 40 to 70%. All efforts for technological rehabilitation are strongly linked to the need for huge investments, which, as we said, are very hard to obtain, taking into account the reconstruction and transition process that the country is undergoing. This can be shown with UNMIK's unsuccessful efforts to reactivate Ferronikeli through the commercialization process. Of the 193 respondents, 45% consider the lack of technological improvement as a serious obstacle, 31% consider it as a medium obstacle, and finally 20.2% of enterprises consider this a small problem and remaining 3.8% did not answer the question. This situation can be improved with the initiation of the privatization process, which may ease the flow of foreign capital in the form of direct investments.

3.3 Delay in the privatization process of SOEs is ranked as the third major barrier facing the surveyed enterprises. Delay in the start up of the privatization process has had a bad influence on the companies' activities and especially on technological improvement and the production process. Results of the survey show that 34.2% of surveyed enterprises consider the delay of the privatization process to be a serious problem; 32.6% rank it as medium obstacle, and 30% consider it as a small obstacle to their activities and remaining 3.2% did not answer the question.

3.4 Insufficient market appears as a complex problem for the survival of enterprises. These enterprises face severe competition from private domestic companies and from imports. At the same time, they found the re-entry into former markets difficult. Of the surveyed enterprises, 26.0% consider the barriers to entry into a new market to be a serious problem, 31.6% as a medium obstacle, and finally 39.4% think that the insufficient market is a small problem.

3.5 Legal and institutional environment – According to the responses obtained from the survey, the existing legislation and especially its incompleteness creates a serious barrier to the economic activity of SOEs. This obstacle relates to the undefined legal status of SOEs; a misunderstanding of the essence and character of social ownership; the enforcement of commercialization as the only method for transformation of SOEs; and finally, the confusion regarding the competencies of central and local government institutions in the appointment of managerial staff at enterprises. Because of that, 18.1% of respondents claim that the lack of proper legislation is a serious problem, 36.7% consider it to be a medium problem and around 42.0% consider it to be a small problem to their activities and remaining 4.2% did not answer the question.

3.6 Taxation system – Based on response, even in the existing situation, the tax system can be considered to be an obstacle to the consolidation process and business activities of SOEs. From the survey, 14.0% of respondents claim that the existing tax system is a serious problem to their business, 21.2% consider it to be a medium problem, whereas 61.1% state that this problem does not have much impact on their activities and the remaining 3.7% did not answer the question.

#### **4. FIXED ASSETS**

The value of fixed assets is based on estimates by the management of the company in accordance with the existing documentation, which itself was based on estimates by commissions created for this purpose after the war. The book value of fixed assets is very doubtful in the current situation and cannot be the main criteria for the evaluation of enterprise capital and wealth, especially because of the following reasons. Book values are based on the old accounting system and are influenced by the inflation that hit the previous currency, and fixed assets have suffered a huge technological devaluation. Hence under current conditions the market value of assets should be recorded.

Table 12: The structure of fixed capital in million DM

| Description | 2000  |       | 2001  |       |
|-------------|-------|-------|-------|-------|
|             | Value | %     | Value | %     |
| Land        | 866   | 19.4  | 1,347 | 37.4  |
| Buildings   | 2,022 | 45.3  | 1,384 | 38.4  |
| Equipment   | 1,576 | 35.3  | 871   | 24.2  |
| Total       | 4,464 | 100.0 | 3,602 | 100.0 |

From the table, one can see the changes that occurred in 2001 compared to 2000 with regard to the overall estimations of the value of fixed assets, which has fallen by 19.4%. The valuation of buildings and equipment in the survey carried out in 2000 was influenced by the emergency phase of post-war reconstruction. In terms of overall capital structure, the land has doubled its share in the fixed assets from 19.4% to 37.4%, whereas the share of buildings has fallen from 45.3% to 38.4%. Equipment as a main component of fixed assets has fallen as well, from 35.3% to 24.2%. These differences in estimation of the value of different categories of fixed assets are obviously the result of subjective perceptions of the respective management of SOEs.<sup>2</sup> Thus, in 2001 the value of land is estimated significantly higher compared buildings and equipment. The highest percentage of equipment is in industry (83.0%), services (5.1%) and in construction (5.0%).

## 5. INVESTMENT

During the post-war period insufficient investment was made in SOEs. The small amount of investment that did take place was directed toward the elementary repair of damages caused by war in order to reactivate some lines of production. There is a lack of investment for more serious rehabilitation of the production process and technological capacities and also, as mentioned, the supply of working capital, which could ensure the flow of raw materials and the stabilization of economic activity at a higher level.

In 2001 an increase of 52.6% in the level of investment was registered compared to 2000, but this increase is again insufficient to fulfill the needs of these enterprises. During 2000 and 2001, the overall value of investments in these enterprises reached 80 million DM, but it covered only 10% of the basic needs estimated as shown in the survey of 2000. The survey of 2001 indicates the following details:

- The value of investments: 58.0 million DM,
- The value of investments in industry: 34.4 million DM
- Average investment per company: 296,043 DM
- Donations: 29.8 million DM
- The amount of banking credits: 3.2 million DM

<sup>2</sup> For example, a wood processing factory has estimated it's equipment at 25 million DM in 2000 that decreased to 9 million DM in 2001. The agricultural cooperative has estimated the value of it's land at 1 million DM in 2000 and 8 million DM in 2001. A rubber-processing factory has estimated the value of building at 92 million DM in 2002 and 40 million in 2001.

According to the survey, respondents show strong commitment towards new investment despite of the existing circumstances. This vision is based on potentially huge investments, specifically in advanced technologies, and the adoption of new production and service schemes. In the current circumstances, the employment of new assets is conditional upon ownership transformation, encouragement of foreign investments and a building of new effective partnerships. Around 65.5% of respondents declared that they have prepared business plans and are making efforts to find new investments.

### 5.1. Investment sources 2001

In the 2001 survey, the largest source of investments was donations (51.2 %), followed by self-generated means (20.9 %) and finally, other sources with 10.3 %. Credit represents only 11.0 %. The highest percentage of self-generated means in actual investments was in the service sector, with 37.0%, followed by the agro-industry (17.6%), hotels and tourism (11.4%) and finally construction (7.3%). Donations were mainly concentrated in industry (80.5%), services (11.1%), and transport (5.1%). The low percentage of joint ventures (5.4%) is a direct result of the delay in the initiation of the privatization process, the non-completion of the legislative and judicial systems and the creation of a secure environment for business activities and investments. The increase in the level of donations was mainly by investments in the mining sector (coal) and other investments by the European Agency for Reconstruction.

### 5.2. Investment according to sectors

According to the responses from the survey, industry is the major recipient of investment resources, with a 59.3% share in the total, followed by the service sector with 17.7% and construction with 8.7 %. These three sectors account for more than 85% of total realized investments.

Table 13: Investments according to the size of the enterprises

| Size of enterprise | The amount of investments in DM | %     |
|--------------------|---------------------------------|-------|
| Micro-enterprises  | 748,580                         | 1.3   |
| Small enterprises  | 10,057,130                      | 17.3  |
| Medium enterprises | 2,489,456                       | 4.3   |
| Large enterprises  | 44,729,237                      | 77.1  |
| Total              | 58,024,403                      | 100.0 |

Around 77 % of the total value of investments was received by large enterprises, 4.3% by medium enterprises, while small and micro-enterprises received 18.6% of the total. From the results presented above, the following conclusions can be drawn:

All surveyed SOEs need serious investment in order to consolidate their business activities, but sources of investment are conditional upon the initiation of ownership

transformation (privatization) and attracting foreign investment, rather than relying on domestic commercial banks and using remittances from abroad.

## 6. ATTITUDES TOWARDS PRIVATIZATION AND THE TAX POLICY

### 6.1. Privatization

In order to present the SOEs management's opinion relating to privatization, questions were included in the survey about the readiness of managers and other employees to participate in this process. According to the results obtained in the surveys of 2000 and 2001, their attitudes have evolved in two directions:

The increase in support for privatization rose from 79% in 2000 to 87% in 2001; Support for the commercialization process fell from 13% in 2000 to only 2.6% in 2001.

The results are given in the table below:

Table 14: Attitude regarding privatization

|                        | 2000  | 2001  |
|------------------------|-------|-------|
| Responses              | %     | %     |
| To keep present status | 7.1   | 7.8   |
| To be commercialized   | 13.5  | 2.6   |
| To be privatized       | 79.4  | 87.0  |
| N.A.                   | 0.0   | 2.6   |
| Total                  | 100.0 | 100.0 |

Results from the survey prove that privatization has strong support both in the business community and in the wider Kosovar society. The attitude of respondents with regard to the form of participation in the privatization process in Kosova are given in the table below:

Table 15: The workers' perception regarding participation in the privatization process

| Description | Workers are ready to participate if shares are granted for free | Workers are ready to buy shares at low prices | Workers are ready to buy shares at market prices |
|-------------|---|---|--|
| Yes         | 63.2  | 55.9  | 23.8   |
| No          | 33.7  | 38.8  | 72.0   |
| No answer   | 3.1   | 5.3   | 4.2  |
| Total       | 100.0   | 100.0   | 100.0  |

Table 16: The managers' perception regarding participation in the privatization

| Description | Managers are ready to participate if shares are granted for free | Managers are ready to buy shares at low prices | Managers are ready to buy shares at market prices |
|-------------|--|--|---|
| Yes         | 43.0   | 55.4   | 34.2  |
| No          | 51.8   | 39.4   | 60.1  |
| No answer   | 5.2  | 5.2  | 5.7   |
| Total       | 100.0  | 100.0  | 100.0   |

Based on these responses, it is clear that both workers and managers are keen and interested in being involved in the privatization process. Taking into consideration the poor social conditions, managers consider that workers are willing to participate in privatization if the shares are granted for free (63.2%); and to a lower extent if shares are available at low prices, whereas managers of SOEs see their possibilities in the privatization process mainly through buying shares at low prices. From these responses, one can draw conclusions about the types of privatization that are supported by managers and workers. While workers support the idea of privatization through the free transfer of shares to workers, managers prefer some kind of combined method, involving the purchase of shares at low and market prices.

Another survey conducted by RIINVEST (2001) with 619 private enterprises shows that around 69% of respondents are ready to participate in the process of privatization. The methods of participation in this process include the following forms: purchase of shares 39 %, purchase of the whole enterprise 11 %, and renting the enterprise facilities 16%. Other respondents do not wish to take part in the privatization process for two reasons: some are not interested (14%) and some do not have the ability (20%).

## 6.2. Observations on tax policy

The survey has shown dissatisfaction amongst the respondents with regard to the tax policy. Only 8% of respondents expect positive effects to follow the enforcement of VAT; 24% expect that it has the expected effect, and 23.8 % think that VAT has only negative effects. From the total number of surveyed enterprises, one-fourth of respondents consider that the non-payment of VAT by most of the business entities is a problem.

Only 23.0% consider that customs tariffs are acceptable, whereas 41.0% think that they are high and 28.0% declare that custom tariffs are very high. Similar opinions are also expressed in terms of the level of excise duty: 25.0% of respondents think that excise duties are acceptable, 52.0% think that they are high and 23.0% consider them to be very high.

Most of the respondents show an average willingness to pay taxes (56.5%), 26.4% show less willingness to pay taxes and only 8 % show a high readiness, whereas 8.3% claim they are not prepared to pay taxes. It is considered that problems in the payment of taxes are caused by the high level of taxes, a lack of control, the fiscal culture and for an

‘important’ reason: ‘because others do not pay them’. Approximately 70% of enterprises have paid different fees and “taxes” to the municipality budget. Tax on property was paid by only 10 enterprises.

## **7. PRIVATIZATION OF SOEs AND THE NEW UNMIK REGULATION ON THE KOSOVA TRUST AGENCY<sup>3</sup>**

For almost three years, the International Administration, Pillar IV and Department of Trade and Industry (DTI) of UNMIK respectively, have been working on the passing of the Regulations for privatisation of SOEs. The slow process has been accompanied by ambiguities, hesitations and has also been politicised. In the second half of April 2002, after a long process of consultations and preparations by the International Administration, but without adequate involvement of Kosovars, Kosova's interim administration and institutions respectively, a Regulation on Kosova Trust Agency (KTA) that will lead to privatisation of SOEs in Kosova was passed. This process has gone through three developmental stages:

### **a) September 1999 – September 2000: “The White Paper”.**

During this period, UNMIK attempted to understand the nature of social ownership and the state of Socially Owned Enterprises (SOEs) after the war, in order to find a way to monitor them since it did not have control over them. In terms of economic policies and activities aimed at rebuilding the economic system, privatisation was declared as an important objective and one of the priorities. As a result of discussions and analysis, Pillar IV of UNMIK produced a proposal known as “The White Paper” by Jolly Dixon (then head of Pillar IV) in the second half of 2000. “The White Paper” emphasised priorities of private sector development and the commencement of privatisation in Kosova, including first of all:

- Setting up a Privatisation Agency and Fund, and selling the enterprises to outside investors, with a possibility for employees to participate in the process by obtaining up to 30-40% of shares, as a complementary method
- Commercialization of SOEs (leasing of SOEs for a period of 10 years).

While the UN legal offices did not support the idea of privatisation, the experiment with commercialization seemed like the only option, which in practice produced very modest results to date.

### **b) November 2000 – June 2001: “Conversion of SOEs into Joint Stock Companies”.**

By the end of 2000, the DTI came out with a new proposal for the transformation of SOEs into Joint Stock Companies, based on “Markovic Laws” of 1989, with the majority

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<sup>3</sup> The statement on the Regulation on KTA presented in this section was discussed and supported by the Riinvest Business Advisory Board and disseminated to the relevant stakeholders in the process of the approval of this Regulation. The Regulation has subsequently been approved without significant changes. However, we consider that the suggestions presented here are relevant to further activities for developing policy procedures for the implementation of the KTA Regulation and also for being considered for further eventual modifications.

of shares (60-70%) going to employees, and the remaining part being sold to investors. Proceeds obtained would serve to set up a Privatisation Fund or they would be allocated for the needs of Kosova's budget. The rationale was that this method might have been acceptable to the Legal Department of the UN under the so-called 'applicable laws' and, furthermore, the sale of the remaining 30-40% could attract outside investors and bring in new capital to enterprises. In relation to this model, local and international experts expressed their concern on the ground of its efficiency and its ability to attract the much-needed outside investors. It now appears that even the UN administration objected to these proposals on grounds similar to their objections to the "White Paper", contesting the UNMIK's mandate to embark on change of ownership.

### **c) June 2001 – May 2002: "Spin-off" Model and KTA**

UNMIK, its Pillar IV and DTI respectively, then embarked on the elaboration of a model that would enable privatization regardless of the identity of the ultimate owners, which would remain to be resolved later on through a separate procedure. The so-called "Spin-off" model involves the setting up of subsidiary companies using the assets of SOEs, and then selling the shares of these subsidiaries without prejudging the ownership of the original SOEs. All proceeds of sale of shares of subsidiaries are expected to be kept by KTA in frozen accounts for the settlement of claims of creditors and the eventual owners of the companies. The KTA will be in charge of the administration of all socially and publicly owned enterprises of Kosova and will endeavour to protect and enhance the value of their assets. The Agency will be managed by the Board of Directors that will report and be responsible to the Special Representative of the Secretary General (SRSG). There will be a special Chamber of Judges at the Supreme Court of Kosova to deal with ownership and creditor claims against each enterprise and any disputes arising out of the KTA's exercise of its functions. The Agency will also implement the liquidation procedures for those SOEs which will be unable to meet their obligations and recover from financial distress.

The major issues arising from this Regulation are:

- (1) The importance of attracting new investment;
- (2) The effective use of the funds generated from sale of shares but remaining under KTA control;
- (3) The efficient administration of SOEs and public enterprises;
- (4) Ownership contests and rights over the assets of SOEs;
- (5) The involvement of Kosovar society and the need for social consensus;
- (6) The provision of transparent procedures;
- (7) The establishment of a supportive institutional environment and implementing mechanisms.

#### **7.1 The Importance of the Regulation in Attracting New Investment**

By establishing subsidiary companies from the assets of SOEs and registering them as new companies based on the Regulation on Business Organisations, and then selling their shares to foreign and domestic investors, the Regulations can potentially create new

opportunities for attracting and increasing investment in Kosovar enterprises. The doors are open to potential investors to buy these assets without the fear of inherited debts and other problems related to SOEs. In this respect, the “Spin-off” model has several advantages compared to other models. Given that the shortage of investment resources for working capital and technological regeneration is the main factor limiting the operation of SOEs, the model provides the legal basis for the infusion of new capital into SOEs, especially if an adequate institutional environment and the necessary support mechanism for its implementation are put in place.

## **7.2 The Effective Use of Funds under KTA Control**

The KTA will keep in trust funds generated from the sale of assets (in separate accounts, one for each SOE), for benefit of creditors and claimants to the ownership of SOEs' assets. These funds will remain frozen – out of their economic use or any possible destination, until the Chamber of Judges at the Supreme Court resolves the process of ownership contests. This is a very specific model not only compared to privatisation methods in other transition countries but also in terms of the treatment of SOEs in other successor states of former Yugoslavia, which have completed or are near the completion of their privatisation process.

The difference stems from the fact that there will be no Privatisation Fund – as a separate institution and the proceeds will not serve to meet certain needs of society (within or outside Kosova's budget). The future of these proceeds will not be known until after the ownership contests are over. It is also not clear who will decide on the use of these proceeds after the settlement of all claims.

The main shortcoming of this document is that it does not overcome the problem of misunderstanding and inadequate treatment of social ownership in Kosova. It seems that this Regulation also considers social ownership as “something unclear, the owner of which is not known”, therefore it remains to be found. We have to emphasise that this is not based on the reality of the situation in Kosova and that if it is taken as a starting point for privatization of social property, it will be difficult to support it with the consensus of Kosovar society, which would be indispensable for any privatization model. The fact that Kosova was an equal constituent member of the federation in former Yugoslavia and had the same competencies and authority over its socially owned property as other federal units, remains ignored by the Regulation. This is the key problem with this Regulation, for which a solution has to be found. In terms of that system, neither the federation nor its members, specifically Republic of Serbia, had any right to interfere with the governance of social ownership in Kosova. The treatment of social ownership in Kosova by this Regulation does not have a defensible legal basis and may result in social and political tensions.

The involvement of Serbia in the governing of social ownership in Kosova (over the 1989 – 1999 period) was the result of the violation of legal order and laws of former Yugoslavia, manifested by the abrogation of autonomy of Kosova in March 1989, accompanied by the imposition of a repressive and discriminatory regime. The “emergency administrative measures” were imposed in virtually all SOEs throughout

Kosova in 1989. These “measures” were enacted by the Serbian Parliament in violation of the Constitution of former Yugoslavia and Constitution of Kosova. The “emergency measures” resulted in open discrimination on the basis of nationality, the expulsion of all Albanian managers from the leading positions of their enterprises, the abolition of the Workers’ Councils and the dismissal of about 70% of Albanian employees. The next step was the “forceful merger” of many Kosovar SOEs with companies in Serbia, subjecting them to Serbian domination. According to the enterprises laws of that time, employees were able to decide, by referendum, on issues such as the merger of their enterprise with other companies or for changes in the statute of their enterprise. The “emergency measures” suspended this right and denied the employees the opportunity to decide on the future of their company. Therefore, all property transactions, their fictitious “transformation” and changes in their statute (such as forced mergers) during the period of “emergency measures” are void and without any legal basis. Equally, there is no legal basis in the enterprise laws of former Yugoslavia for any “special rights” of Serbia over social ownership in Kosova and her involvement in the privatisation process in Kosova (Declaration of the Serbian Minister of Privatisation during the discussion between UNMIK’s representatives and the Serbian Government concerning Regulation on KTA<sup>4</sup>).

At times, the Regulation seems to reverse the position of real claimants in the Kosova conflict: it is the Serbian regime which inflicted huge damages to SOEs and abused its position of power during the period of “emergency measures”, and then embarked on wholesale destruction of property and life in Kosova. It is the Serbian regime that should be the subject of claims by Kosovar society and UNMIK, who is speaking for it at present.

The real owner of SOEs is primarily Kosovar society. According to the applicable laws, there should not be any obstacle to setting up and effectively managing a “Social Privatization Fund”, with its resources coming from the sale of shares of subsidiaries of SOEs. Such a fund, based on the decision made by the Parliament of Kosova in cooperation with SRSG, should address several immediate needs during the privatization process:

- Job creation, social assistance and retraining of employees that remain unemployed during and after privatization;
- Supporting the Pension Fund;
- Investments to improve infrastructure;
- Setting up a Restitution Fund (with 10 –20% of the sale of shares) to meet the legitimate claims of creditors.

This model would ensure the establishment of a legal basis for privatization and the effective use of the proceeds from privatization. It can also provide a framework for the resolution of the problem of liabilities and claims (which must be settled at the same time) through the use of a Restitution Fund and the Kosova budget, if the resources of this Fund were insufficient.

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<sup>4</sup> See “Koha Ditore” and “24 orë”, 2 May 2002 and “Epoka e Re”, 1 May 2002.

All this is possible in a completely legal manner and with respect for the monitoring role of SRSG. Such a solution would also have a better macroeconomic consequence than that suggested by the Regulation. The proceeds of the sale of shares of subsidiary companies to domestic buyers will not be available for economic use. The freezing of these funds in KTA accounts for a long time will have a recessionary impact, especially at a time when social problems and unemployment levels are already very severe. In addition to this, employees that remain unemployed should benefit from their right to social assistance and retraining, first of all from the Privatization Fund. There is a fear that ignoring these problems and postponing them for an indefinite period may result in social and political tensions which will turn to a serious impediment in implementing the proposed model.

Therefore, in order to create the necessary conditions and to reach a basic social consensus in favour of the proposed model, necessary changes that would reconcile the interests and rights of Kosovar society with the interests of creditors should be incorporated. The specific feature of Kosova, being under the UN interim administration, UNMIK, should not opt for solutions that undermine the character of social ownership and violate the rights of Kosovar society and employees.

### **7.3 The Efficiency in Administration of Socially and Publicly Owned Enterprises**

The Agency has taken on the role of direct administration of SOEs and not only their supervision. This administration includes electing managerial and leading structures, appointing supervisory boards, financial management policies and financial control (article 2) in all these enterprises. This means that the character of SOEs and their competencies will be changed substantially, even before their privatization. The capacities of this Agency are very limited and would hardly be able to effectively administer about 350 socially and 60-70 publicly owned enterprises immediately after the establishment of subsidiary companies, their privatization, bankruptcy procedures in some of their companies, managing the proceeds, and many other obligations and competencies. From this point of view, a monitoring function in SOEs until they embark on “Spin-off” procedures would be preferable, rather than their direct administration.

### **7.4 Ownership Claims and Rights over the Assets of SOEs**

The establishment of a judicial framework, the special Chamber of Judges within the Supreme Court of Kosova, is an important mechanism for the progress of this process. In order to ensure the effectiveness of this process and a definitive solution to the problem of claims, the Regulation should define a precise deadline for applications by eventual claimants, and possibly a deadline for the end of the decision-making procedures concerning claims.

As far as solving the problem of ownership claims is concerned, the Regulation must define more clearly “the character of applicable laws” and the “non-discriminating implementation” (referred to in articles 5.3 and 5.4 of the Regulation) because such a vacuum in definition will present an extra burden for the Board of Agency and the Chamber of Judges who may have to decide on them. To make it absolutely clear, it is

necessary to explicitly include in the Regulation as discriminatory all the “emergency measures” and ownership transactions which were imposed by violence and force on Kosovar society. The administration of SOEs by managerial structures installed by the Serbian regime has resulted in much damage to social ownership in Kosova (abuse, disinvestments, losses from the dismissal of employees from their work places, war damages, etc.). Now the question arises: “who is responsible and who will have to pay for these damages? The first part of the question leads directly to those who imposed these damages on Kosovar society: the Serbian Government. As the Agency will administer socially and publicly owned enterprises, it is obvious that it should also take up and pursue the claims of Kosovar SOEs against parties outside Kosova, most importantly in Serbia.

The settlement of mutual claims and liabilities between SOEs after the dissolution of Yugoslavia was a problem facing all successor states of former Yugoslavia – and Kosova is no exception. But this settlement has not affected the development of the privatization process in any of the entities of the former Yugoslav federation, including Montenegro and Republika Srpska. Obviously, it is necessary to develop a balanced approach for the resolution of ownership questions with Serbia in order for both parties to be able to proceed with economic development.

## **7.5 The Involvement of Kosovar Society and Reaching a Needed Social Consensus**

The Regulation has ignored the involvement and participation of Kosovar institutions that emerged from democratic elections in Kosova – especially the Parliament, Government and civil society – with the exception of the expected participation of two ministers in the Board of Directors of the Agency. Although, according to the Constitutional Framework, ownership issues and ownership transformation are considered to be under the reserved power of SRSG, the involvement of Parliament, the Government and civil society of Kosova in policy-making for privatization and its implementation provides the policy with the social support and political consensus necessary for its success.

Ownership issues are specific and complicated. Nevertheless, its transformation in all transition countries was presumed to be with social consensus, monitoring and transparency. Kosova should not be an exception. The successful implementation of the Regulation requires the positive attitude of its most important stakeholders, the Kosovar people, who are most affected by the process.

## **7.6. The Provision of Transparent Procedures**

Although article 10.1 on operational policies of the Agency states that “transparent procedures and equal application to provide fair competition to obtain a certain value for the shares of companies in the market will be in place”, details of such a procedure are not elaborated even in general terms. Elements of transparent procedures should be treated explicitly in this Regulation. Also, attention should be paid to the consideration of a business plan as one of the elements used to evaluate the bids to buy the shares, avoiding the inclusion of subjective elements in the evaluation of bids.

The Regulation should also take into consideration and include the obligation of KTA to report to Parliament and the Government and provide transparent information to the public.

### **7.7. Establishing an Institutional Environment and Implementing Mechanisms**

The implementation of this Regulation, after improvements based on consultations are introduced into the text, is of special importance in facilitating the economic development of Kosova. The creation of a positive attitude in Kosovar opinion and institutions, as well as in the SOEs themselves, is a very important precondition for successful implementation of the Regulation. At the same time, the completion of a judicial framework and institutional environment is of special importance, especially in:

- Passing the Law on privatization of land;
- Passing the Law on Mortgages;
- The creation of greater bid/credit offer with better terms and conditions to support private investors;
- The creation of legislation to establish a stock exchange
- Further improvements in taxation policy.

## ANNEX I

### POSITION PAPER PREPARED AFTER THE FIRST INTERNATIONAL ROUNDTABLE FORUM ON “PRIVATIZATION OF SOCIALLY OWNED ENTERPRISES” HELD ON MARCH 30, 2001

In cooperation with CIPE - Washington and supported by USAID

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#### **Position Paper on the Privatization of Socially Owned Enterprises**

**April 2001**

*This Position Paper on privatization represents the views of the Riinvest Institute for Development Research based in Pristina. The document is part of the project entitled “Promoting Economic Development Through Civil Society”, which Riinvest is implementing together with the Washington-based Center for International Private Enterprise, and which is supported by the United States Agency for International Development (USAID). Through a combination of research and advocacy and the input of the local business community, the project is addressing selected key economic reform issues in Kosova, of which privatization is a high priority.*

- **There is an overwhelming consensus that Privatization is necessary, essential and urgent as a fundamental pillar in building a market economy and democracy in Kosova.** This opinion was confirmed by all Kosovar, international and government representatives at the recent International Roundtable Forum on Privatization held on March 30, 2001, organized by the Riinvest Institute for Development Research and the Center for International Private Enterprise (CIPE), supported by USAID, and attended by over 100 people. This consensus is strongly supported by Riinvest surveys of the Kosovar business community, which show that almost 80% of the private business community and 84% of managers of SOEs support immediate Privatization and that the business community is interested in participating in the process in a variety of ways. An effective market economy is essential for developing democratic institutions. In our opinion, this cannot be achieved by preserving the existing socially owned and self-management ownership structure, but through protecting and respecting property rights and creating new and effective ownership structures.
- **Resolution 1244 does not prohibit Privatization.** We understand Resolution 1244 of the Security Council and UNMIK regulations as being oriented toward building democratic institutions, substantial autonomy and self-governance of Kosova before its final status is determined. In our view, building a market economy is critical to building substantial autonomy and self-governance, and that Privatization – as a key factor in the more efficient governance of economic assets and resources – is in turn a critical pillar of a market economy. Hence, we believe that Privatization is in accordance with the scope of UNMIK authority and that Resolution 1244 does not prevent Privatization.
- **Social ownership in other entities of former Yugoslavia has not proven to be an obstacle to Privatization. Treating Kosova differently in this respect risks public discontent, and a long-term distrust among Kosovar citizens towards internationally developed economic reforms.** In legal terms, Kosova has the same rights to govern its economic affairs

and social ownership as other units of the former Yugoslav Federation. Imposing a different approach on Kosova could be an obstacle to building up a market economy, and a kind of “discrimination”, treating it as the only exception in the region and among other former socialist countries.

- **Possible claims should not be viewed as a barrier to Privatization.** Possible ownership claims, which are exaggerated and considered as an obstacle to Privatization, should be treated separately from the Privatization process. A Restitution Fund could be established for compensation of claims that would be approved in the courts (Kosovar/international). Riinvest research shows total claims on 192 surveyed SOEs to be approximately 2% of estimated asset value.
- **It is critical for UNMIK to take a clearer position on the issue of ownership transformation in Kosova.** The hesitation by UNMIK continues to be major barrier preventing the implementation, or even serious consideration of, broader ownership transformation. The uncertainty about future ownership caused by any delay and hesitation would discourage new investment and lead to further deterioration of the financial position of SOEs.
- **It is important to avoid a situation where there are no options, or only one option for ownership transformation.** Such a situation could result in greater misunderstanding between Kosovar society and the international community and this will be an obstacle in facilitating Kosova's economic development. Given the significant misunderstandings about ownership transformation and Privatization that have occurred elsewhere in the region, it is important that a broad public discussion about ownership transformation continue to take place here as a way of creating a positive atmosphere and building a broader consensus.
- **Kosova can learn a great deal from the experiences of implementing Privatization elsewhere, particularly in the Central and Eastern European region.** International experience shows that an effective Privatization program:
  - Facilitates restructuring, including the ability to attract outside capital;
  - Facilitates effective corporate governance that includes protecting the rights of minority shareholders;
  - Facilitates further evolution of ownership especially encouraging new owners to join.
- **The debate in Kosova over the most appropriate forms of ownership transformation should be based on the impact of each transformation model on:**
  - Enterprise efficiency and effectiveness (growth and development performance, restructuring, and corporate governance);
  - Attracting private investment (foreign and domestic);
  - Impact on the reform process, and development of a market economy and democracy.
- **The structure of SOEs in Kosova (which can be classified primarily as small and medium-sized) points to the attractiveness of direct sale to foreign and domestic private investors as a Privatization method.** Research carried out by Riinvest on a sample of nearly 200 SOEs shows that 50% of enterprises have fixed assets valued (by owners) at less than 10 million DEM, and another 36% of enterprises with fixed assets value at between 10 – 50 million DEM. In terms of employees, 38% have less than 100 employees and 86% have less than 400 employees.

- **There is an urgent and massive need for cash infusion into socially owned enterprises.** The question arises as to whether current UNMIK and DTI proposals will best facilitate this need for cash infusion. International experience highlights the difficulties of attracting bank credit and outside capital to enterprises privatized through a transfer of the majority of shares to employees and/or management. International experience also shows the considerably greater degree of investment undertaken by privatized companies (for example, 10 times greater in Poland) as opposed to state/socially owned commercialized companies.
- **There is much criticism by the Kosovar business community and international experts about the ongoing commercialization process.** Our major concerns are that: (i) it ties the hands of future Kosovar governments to this form of control; (ii) there is no guarantee that commercialized companies will not be decapitalized; (iii) there is no guarantee that commercialized companies will have effective and responsible management; (iv) it may discourage outside investors to come in at some point in the future; and (v) the effects are not significant or comparable to other, more advanced Privatization methods.
- Although we feel that transformation of SOEs into joint stock companies (with majority employee share ownership) will not significantly improve the enterprise's financial situation and its corporate governance, **this new DTI proposal would be a better solution than commercialization.** This model could be improved by including more explicitly the possibility of issuing additional shares, preferably at the beginning of the process, to potential private buyers and stronger corporate governance. In these cases **this model could be an acceptable solution, especially if other forms of Privatization are not possible.**
- **Corporate governance issues are fundamental in all types of ownership transformation.** All key actors must be educated in problems of corporate governance, including at minimum:
  - Boards of Directors
  - Managers
  - Employees and their representative bodies
  - Relevant government entities
  - General public – who might also be shareholders at a certain stage
- **Continued efforts are needed to inform and educate the public about ownership transformation and Privatization,** and seek ways to increase their level of understanding, involvement and support for implementing this process.
- **Other institutional reforms must continue.** This includes, in particular, continued taxation policy development, and the establishment of accounting and bankruptcy regulations to complete the set of legal reforms needed as a minimum for a functioning market economy and successful Privatization.
- **There is necessity to build a consensus among Kosovar society and the international administration** toward successful Privatization based on a consistent Privatization strategy.

## ANNEX 2

### A Brief Overview of the Commercialization of Socially Owned Enterprises (SOEs)

The DTI embarked on the commercialization of SOEs in the second half of 2000 and, to date, it has announced commercialization tenders for 61 SOEs. Only 28 concrete offers for commercialization have been received. Based on the declared tenders, commercialization contracts have been signed for 13 SOEs so far. The DTI estimates that about 2,470 people will be employed and investments totaling 41.4 million DM will be provided. Furthermore, the annual rent to be paid for the contracted period is estimated at 1,886,000 DM. Amongst the SOEs included for commercialization, there are 4 enterprises that deal with construction material, 5 in the food industry, 2 in the chemical and plastic industry and one in leather and textile. The contracts signed show that 10 contractors are domestic and 3 others foreign investors.

According to the DTI, final negotiations are under way for the commercialization of 11 other SOEs, which would provide jobs for 857 workers and investments of 38.1 million DM. In this group of enterprises, three are engaged in tourism and hospitality, three in wood processing and five in other sectors. All commercialisation contracts contain the undertaking by the contractors that they would employ an agreed number of workers and make an agreed minimum amount of investment in the commercialised SOEs.

Main indicators of SOEs included in the commercialization process-

|                    | Number of enterprises | Basic employment | Number of generated jobs | Planned investment (million DM) | Planned concession (DM) |
|--------------------|-----------------------|------------------|--------------------------|---------------------------------|-------------------------|
| Contracts signed   | 13                    | 1,248            | 2,470                    | 41.4                            | 1,886,000               |
| Final negotiations | 11                    | 33               | 857                      | 38.1                            | -                       |
| Total              | 24                    | 1,281            | 3,327                    | 79.5                            | 1,886,000               |

Source: DTI, 2002

The Commercialization process has been accompanied by internal tensions in enterprises and local administration. In some cases, the attempt by the DTI to include SOEs in the commercialization process have failed because workers and the management were not involved in negotiations with potential partners. The non-compliance of a foreign contractor with the terms of the contract has resulted in the commercialization of the SOE "Mirusha" from Klina being abandoned. It is estimated that some other contracts between partners and SOEs are under threat because of the above-mentioned problems.

Based on the data available, it is difficult to assess the extent to which the requirements of the contracts are being met. The DTI's partial data indicates an investment of 5.8 million DM and payment of annual rent of 800,000 DM. However, data on the progress of individual SOEs and their contractor's compliance with the terms of the contract are not available. There is no information on the use to which the annual rent has been put. Also, there is yet no overall assessment of the results of the commercialization process by the UNMIK administration or Government of Kosova. However, there seems to be no doubt that the outcomes of commercialization are far below the expectations.