

**Draft Strategy of the Privatisation Department of the Kosovo Trust Agency
April 2004**

1.1 Kosovo Privatisation Strategy

1.1.1 Objectives and Results

- Completion of the privatisation of Socially-Owned Enterprises in Kosovo in a transparent and efficient manner to foster a more vibrant private sector by rapidly moving un/under-utilized assets into the private sector for more efficient and productive use.

1.1.2 Current Situation

There are nearly 500 Socially-Owned Enterprises (“SOEs”) in Kosovo. These represent 90 percent of Kosovo’s industrial and mining base, 50 percent of commercial retail space, and 20 percent of agricultural land - including all prime commercial agricultural land and the vast majority of Kosovo’s forests.

With the exception of a limited rehabilitation of some SOEs in the building materials field (financed by international donors to support housing reconstruction), the majority of SOE assets have continued to deteriorate, agricultural land remains uncultivated, and forests are being illegally cut down. Reversing this trend is one of the greatest challenges facing UNMIK and the international community; effective privatisation is widely recognized as the key to sustainable, private sector-led economic development, international capital investment in the province’s industrial base and the creation of jobs for Kosovo’s largely un/under-employed young population.

Note: The number of enterprises confirmed as being SOEs is unclear. This is the result of the unclear legal definition of “social” ownership and missing or destroyed documentation. The KTA Privatisation Department’s SOE database contains the following latest information: 450 enterprises have records clearly indicating that they are SOEs. For another 50 enterprises, documentation indicates that they may have been partially converted to Joint Stock Company status through share sales to employees during the late 1980s/early 1990s. For another 130 (small) enterprises, the records are unclear as to whether they are fully or partially socially or privately owned. As a result, we assume that the SOE universe will contain approximately 500 enterprises. For performance monitoring purposes, we are assuming a base of 450 confirmed SOEs to be privatised.

While 75 percent of SOEs are classified as “operating”, this is a very broad definition of the word that fails to capture exactly how moribund the sector is. In most cases, operating SOEs employ a very small percentage of their original staff and produce an even smaller percentage of their original output of goods and services. Excess assets are frequently leased to third parties in the private sector for other uses.

The KTA’s privatisation team has played a leadership role in designing and affecting the regulatory and policy framework, and the related transactional procedures, for Kosovo’s privatisation program. In addition, through a variety of innovative and cooperative measures, the team has assisted in securing an international community, local government and public consensus for the adoption of a comprehensive privatisation policy. Indeed, Kosovo is notable as being one of the few transition economies where privatisation is viewed positively, and is actively desired, by the majority of the general population – including the government, business community, and trade unions.

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The privatisation team's work has included the preparation of the two regulations that are the cornerstones of the current SOE transformation program: the Kosovo Trust Agency (KTA) Regulation and the Special Chamber Regulation, adopted by UNMIK in June 2002.

The KTA was established in 2002 under the EU-led UNMIK Pillar IV with agreement by the international community and the PISG that experienced advisors would lead the Privatisation Department. Within the KTA, these advisors focused on the complex process of SOE identification, documentation and preparation for privatisation, the training/education of KTA staff, SOE employees, counterparts and the public, and the drafting of and approval by the KTA Board (four internationals and four Kosovars) of all privatisation procedures. The team also played a key role in the drafting and adoption of the UN's Land Use Regulation of May 2003, which provided for 99-year leaseholds of SOE land via the "spin-off" method of tender, and thereby eliminated the final legal hurdle to the initiation of the privatisation program.

Within a week of the adoption of this final regulation, the privatisation team led the KTA in launching the 2003 privatisation program. SOE assets in all sectors of the economy and in all regions were offered to local and international strategic investors following a massive investor promotion and public education program. The first two very successful tender tranches were completed in July and September, with more than 200 bids received for the 24 SOEs on offer. Total bids for these first two tenders amounted to more than €150,000,000. This result was recognized by the IMF, World Bank, UNMIK, EU, PISG, Kosovo public, and the US as significantly exceeding expectations. Indeed, on September 4, 2003, Prime Minister Bajram Rexhepi stated that "These bids from serious investors and the successful start of the privatisation program are critical to our economic development and will help create sustainable prosperity for the people of Kosovo. The privatisation team at the KTA is to be congratulated."

Since October, however, the privatisation process has stalled. This is primarily the result of three factors: new guidelines set by the UN regarding the determination of SOE status (i.e. what documentation is required to confirm that an enterprise is, in fact, "socially-owned"); the delay in adoption by UNMIK of a regulation for the liquidation of SOE land; and the desire by new officials to introduce major changes to the privatisation policies and procedures.

1.1.3 Strategy

Ongoing and planned activities of the privatisation team are designed to address the obstacles and opportunities outlined above while achieving overall objectives for privatisation to complete the process of selling all strategic and "going-concern" SOEs by mid-2005, with rapid liquidations of insolvent SOEs and SOE assets completed by early 2006.

In terms of policy initiatives, an aggressive re-launch of the privatisation program will be effected with as few changes as possible to existing transparent and proven procedures. Such continuity will lessen investor concerns over recent delays and promote continuity and comparability between tranches.

Human resources and institutional capacity building will focus on further expanding the current KTA skill base, identifying and addressing additional needs during the implementation process, and institutionalising the capacities of the organization. These

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initiatives will enable the privatisation team to, over time, give senior Kosovar KTA staff more day-to-day decision-making authority.

By involving more Kosovo government counterparts and third parties in privatisation working groups and giving them more "ownership" over the process, we will ensure political and public support for the program and its results. Such a policy is advisable regardless of whether UNMIK elects to transfer more decision-making authority to the PISG after the KTA's formal mandate to privatise expires in June 2005, or not. The KTA privatisation team will also ensure that a post-privatisation framework is laid for sound corporate governance practices in newly privatised SOEs - such a framework being a prerequisite for sustainable progress and the future development of local and regional financial and capital markets.

1.1.4 Key Activities

Further Policy Initiatives

The KTA privatisation team's strategy will be to build upon the existing foundation and not to re-create rules and processes that will delay or impede the privatisation process. Education and outreach to both the government and the general population will be driven by a recognition that buy-in at multiple levels is required for continued success. At the enterprise level, the ongoing "Employee Participation" program, by which SOE employees receive 20 percent of the proceeds from spin-offs, has proven to be a particularly effective outreach tool.

Liquidation

The privatisation team will work closely with the KTA management and Board to gain approval for the previously-drafted Liquidation Procedures, thereby enabling the quick, auction-based sale of non-operating SOE assets. This will be a critical step, as the majority of SOEs are candidates for liquidation. In addition, the team will work closely with the UNMIK Office of the Legal Advisor ("OLA") to promote the rapid promulgation of a regulation that allows for the liquidation of SOE land.

Agriculture and Forestry

A priority will be to resolve the currently indeterminate status of the agro-cooperatives via the OLA. The likely solution will be the separation of SOE property from the privately owned/contributed assets within each coop (where possible). This would then be followed by the tender or liquidation-via-auction of the SOE assets, including agricultural land.

We will implement the privatisation of non-forest SOE assets and tender long-term commercial forest management/extraction concessions. In the medium term, we will transfer management/award of the concessions to the Kosovo Forest Agency (under MAFRD) and the Ministry of Environment and Spatial Planning, to ensure that forests are conserved and properly utilized.

Cadastral Records

We will advise the KTA on the drafting of a clear, unambiguous statement by the SRSG regarding SOE land use. This statement will cover eventualities such as when cadastral records have not been updated, are missing, have been falsified or are disputed. If a SOE

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has been historically utilizing a particular parcel of land, then the KTA would be allowed to facilitate the registration of that land in the name of the SOE at the Cadastral Agency, thereby providing a way for the KTA to sell such land and bring it into the private sector.

Spin-Off Privatisation Tenders

We will provide guidance to the KTA management and Board in streamlining the SOE tender preparation process by addressing potential obstacles (e.g. cadastral/land possession records) and identifying ownership and creditor claims prior to tender. We will also develop procedural enhancements to promote serious bidders and improve existing processes (e.g. increase bid deposits based on estimated sales price) while working to avoid unnecessarily extensive revisions of already proven policies, procedures and rules of tender (such changes inevitably lead to long delays, loss of investor confidence, negative press / public response, and increased government opposition).

Institutional Development

The KTA operates under a June 2005 sunset clause, when its responsibilities for the privatisation of SOEs and the management / restructuring of "Publicly-Owned Enterprises" (public utilities) may be transferred to the PISG. While it is likely that the UN will extend the KTA's mandate in some form beyond June 2005, it is also likely that over the medium-term the PISG will assume greater involvement with both privatisation and public utilities.

In response to this scenario, over the near term, we will develop the institutional backbone of the privatisation program through:

- Encouraging the secondment of officials from the Ministry of Trade and Investment, Ministry of Finance and Economy, Ministry of Agriculture, Kosovo Cadastral Agency and the Trade Union Federation to serve as counterpart representatives in partner organizations.
- Working closely with the internationally-funded municipal technical assistance projects to ensure the inclusion of regional and municipal economic development, agriculture and cadastral officials in planned privatisation initiatives.
- Fostering the continued development of privatisation working groups, such as the existing Agribusiness Privatisation Working Group, as a means of ensuring legislation and procedures are relevant to the task at hand.

These linkages will help to ensure that the privatisation program achieves goals that directly contribute to the sustainable development of Kosovo's economy.

Human Resource Capacity Building

We will focus on building the technical expertise of KTA staff, so as to complete the planned SOE privatisation program by early 2006. We will also further open up the privatisation process by inviting additional counterparts to participate in policy and implementation working groups. In addition, we will work with both senior KTA Kosovar staff and government counterparts to prepare them for leadership roles in the program. Cooperation and joint working groups are the best mechanisms to achieve this, given the

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uncertainties regarding the UN's reserve powers over privatisation and the possible enhanced role of the PISG after June 2005.

Our team will emphasise the capacity building of counterparts and staff at all levels. The training and guidance programs that we have initiated, and will continue to provide, will assist in both ongoing KTA management and in the implementation of an accelerated privatisation program. In addition, by creating a cadre of trained Kosovar staff within the KTA, it is possible to promote market-orientated, financially trained professionals who can later add value in the private sector, following the cessation of KTA's mandate.

Corporate governance training and strategic leadership skills will be provided to the four Kosovar KTA Board members and to senior KTA Kosovar staff. This will include workshops, seminars and tutorials, conducted either internally or in conjunction with other donor programs. We have hope to form partnerships with outside institutions with whom we will arrange for mentoring or training programs to be conducted in Kosovo or abroad. Such programs will be directed towards Kosovar KTA officials and Board members, plus privatisation working group counterparts from government ministries and public and private organizations. Subject matter would include:

- privatisation and post-privatisation experiences of other countries,
- the role of the Board of Directors, financial market development and financing alternatives for privatised/private sector industry,
- financial and human resource management,
- general business applications and accounting.

We will also focus on sector-specific training, including mining/minerals/metal processing, wineries, commercial agriculture, consumer goods / services and the government's role in agro-forestry land management.

Further, we will organise a "SOE New Co Owners' Association" to help build the governance and business skills of the owners and managers of newly privatised enterprises.

Immediate Steps

- Re-launch the privatisation, public education and investor promotion programs with EU, UNMIK, PISG, and US support; encourage the establishment of a more formal, multi-donor and counterpart working group to guide this initiative.
- Commence privatisation of agricultural land and a special spin-off program for strategic enterprises (including Ferronikeli, wineries, Grand Hotel group, Peje Brewery and metal processing plants).
- Initiate preparation of a strategy for the privatisation of Trepca Mining complex.
- Form a SOE New Co Owners Association as a primary vehicle for corporate governance training for the new, private sector owners of SOE assets.
- Initiate a process to turnover key KTA privatisation leadership roles to local staff within 12 months, with the international managers becoming advisors as opposed to officials.