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Lessons Learned and Analysis  
Unit of the EU Pillar of UNMIK in Kosovo

## **THE OTTOMAN DILEMMA**

### **POWER AND PROPERTY RELATIONS UNDER THE UNITED NATIONS MISSION IN KOSOVO**

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**THE OTTOMAN DILEMMA: POWER AND PROPERTY RELATIONS  
UNDER THE UNITED NATIONS MISSION IN KOSOVO**

LESSONS LEARNED AND ANALYSIS UNIT<sup>1</sup>

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<sup>1</sup> The Lessons Learned and Analysis Unit is a project of the EU Pillar of UNMIK and the European Stability Initiative (ESI). It aims to provide policy makers and the public in Kosovo and outside with independent policy analysis based on empirical field research. The views expressed in its reports are those of the LLA, and do not represent those of the European Union Pillar and its staff or UNMIK. The advisory board of the LLA consists of *Martti Ahtisaari, Peter Arbenz, Carl Bildt, Thomas Carothers, Alain Le Roy, Ian Martin, Gary Matthews* and *Alex Rondos*.

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**EXECUTIVE SUMMARY**

The United Nations Mission in Kosovo (UNMIK) has made itself responsible as trustee and administrator for a vast amount of state and socially owned property across Kosovo, including some 370 socially owned enterprises (SOEs). However, over the past three years, it has lacked the institutional resources to establish an effective property regime. As a result, control over some of Kosovo's most valuable economic assets is being determined outside the legal system, in countless individual power struggles across Kosovo. The results have been harmful both to economic development, social and political stability and the establishment of the rule of law.

This report analyses different strategies employed by UNMIK to fulfil its responsibility as trustee of social property, including direct administration of SOEs, the restoration of Yugoslav workplace democracy ('self-management') under the 1988 Law on Enterprises, and granting concessions over SOEs to private investors ('commercialisation'). It concludes that these efforts have done little to curb the confusion over commercial property or to promote an environment more conducive for private sector growth.

This is UNMIK's 'Ottoman dilemma': because of its limited capacity, the mission has intervened in the management of SOEs and their property only when specific disputes have come to its attention. Its efforts to keep the peace have led it to accept existing power relations and diverse, localised solutions to complex problems. As the Ottoman reformers found in the Balkans in the 19<sup>th</sup> century, formal legal authority over property, however strong on paper, does not translate into genuine, real-world influence. Without the administrative and regulatory apparatus of a modern state, UNMIK has relied on the tolerance of post-war power brokers, undermining the principle of the uniform application of laws.

In June 2002 UNMIK established the Kosovo Trust Agency (KTA) as the new institutional home for its authority over socially owned enterprises. Given the experience of the past three years, the KTA is likely to achieve a small number of successful privatisations, and perhaps a few liquidations. There is a risk that the great majority of SOEs will be left to struggle on in their present state. To create a consistent system of property rights in Kosovo will require, in addition to the creation of the KTA, a broad and well-structured alliance of institutions, involving all Pillars of UNMIK, the Central Fiscal Authority (CFA), the Ministry of Labour and Social Welfare, as well as municipal bodies, cadastral agencies and other organisations providing international technical support in this area.

The lessons to be drawn from this area extend beyond the issue of social property.

First, it is relatively easy for an international mission to assert legal authority over an area, but much more difficult for it to build up the institutional resources to fulfil a responsibility which exists on paper. There are clear dangers in assuming powers without the capacity to exercise them. The social realm does not remain idle, waiting for the international community to allocate attention and resources. Any vacuum of authority is filled by domestic actors. In the field of social property, UNMIK assumed administrative authority over the entire public economy, and then handed control to a department which, in September 2001, had only 21 staff (11 international and 10 Kosovar) across Kosovo to deal with socially owned enterprises.

The result was that this under-resourced institution remained marginal to the real struggles for control over assets in the field.

Second, the UN erred in assuming that the safest option would be to maintain the *status quo*, paying lip service to ‘applicable law’ from the 1980s. This strategy left a large share of Kosovo’s most valuable assets in a legal vacuum, within a system of self-management socialism whose institutional controls had disintegrated. The *status quo* was inherently unsustainable, spreading confusion in the commercial property field which undermined the UN mission’s basic goal of creating a viable economy under the rule of law. Replacing the old system with a functioning property regime was a necessary part of the UN’s trusteeship obligations, and the failure to do so has carried significant economic and social costs. It is simply not possible to defer difficult property questions until after a resolution of Kosovo’s final status.

Third, no genuine social change can be brought about without identifying and working with constituencies and local interests with a stake in such reforms. For this reason, property creation and resolving the status of socially owned enterprises is not just a preserve of economists and lawyers, but a political and social problem *par excellence*. It concerns all Pillars of UNMIK, international donors and the new institutions of Kosovo self-government. To have any chance of succeeding, it requires a concerted effort across all these institutions. This report suggests the creation of a broad-based property task force, which would mobilise the efforts of a wider coalition of institutions than has been envisaged up to now.

UNMIK has arrived at a critical point in its administration of Kosovo. With international donations set to diminish sharply in the coming year, and the momentum of the post-war reconstruction and housing boom beginning to slow, Kosovo’s private sector urgently needs a functioning property regime in order to develop further.

This report provides detailed information on the emergence of socially destructive institutions in the field of social property. It also provides a set of specific recommendations for how UNMIK might go about replacing them through a broad-based property creation strategy, given existing administrative and financial resources:

- a) Make SOEs subject to the same laws as private enterprises, particularly in the areas of tax and employment relations. Require them to pay public utility bills, as a key step towards hardening budget constraints. Use these legal mechanisms both to begin the process of collecting systematic information on SOEs, and for determining which SOEs are viable as going concerns and which should ultimately proceed to liquidation.
- b) Enforce the rules in the applicable law against leasing social property by otherwise inactive SOEs. By reducing the scope for SOE managers to extract unearned cash revenues, this would help to defuse conflicts over control of SOEs and limit resistance to eventual privatisation or liquidation.
- c) Begin a process of small-scale privatisation of individual socially owned assets.

“The economy is restarting at an incredible speed... Out in the streets you see lively market places, you see buying and selling, and it is buying and selling not only of foodstuffs but of building materials and so on. So an economy is up and running in Kosovo and if we want that economy to be a normal market economy, we have to be up and running too because the rules of the market need to be put in place. The market is there but the rules are not.”

*Joly Dixon, EU Pillar head,  
Kosovo, 28 July 1999<sup>2</sup>*

“Property creation is not at all like a privatisation program, which involves selling only a dozen or so bundles of assets a year. The goal of property reform is to award property rights for millions of assets to millions of people in a short time. This means that at least half the job is about communications... The leaders of property reform need to describe how popular capitalism will affect many different interest groups, show them the benefits they will derive from it, and persuade them that it is a win-win exercise for all elements of society.”

*Hernando de Soto, 2000<sup>3</sup>*

## **I. INTRODUCTION**

When the United Nations Mission in Kosovo (UNMIK) established its interim administration in the summer of 1999, it appointed itself the administrator of all state property. During the first year of its mission, it extended this authority over the fruits of five decades of socialist industrialisation in Kosovo: some 370 socially owned enterprises (SOEs).<sup>4</sup> With the legal confusion surrounding Kosovo’s status and a decade of partial reforms under Milosevic, nobody was quite sure how these SOEs should be characterised. But UNMIK’s view was suitably pragmatic: “the results of production of a socially owned enterprise belong to society as a whole, e.g. the public”.<sup>5</sup>

Thus, by the stroke of a pen, UNMIK appointed itself trustee and landlord of Kosovo’s most valuable real estate. This includes the diverse array of assets which constitute Kosovo’s public economy, from thousands of corner stores across every town of the province to the sprawling Trepca complex in Mitrovica. With the establishment of the Kosovo Trust Agency (KTA) in June 2002, this authority has found a new institutional home.<sup>6</sup>

Trusteeship, however, entails responsibility as well as authority – in this case, the responsibility to wield its authority for the greater good of Kosovo’s economy and society. In reality, UNMIK’s capacity to play the role of the state and administer the public economy has

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<sup>2</sup> Speech by Joly Dixon, First Donors’ conference for Kosovo, Brussels, 28 July 1999.

<sup>3</sup> Hernando de Soto, *The Mystery of Capital*, 2000, p. 206.

<sup>4</sup> UNMIK Regulation 1999/1, as amended by Regulations 1999/24 and 2000/59. The latest SOE database maintained by UNMIK lists 339 SOEs in June 2002. However, it is almost certain that there are more SOEs than this. Adding up data from regional offices one arrives at 370, and there may be more that have not yet been identified. In addition, the KTA will also be responsible for all social property in the agricultural sector.

<sup>5</sup> UNMIK, *White Paper on Enterprise Development*, 7 September 2000 (prepared jointly by the UN and the EU Pillar).

<sup>6</sup> See Regulation 2002/12 on the establishment of the Kosovo Trust Agency, 13 June 2002.

been decidedly tenuous. The resources available to the Department of Trade and Industry have been modest, and in practice UNMIK has wielded very little influence over what happens within these companies. It has been unable to compile an accurate list of SOEs, their employees, assets or activities. The most fundamental questions – who controls the assets, who benefits from the revenues they produce – are settled outside the legal system, through countless individual power struggles across Kosovo.

The result is that Kosovo today has a dual property system: an often fiercely competitive open market where private companies bid for scarce commercial property and compete for customers; and a series of quasi-feudal estates, where a privileged few wield control over assets belonging ‘to society as a whole’ and divert the revenues for their own benefit. This dual system is both highly inefficient and deeply unfair. Private companies stand or fall on their ability to turn a profit; SOEs survive through their ability to exploit the weakness of the UNMIK administration. Private companies pay exorbitant rents for real estate; the SOEs subsidise decrepit businesses by renting it out. Private businesses carry most of the tax burden; SOE managers and small groups of workers share out untaxed rental income among themselves. The new private sector pays to supplement inadequate public utilities and infrastructure; SOEs use the utilities but rarely pay for them. If economic prosperity and job creation are critical to Kosovo’s future, then the priority for the international mission is to break up these quasi-feudal estates and replace them with a fair and effective system of property rights.

This report is based on months of field research by the EU Pillar’s Lessons Learned and Analysis Unit into the remains of the socially owned sector. It examines the different strategies employed by UNMIK over the past three years to fulfil its mandate as trustee of social property. It analyses property relations as they are played out in the field, and the economic and social costs of the present confusion. It also makes some concrete proposals for future economic policy in this sector. The central question it seeks to answer is what leverage UNMIK can bring to bear to overcome an untenable *status quo*, given present legal, financial and human resource constraints.

The report concludes that the most effective strategy would be to take the modern taxation system developed by UNMIK’s Central Fiscal Authority over the past three years, and apply it equally to the socially owned sector. There is a direct linkage between taxation and a modern system of property rights. An effective tax system cannot function without clear property rights, and historically the need of the modern state to raise revenue is what drove the development of the property system.

Extending the tax system and other applicable law in Kosovo into the SOE sector would advance a number of important goals. It would harden the budget constraints on SOEs, helping to sort out the deadwood from the most promising candidates for privatisation. This would greatly facilitate the work of the new Kosovo Trust Agency, allowing it to concentrate its resources on the limited number of genuinely promising SOEs. As for those SOEs with no future as going concerns, it would help to prize out their productive assets and put them into circulation on the open market. It would also contribute to developing a sustainable and equitable revenue system, which is basic to Kosovo’s capacity for effective self-government.

Critically, this is also a strategy in which UNMIK would have a number of natural allies. Kosovo’s dynamic new private sector and its new institutions of self-government share an interest in ending the effectively tax-free status of social property. Neither the private sector

nor international donors have any interest in continuing to subsidise the relics of socialist industries. As foreign assistance begins to fall and the share of revenues collected at the borders declines, Kosovo's institutions will need new sources of revenue which do not increase the tax burden on the private sector. Given the difficulties which UNMIK has faced in trying to impose its will on the SOEs in the past three years, mobilising wider support must be a critical component of the strategy.

Creating a consistent system of property rights in Kosovo will require a broad and well-structured alliance of institutions, involving the Central Fiscal Authority (CFA), the Kosovo Trust Agency (KTA) and the Ministry of Labour and Social Welfare. It will require some rethinking of international priorities in allocating resources for technical assistance and institution building by UNMIK as well as by key international donors. Most importantly, it requires a sophisticated political campaign to convince broad sections of Kosovar society of the benefits of such a policy, and its role in the creation of a level playing field for economic development. The main lesson of the past three years is that such a campaign is essential if policies and strategies developed within UNMIK are to influence the behaviour of real economic actors in the field.

## II. CONTEXT

### A. *The de-industrialisation of Kosovo*

To explore the position of SOEs in Kosovo's economy, the LLA undertook detailed field research in the municipality of Peja/Pec,<sup>7</sup> as well as a series of enterprise-level case studies across Kosovo. What emerged from the research was a stark picture of almost total de-industrialisation. During Kosovo's two decades of industrial development, from the mid-1960s to the mid-80s, Peja was an important manufacturing centre. Today, its economy bears a striking resemblance to the Peja of pre-socialist times, before industrialisation had begun: small traders, handicrafts, subsistence agriculture and a handful of small, private production units, notably a brick factory and a bakery. The industrial structures developed under Yugoslav socialism have collapsed.

Two decades ago, 10,200 people were employed in SOEs in Peja.<sup>8</sup> Today, no more than 1,500 people are regularly employed by these same enterprises. Only a handful of them are still producing anything at all.

In the socialist era, a factory producing vehicle components for the giant Zastava plant in Serbia was the industrial crown jewel of the area and one of the largest SOEs in Kosovo.<sup>9</sup> Today, this position is held by the Peja brewery which, with 520 workers, provides a third of all employment in the socially owned sector. The other three enterprises which are able to pay regular salaries are a bakery, a brick factory and a trading company, 17 Nentori, which has ceased to trade in its own right but leases out the shopping centre in downtown Peja and a

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<sup>7</sup> The case study on de-industrialisation in Peja was presented to UNMIK and EU Pillar staff in February 2002. A revised and updated version will appear in a forthcoming LLA-ESI report.

<sup>8</sup> There were then a total of about 75,000 people employed in SOEs in all of Kosovo.

<sup>9</sup> Throughout its history it was an unreliable supplier subject to persistent industrial unrest. In January 1989 180 out of 320 lorry chassis delivered by Ramiz Sadiku to IVECO (FIAT's lorry subsidiary) were returned as substandard. For more background see forthcoming LLA-ESI report *Kosovo's Deindustrialisation – a case study of Peja*, as well as Michael Palairret, *Ramiz Sadiku: A Case Study in the Industrialisation of Kosovo*, Soviet Studies, Vol. 44, No. 5, 1992.

large number of shops across Peja region. The remaining SOEs engage in sporadic production, sell off old stocks or derive their income from renting out retail outlets and production halls to the private sector.

The picture is similar right across Kosovo. Only a small percentage of the active workforce is employed by SOEs. It appears that well under 20,000 people, of a population of some 1.9 million, draw a regular income from an SOE.<sup>10</sup> In a society where half of the population is under 25 years old, most people have never worked in an SOE.

In sum, the period of socialist industrial development appears in retrospect to have been a brief episode in Kosovo's economic history. Of course, many of its social consequences remain, particularly the mass migration of population from the countryside into the urban centres.

The collapse of the industrial sector, which started in the early 1980s, has a number of important implications. One, ironically enough, is positive in nature. Kosovo has already been through most of the pain of job cuts in unsustainable enterprises. Elsewhere in the former Yugoslavia and across post-communist Europe, states are struggling to deal with the enormous social dislocation caused by the collapse of major industries. Entire cities dependent on decaying industrial giants are entering a period of urban decline, and severing state subsidies to loss-making firms comes at a tremendous social cost. Workers socialised into a certain working environment have great trouble moving across to the private sector.

In Kosovo, however, socialist industrialisation was both later and smaller in scale than elsewhere in the former Yugoslavia. A far lower proportion of the workforce ever worked in these industries. Furthermore, in the painful decade which followed the loss of Kosovo's autonomy, the great majority of Kosovar households have had to develop economic survival strategies which did not depend upon the socialist system, chiefly involving trade, subsistence agriculture and a large migrant workforce. This comparative advantage goes a long way to explaining the speed with which Kosovo's private economy developed in the early 1990s and bounced back after the war.

The other major implication is that, after two decades of heavy de-capitalisation of Kosovo's SOEs, with its industrial stock obsolete and its corporate structures severely dysfunctional, privatisation in Kosovo will be a process of managed retirement of the great majority of the SOEs. There are precious few going concerns which are likely to be of interest to a serious investor. Under these circumstances, the most effective form of privatisation is the efficient liquidation of individual assets, particularly real estate.

### *B. The collapse of social property*

While SOEs have largely ceased to matter in economic terms, they continue to exist as legal and social entities. However, the institution of social property, of which SOEs were an integral part, has disintegrated. Traditionally, SOEs were governed by a complex legal framework regulating their identity, management and their 'rights of use' over social property. SOEs were granted the right to use social property specifically for the purposes of

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<sup>10</sup> By way of comparison, the total number of people employed in industry in the late 1940s was some 17,000.

social production, as defined in their company statutes. They had no right to use social property for any other purpose, least of all to sell or lease it for profit.

On paper, this legal framework continues to be the applicable law in Kosovo. In practice, however, with no public institution willing or able to enforce it, SOEs now find themselves operating in a legal vacuum.

A significant share of Kosovo's commercial real estate – shops, warehouses, land – is controlled by SOEs, much of it in urban areas where a shortage of business premises makes it extremely valuable on the open market. Real-estate prices in Kosovo, particularly for land serviced by infrastructure, can be extremely high. The SOE Dardania, for example, rents out 1.11 ha of land in Prishtina to a private company, Besholli Commerce, for €7,500 per month. The metal factory Eurometal in Ferizaj rents out 8 hectares of land to the US-government contractor Brown and Root for €12,000 a month. In the towns, the rental price of a shop without telephone line or running water can be as high as in downtown Berlin.

Not surprisingly, the SOEs have responded by turning themselves into real-estate agencies, charging premium prices on rental to the private sector. For most of them, this rental income is the main reason for their continued existence. It generates an untaxed revenue stream which is used to pay the remaining workers, with the rest disappearing into private hands.

For example, the trading company '17 Nentori' in Peja, whose director is municipal party chief of the PDK, has ceased to trade under its own name. Instead, it rents out its 107 premises, including 49 shops in the 'Shtepia e Mallrave' (shopping mall), at rates of €100 to €820 per month, generating revenues of around €24,000 per month. The lessees are required to employ at least one of 17 Nentori's 290 workers at a salary of €175 per month, plus breakfast. The trade enterprise 'Liria' in Prizren has also stopped trading and now rents out some 100 shops, distributing the income among its workers. The costs to the private sector are substantial, constituting a significant barrier to market entry. In Ferizaj, a family who leases a 150 m<sup>2</sup> shop in a prime location from an SOE for €1,550 per month is obliged to employ four former workers of the SOE for €150 each, even though they never show up to work.

Legal uncertainty is even more damaging than high rental prices. Because leases of socially owned real estate are technically illegal, the lessee is at the mercy of the SOE, enjoying no legal protection of any kind. Leases tend to be short-term and insecure, acting as a major disincentive to business investment. For example, the private soft-drink bottling company Fluidi rents a factory hall from the IBG Battery Factory in Gjilane for €4 per m<sup>2</sup>. The company has invested substantially in the premises, refurbishing the electrical transformers, elevating the roof to make space for larger machines and even constructing a new building. However, the response of the SOE was to increase the rent, prompting the company to look for new premises. In this environment, commercial interests with connections to the management of SOEs, or the political parties which stand behind them, enjoy an obvious competitive advantage.

In some cases, SOEs are leasing out not just real estate, but also entire production units, complete with workers, in what amounts to a kind of informal 'commercialisation'. In Prizren, the Ramiz Sadiku brick factory prepared a tender, reviewed 9 offers and then signed its own concession agreement with the private investor Fazli Kryeziu, director and owner of the Prizren-based Pagarusha Company. The construction company '1 May' in Rahovec rents

out land to people running separator stations for sand and gravel along the banks of the Drini River. In Peja, an agricultural co-operative has signed a 10-year lease agreement for 500 ha of land plus its stables in Vitomerica with the private company Fructus.

Because of the high rental prices, even the most decrepit SOEs, whose core businesses have long ceased to operate, may control important revenue streams. As a result, the struggle for control over the SOEs themselves is a serious business, but one which takes place largely outside of any established legal system. In Prishtina, a former unit manager in the Kosovabrick factory has managed to secure control of half of the SOE's premises, which he rents out to various private enterprises. UNMIK has tacitly accepted this arrangement by commercialising the other half of the property, including the production unit. In the case of the SOE Agromorava in Vitina, which controls nearly 1,000 ha of valuable agricultural land, the workers have complained to UNMIK that the director, supported by a hard core of ten workers, is attempting to sell off land and pocket the income. In 'self-defence', the workers have taken to guarding the land against encroachment by the director. In Gjakova, in the agricultural combine Ereniku, a bitter struggle has broken out between a self-appointed post-war director, Masar Lluka, and a general manager Shahin Dula appointed by the workers' council in March 2001, and re-elected in February 2002. Workers in four of the company's six divisions support Mr. Dula, while the remainder support Mr. Lluka, who continues to draw rental income from some of the company's land. Both men recently spent several days in police custody, having been found guilty of breaching the peace by the municipal court.

There are numerous cases across Kosovo of property occupied or leased out by private interests with no legal title whatsoever. For example, the shopping centre in Podujevo was seized by the PDK and rented out. The PDK subsequently informed both the municipality and DTI that it had signed a lease with the SOE director, and that they were too late to intervene. In central Prizren, a two-story building housing the Punto boutique was seized by a private individual who claimed to have rented it from the Serbian Orthodox Church. Unable to produce any documentation for this lease, his continuing possession comes down to the ability of his relatives and friends to chase away municipal inspectors.

Some SOEs are even illegally selling their assets. The SOE Ereniku in Gjakova sold some of its land with UNMIK's encouragement, although usually UNMIK has vetoed asset sales.<sup>11</sup> Other enterprises have used their revenues to resume the socialist practice of building apartments for their 'employees'. The Grand Hotel in Prishtina, for example, has constructed an entire apartment block in the heart of the capital near the OSCE headquarters, on municipal land which once housed a sports stadium.

Without a government capable of enforcing property rights, shopkeepers and small businessmen across Kosovo are resorting to private security companies to protect their interests. The absence of clear, enforceable property titles creates a market for private protection agencies, substituting for the weak state. The whole environment is highly conducive to the emergence of protection rackets.

In short, the legal and institutional framework surrounding social property has disintegrated, leaving a free-for-all among those strong enough to seize control of SOEs or their property. Property relations in Kosovo are a function of power, rather than law. The informal property system which results is economically inefficient, socially divisive and deeply unfair. Rent

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<sup>11</sup> DTI legal advisor Allan Shin told SOE managers in Gjakova in May 2001 that selling assets was acceptable, as long as it did not involve the sale of 'core assets' and did not exceed DM 1 million in value.

paid to the individuals controlling SOEs is neither a market transaction nor a tax to a public institution; more than anything else, it resembles the feudal dues paid to a *seigneur*.

### **III. UNMIK AS TRUSTEE OF SOCIAL PROPERTY**

Among all this chaos, the most obvious question is: what has happened to UNMIK's responsibilities as trustee of social property? Since 1999, across its various institutional divisions, UNMIK has adopted four quite different policies towards SOEs, sometimes concurrently.<sup>12</sup>

1. From late 1999 to the end of 2000, UN administrators at municipal level tried to direct the activities of enterprises on their territory by reinstating socialist-era reporting requirements and institutional controls.
2. From early 2001, the newly established Department of Trade and Industry (DTI), operating within the EU Pillar, experimented with imposing interim international management, a strategy used on six different occasions.
3. From March 2001, DTI in co-operation with UN municipal administrators sought to reshape the corporate governance of SOEs by reintroducing the old system of management by workers' councils, which were directly elected by the workforce of each enterprise – a system which was once the cornerstone of Yugoslav self-management socialism.
4. In parallel, DTI developed a policy of granting concession agreements over SOEs to private investors. This policy, which became known as 'commercialisation', was designed to accommodate legal concerns about direct privatisation imposed by the UN Legal Office in New York.

#### *A. Post-war controls of enterprises*

In the immediate post-war period, the question of who controlled SOEs was settled largely by force. As the Serbian administration withdrew from Kosovo, Kosovar enterprise 'directors' seized controlled of assets, often with the support of the self-appointed 'provisional government' of the UCK and its municipal structures. In many cases, the new management was able to generate working capital by selling off stock or renting premises. In the chaos of this early period, the directors also controlled the reconstitution of the workforce, often selecting arbitrarily from among the pre-war or even the pre-1990 workers' collective. Workers loyal to the new management were rewarded with continuing income; others, including of course the displaced Serbs, disappeared off the books.

Most of the SOE managers in the Peja region were selected by the provisional government, led by Hasan Meta (president) and Ethem Ceku (chief of the administrative board). One of the first acts of the new authorities was to issue licences to operate particular companies or premises. Shops in Peja town were plastered with posters proclaiming them to be 'prone e shtetit' (public property). In November 1999, the UNMIK revenue authority discovered at

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<sup>12</sup> For political reasons, the Trepce mining complex has always been treated separately, and for much of 2000 appeared to monopolise UNMIK's economic policy.

least one “comprehensive parallel tax gathering system” operating in the Peja region. Six out of eight businesses surveyed had been asked to pay tax to the provisional government of Kosovo. Three who had made payments were issued with receipts and payments books.

When the UNMIK municipal administration began its work in early 2000, municipal administrators tried to bring some order to this sector by formalising municipal control over the SOEs. In socialist Yugoslavia, SOEs had regular reporting obligations to the municipality. If an enterprise failed to comply with a myriad of self-management rules, it was the municipality who intervened to protect the public interest. Under the 1988 Law on Enterprises, if a socially owned enterprise “does not use social funds appropriately or does not permanently renew the social funds, does not increase and promote them” or if, by performing business “contrary to the regulations and self-management enactments, it causes larger scale damage to the social community”, the municipality had an obligation to take a range of measures. These included dismissing the steering board, removing workers from management positions, disbanding the workers’ council or disciplinary commission, temporarily restricting the self-management rights of the workers or appointing a new, temporary management body.<sup>13</sup>

In Peja, the municipal council chaired by UNMIK began to summon SOE managers to report on their activities. On 12 April 2000, reports on the Peja brick and battery factories were submitted. The minutes of the Council noted that “although the legal points may take time to resolve the members recognised their responsibility through the Administrative Board and Municipal Council to ensure that there was professional management in place to develop viable enterprises.”<sup>14</sup> This was “intended as a first means of addressing the paramount policy objective to revive the local economy”.<sup>15</sup> As one UNMIK municipal official explained in May 2000, the Municipal Council “has a mandate to hire and fire top management and monthly reports on each socially owned enterprise are forwarded to the Director of Economy and to the Administrative Board for review and approval.”<sup>16</sup> The Director of Economy in Peja, a Kosovar, had seven inspectors at his disposal to enforce this policy.

At the same time, the municipality tried to assert its authority over SOE shops in Peja town. Under the applicable law, the municipality holds the ‘right of disposal’ over socially owned property, while an SOE holds only a ‘right to use’ the premises for its own business activities. The law does not permit a ‘user’ of socially owned property to let it for profit. The municipality established rental prices across different zones of the town, ranging from €2.5/m<sup>2</sup> on the outskirts to €10/m<sup>2</sup> in the old market, and began to conclude its own contracts on lease, collecting the revenues in a special account. In practice, however, it never controlled more than a fraction of the shops in question.

The system of joint Kosovar-UNMIK supervision of SOEs at municipal level came to an end in late 2000 without ever having achieved genuine control over the enterprises. The Peja Brewery, to give one example, was repeatedly summoned to report to the Council, which noted that its “financial reporting had been quite poor”.<sup>17</sup> Almost nowhere did UNMIK attempt to challenge the appointment of directors by the post-war power structures. As an

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<sup>13</sup> Law on Enterprises, 1988, Article 79.

<sup>14</sup> Peja Council meeting, minutes, 12 April 2000.

<sup>15</sup> Peja Council meeting, minutes, 12 April 2000.

<sup>16</sup> Peja Council meeting, minutes, 31 May 2000.

<sup>17</sup> Peja Council meeting, 19 July 2000. The Council praised “the sponsorship and support the company also gave as part of its commitment to the city and administration”.

UNMIK deputy municipal administrator for Gjilane put it, “it was decided that in view of other priorities we should allow the existing directors to stay in their posts as long as they were not causing problems”.<sup>18</sup>

*B. DTI and the revival of workplace democracy*

The period of municipal supervision of SOEs ended, paradoxically enough, with the first municipal elections in December 2000. The establishment of new, democratically legitimised municipal governments did generate a whole series of ‘problems’ in the SOE sector. New LDK administrations in Podujevo and Gjilane moved quickly to replace enterprise directors appointed by their main political opponents, the PDK. Other municipalities began to follow suit. The scene was set for a potentially dangerous struggle for control by different elements across the Kosovar political spectrum. These confrontations forced UNMIK to define a more active policy.

There were additional reasons, internal to UNMIK, which called for the development of a new policy. The Department of Trade and Industry (DTI) was established in December 2000, requiring a division of responsibilities between DTI and the municipal administrators, who answered to the Department of Local Administration. DTI was also staking out a position in the wider legal debate as to whether privatisation was possible within the scope of an interim administration in Kosovo. The development of policy within DTI was also influenced by the political affiliations of its successive Kosovar co-heads, all of whom were appointed by the PDK and opposed the attempts of LDK-controlled municipalities to change enterprise managers loyal to the PDK.

The policy which emerged in early 2001 had three main features. First, it involved excluding all municipal control over the SOEs. A Memorandum concluded in February 2001 between DTI and the Department of Local Administration asserted (mistakenly, as it transpired) that the applicable law “provides no authority to governmental bodies, at any level, to manage SOEs”.<sup>19</sup> Second, to resolve disputes over the management of SOEs, DTI revived the institution of the workers’ council as chief executive body, elected by the workers’ collective as a whole. When necessary to resolve specific disputes, DTI resorted to interim international administration over particular enterprises to prepare the way for workers’ council elections. Third, DTI and DLA jointly began to look for investors interested in leasing out SOEs under concession agreements, as a provisional strategy to attract investment and create jobs until such time as the way was cleared for real privatisation.<sup>20</sup>

DTI was never fully autonomous in these policy choices. The power to intervene in SOEs remained the preserve of the SRSG himself, and DTI was required by its founding regulation to seek in every case a “determination by the SRSG that a specific SOE shall be administered

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<sup>18</sup> Deputy Municipal Administrator in Gjilane, 14 March 2001.

<sup>19</sup> The DTI Memo refers to the Law on Enterprises as it was amended in 1990, as part of a series of legal reforms leading to the corporatisation of SOEs. In fact, the applicable law was the original 1988 SFRY text, which contained the provisions on municipal control of SOEs quoted above. This mistake led to considerable tensions and misunderstandings between UNMIK and municipal administrations.

<sup>20</sup> To implement this strategy of ‘commercialisation’, UNMIK Pillars 2 and 4 collaborated in establishing regional Business Transformation Teams who were responsible for identifying promising candidates for concession. They included representatives from the UN Regional Administrations, DTI, DLA and Business Management experts seconded by the Canadian International Development Agency.

by UNMIK.”<sup>21</sup> Even though UNMIK had no other mechanism than DTI at its disposal to respond to enterprise-level disputes, the Office of the Legal Advisor proved decidedly reluctant to authorise DTI’s intervention in many instances. This division of powers and responsibilities generated an institutional vacuum within UNMIK in exercising its trusteeship role.

The first real test for DTI – and a defining moment in shaping its policy – came in early 2001 when workers in the metalworking plant Zahir Pajaziti in Podujevo rebelled against the PDK-affiliated management. At the urging of the new municipal administration, an *ad hoc* workers’ committee was established, which insisted that the entire management resign and be replaced by the committee’s own appointees. DTI sought a solution to the dispute in the 1988 SFRY Law on Enterprises and the company’s own statutes.<sup>22</sup> These stipulated the election of a workers’ council, which would in turn appoint a new managing director. DTI appointed one of its own international staff as interim manager, until such time as a workplace election could be arranged.

This became the first occasion on which UNMIK helped organise and monitor a workers’ council election. A general meeting of the workforce decided on the number of representatives to the workers’ council and the allocation of representatives across different divisions of the company. A committee was appointed to prepare the voters’ list, which originally contained 400 names but was later reduced to 350, excluding workers on unpaid leave (and thereby stepping outside the legal framework of the 1988 law). Elections were held in the company canteen on 8 March 2001. Each worker filled out a ballot paper printed by the municipality and signed by an international observer, and deposited it in a ballot box provided by OSCE.

In the end, the election legitimised the municipality’s intervention into the company. Four days after the election, the workers’ council at its first regular meeting attempted to summarily dismiss the entire management team. The DTI Administrator intervened to prevent this, but permitted the managing director to be replaced by his former chief accountant, who was the candidate favoured from the outset by the LDK municipal administration. The DTI Administrator introduced some rules concerning cash management, but otherwise limited his role to that of an advisor pending the appointment of a permanent management team.

Once the DTI strategy for resolving conflicts in SOEs had been established, successive cases followed a similar pattern. In the construction company ‘Morava e Binces’ in Gjilane, workers rebelled against a PDK-appointed manager who had failed to pay salaries regularly. On 9 April 2001, DTI appointed an interim international administrator, who was directed to use his authority sparingly until the election of a permanent workers’ council and manager.<sup>23</sup> The administrator took the candidate favoured by the LDK municipal administration as an interim deputy, until such time as he was duly elected.

As a result, interim international management proved a resource-intensive but ultimately superficial tool of intervention. Workers’ council elections ended up ratifying the

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<sup>21</sup> UNMIK Regulation 2000/63, Section 2.2.

<sup>22</sup> See DTI Summary, ‘Legitimising the SOE’s Workers Council and Management Body’, 2001.

<sup>23</sup> Reviewing the company finances, he found that €400,000 had ‘disappeared’ from the company accounts. Numerous receipts were missing, particularly concerning construction works on a TMK barrack, a school and a few memorial statues.

management team favoured by the municipalities. International management was imposed on only six different companies in the last two years, three of them in Gjilane. However, it did no more than preserve the peace – in no case was there any attempt to restructure an enterprise or introduce a new business plan.

Since early 2001, DTI has committed a significant proportion of its field resources to promoting workers' council elections across Kosovo, with the exception of Northern Kosovo and the Serb enclaves. By July 2002, a total of 110 workers' council elections have been monitored by DTI.<sup>24</sup>

**Table 1: Overview of DTI Interim Management, 2001-2002**

<b>Enterprise</b>	<b>Region</b>	<b>Date</b>	<b>Reason</b>
Zahir Pajaziti	Podujevo	Feb 2001-May 2001	Dismissal of Managing Director by workers
Morava I Binces	Gjilane	April 2001-August 2001	Intervention by municipal authorities to appoint a new Managing Director
Jugoterm	Gjilane	June 2001-January 2002	Intervention by municipal authorities to appoint a new Managing Director
IBG Battery Factory	Gjilane	June 2001-December 2002	Intervention by municipal authorities to appoint a new Managing Director
Trasing	Pristina	December 2001 (ongoing)	Illegal separation of the quarry unit from Trasing SOE
Mirusha	Peja	April 2002 (ongoing)	Cancellation of the commercialisation contract and money disappearing from SOE account

### *C. The ghost of self-management socialism*

Far more important than direct international administration of SOEs was the new DTI commitment to the Law on Enterprises of 1988. This law was a key component of Yugoslav self-management socialism, a form of corporate governance elaborated over decades by Tito's ideologists and the apparatchiks who succeeded him, and then abandoned as unworkable in 1990 by the very party which had created it. One of the paradoxical effects of UNMIK's commitment to the 1989 statute book as the applicable law was to restore self-management socialism in all its glory – at least on paper.

Under the old Yugoslav system, the workers' collective was the primary unit of self-management, in effect constituting the company itself.<sup>25</sup> It elected a workers' council,

<sup>24</sup> There is no single database on this, however. For 50 percent of all enterprises listed in the DTI SOE database in June 2002, there is no information on their form of governance.

<sup>25</sup> This is exactly the reverse of Western employment relations, where individual workers conclude employment contracts with the company as primary legal entity.

typically comprising 10 to 20 workers, which formed the highest executive body of the enterprise and was in turn responsible for appointing the management. According to the 1988 Law, the responsibilities of the workers' council were to:

“determine the organisation of the socially owned company, pass the work plan and the plan of development of the company, determine the foundation for the business transactions policy, appoint and remove from office the executive and steering bodies and direct, control and assess their performance, decide on the distribution of profit and review the proposals placed by trade unions with regard to exercising self-management rights and material status of the workers, conclude self-management agreements and contracts.”<sup>26</sup>

In ideological terms, this system of self-management was part of the ‘withering away of the state’ in favour of direct workers’ rule.

Under self-management, the workers did not ‘own’ the company – the capital remained socially owned. However, the workers’ collective was vested with formal responsibility for managing and preserving the socially owned capital, which might include financial capital invested by a development fund or bank and real estate allocated by the municipality. The collective was authorised to ‘appropriate all value-added’ produced by the company, after interest, taxes and depreciation, but remained subject to extremely tight constraints designed to preserve the value of the capital. In reality, the authority of the collective over business decisions was limited to marginal adjustments in the allocation of ‘net income’ among a number of funds: a capital fund for re-investment in the enterprise; collective consumption (goods purchased for the benefit of the collective as a whole, such as holiday facilities); salaries; and reserves. The workers had no authority to dispose of the assets of the company, nor to use socially owned capital for any purpose other than that for which it was originally allocated. This purpose was strictly defined in the company statutes.

As a form of corporate governance, workers’ self-management had a number of obvious limitations, analysed extensively by both Yugoslav and foreign commentators during the 1970s and 80s.<sup>27</sup> The workers’ collective displayed a predictable tendency to maximise salaries and benefits within the limits permitted, to protect its membership against dismissal, to resist expansion of the collective itself, to resist restructuring of the company, to resist new business initiatives requiring skills which the current membership did not possess and, perhaps most importantly, to allow the progressive de-capitalisation of the company itself.

For this reason, socialist Yugoslavia constantly experimented with institutional controls designed to limit the freedom of the self-management enterprise. As mentioned above, the SOEs had direct reporting lines to the municipality, and through the municipality to the communist party. There were statutory limits on the authority of the collective to raise salaries and distribute revenues. There were complex systems of contractual planning through social and self-management agreements, which locked SOEs into production targets

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<sup>26</sup> Article 49.

<sup>27</sup> Among the accounts available in English are: Harald Lydall, *Yugoslavia in Crisis*, Clarendon, 1989; Christopher Prout, *Market Socialism in Yugoslavia*, Oxford University Press, 1985; E.O. Furubotn and S. Pejovich, ‘Property Rights and the Behaviour of the Firm in a Socialist State: the Example of Yugoslavia’, 30 *Zeitschrift fuer Nationaloekonomie*, 1970; Willem Burger, Gerard Kester and Guus den Ouden, *Self-Management and Investment Control in Yugoslavia*, Institute of Social Studies, The Hague, 1977; B. Ward, ‘The Firm in Illyria: Market Syndicalism’, *American Economic Review*, Volume 48, September 1958.

and wider sectoral strategies, limited wage differentials between firms, and determined access to credit, hard currency and import/export licenses.

Needless to say, the complex institutional controls which surrounded workers' self-management have long since disappeared from Kosovo. The communist party is gone. UNMIK has forbidden the municipalities to supervise SOEs. Regulations governing use of socially owned property are not monitored, let alone enforced. As a result, for the first time in the history of self-management, the SOEs are free to use social capital in any way they choose, spending their income entirely on salaries or the personal profit of the new management.

UNMIK's resort to socialist law on workplace democracy therefore raises more questions than it answers. One very basic problem is: who is the workers' collective? On the one hand, the 1988 Law on Enterprises and the company's statutes set out in detail the rules governing the acquisition and loss of membership in the collective. On the other hand, SOEs have in theory become subject to UNMIK's regulation on labour relations,<sup>28</sup> which provides that every worker should have an individual employment contract. In practice, neither legal regime is being applied to SOEs. When preparing for workers' elections, UNMIK simply accepts the lists of workers presented to it by those presently in control of the company.

Elections without clear rules as to who has the right to vote are deeply unsound. Whoever controls the SOE can influence the composition of the workforce by selecting from among the pool of past and present workers. This in turn enables them to influence the outcome of a workers' election. It is therefore not surprising to find that, in many cases, workplace elections have simply legitimised the existing power relations within the SOE. This legal confusion also has distinct social implications. It discriminates directly against the Serb and Montenegrin workers who fled Kosovo at the end of the war, and also discriminates against many Kosovar Albanians on the basis of their political affiliation.

A second problem concerns managerial accountability. Most important decisions are supposed to be taken by the council, not by the director, and some must be approved by the collective as a whole. Directors can be appointed and removed easily by the workers' council, especially now that political supervision has been removed. As a result, management is relatively weak and responsibility is widely dispersed – a problem that has always bedevilled Yugoslav enterprises. In fact, breaking down the power of 'technocracy' – that is, management – was always one of the political goals of self-management.

A third problem is one of consistency. The 1988 Law appears to operate only where needed to resolve a specific dispute, and in other cases was disregarded, even by DTI itself. The majority of SOEs have not held an election, and yet continue to operate and enter into binding obligations. DTI has established no system for monitoring where workers' council elections have been held, and does not appear to regard them as a legal obligation of SOEs. The result is a wide diversity of corporate governance arrangements across Kosovo's SOEs, including directors appointed by the post-war UCK government or by local municipalities, pre-1989 directors who have returned to their posts, and directors duly appointed by an elected workers' council.

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<sup>28</sup> UNMIK Regulation 2001/27 on Essential Labour Law in Kosovo, Section 1.1: 'The present regulation shall regulate employment in Kosovo, including employment relationships under which work or services are performed'.

This somewhat half-hearted attempt to restore workplace democracy has had two unintended consequences for future policy in the SOE sector. One is that it has strengthened the most conservative elements in each company, guaranteeing resistance to future reforms. The evidence can already be seen in the results of commercialisation, outlined below. All twelve successful concession agreements were concluded with companies where no workers' council election had been held. Conversely, wherever a workers' council was in place, it invariably moved to block the conclusion of a concession agreement, unwilling to yield its newly restored authority to an external investor. Cases where an elected workers' council rejected the approach of an investor selected by a tender committee include FAN Zahir Pajaziti (Podujevo), Eurometal (Ferizaj), Morava e Binces (Gjilane), Ramiz Sadiku (Prizren) and the Trofta Fish Farm (Istog).

The other effect is to raise the expectations of the workers' collectives as to the benefits they will eventually receive from privatisation. In early 2000, in an attempt to win approval from the UN for privatisation, DTI briefly argued that SOEs in some sense already 'belonged' to the workers, and were therefore not state property at all. This argument was later shelved. However, Yugoslav self-management always produced a strong subjective sense of ownership on the part of workers. Their monthly pay slips indicated a large gross salary, followed by a long list of deductions for taxes, charges and allocations within the company. As a result, the workers came to believe that their own funds were being used to build the company. On the eve of a long-awaited privatisation process, the reconstitution of workers' collectives has created the expectation that workers are to become the new captains of industry in Kosovo. These expectations must eventually be shattered. When that happens, UNMIK may find itself in serious conflict with the very structures it has worked to restore.

#### *D. Making concessions on SOEs*

Together with workers' council elections and direct administration, DTI had a third arrow in its quiver of strategies towards the SOEs. Because of opposition from the UN Legal Office towards any overt privatisation scheme, DTI together with the Department of Local Administration devised the alternative of leasing out SOEs to private commercial interests – a policy which became known as 'commercialisation'.<sup>29</sup> It was intended as a means of attracting fresh capital into the SOE sector and creating new employment, without addressing the complex problem of ownership of SOEs.<sup>30</sup>

The main features of the commercialisation strategy were as follows. DTI offered lease contracts of ten years over selected SOEs, through public tender. The successful bidder undertook to pay an annual concession fee and to make a series of capital investments in the company. The concession agreements also included obligations to retain the workforce, invest in training programmes and to share future profits with the workers. The relatively modest revenues from the concession agreements were not put into the Kosovo Consolidated Budget, but placed on trust to resolve future ownership claims against the company. The

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<sup>29</sup> The experience with commercialisation is examined in more detail in a forthcoming LLA-ESI report.

<sup>30</sup> "Concessions may be granted for a wide range of commercial activities, including without limitation, mining and quarrying; construction and operation of buildings, roads, railways, air transport facilities and other transport facilities, or oil and gas pipelines, facilities and outlets; public utility and telecommunication facilities; agriculture, water management and supply facilities": Finance Administration Instruction 1999/2, revised on December 15, 1999. See also Finance Administration Instruction No. 5/2000 on Concessions", 5 July 2000.

concession agreements give the lessee preferential rights in any future privatisation process. However, if privatisation does not take place, the lessee has no right to recover the costs of its investment in the company. According to rules issued by Central Fiscal Authority (CFA) in 2000, while the value of an SOE under concession may not be decreased, any increase in value must not raise an obligation on the part of UNMIK to pay for the investment.

The concession agreement concluded over the Sharr Cement factory in Hani i Elezit on 13 June 2000 was both the most significant of all commercialisation deals and the trigger for the development of the policy itself. Located close to the Macedonian border, Sharr Cement began to attract the interest of foreign investors as soon as the UNMIK mission was in place. As early as November 1999, the Head of the EU Pillar Joly Dixon inquired into the possibility of issuing “a concession or a lease to a reputable cement producer, who will undertake investments towards the long-term development of the plant and take steps toward its revival in the immediate future.”

The Sharr Cement factory was an atypical case in a number of ways. The fall of the Berlin Wall triggered a highly competitive race among the global industry to buy into cement factories across Central and Eastern Europe. According to industry sources,<sup>31</sup> the best prospects were to be found in South Eastern Europe, where cement factories were being acquired at speed by large Western European consortia such as Lafarge (France), Heracles (Greece), Holderbank (Switzerland) and Heidelberger (Germany). It is therefore not surprising that 21 companies from around the world expressed an interest in Sharr.

**Table 2: Overview of concession agreements**

	<b>Date of signature</b>	<b>Sector</b>	<b>Tender offers</b>	<b>Investor</b>
Sharr Cement	13-Jun-00	Construction	9	Holderbank AG.
Mirusha	6-Dec-00	Construction	2	SACET/SNAAB
Progress Meat	2-Mar-01	Agro-processing	1	Fructus
Progress Export	19-Apr-01	Agro-processing	3	Abi Elif-19
Fapol	2-Jul-01	Construction	1	CRK Consortium
Mustafa Goga	9-Nov-01	Construction	1	KMPN Tullarja
Alcon Sunflower	8-Aug-01	Agro-processing	1	Alcon Ltd.
Betonjerka	25-Jun-01	Construction	1	2K-Group
Adi Poultry	2-Jul-01	Agro-processing	1	ADI
Artizanati	5-Oct-01	Textile	1	Astra-B
Kosova Brick	1-Nov-01	Construction	3	Italkosova
Termovent	29-Nov-01	Ventilators	1	Dajti Ltd.
Minex	5-Feb-02	Agro-processing	1	Neraimpex

The winning bidder, the Swiss giant Holderbank, was well acquainted with the Balkan market, having bought into cement plants in Hungary, Croatia, Romania and Bulgaria. Holderbank already owned shares in the Usje cement plant in Macedonia (Sharr’s nearest competitor) and recently acquired one of Serbia’s three cement factories, located in Novi

<sup>31</sup> Jim Catterson, ‘The Cement Industry - International Overview’, May 2001.

Popovac, where it made a total investment of over €150 million to acquire 70 percent of the company. For its ten-year concession over Sharr, Holderbank agreed to pay an annual rent of at least €500,000, to make additional investments of around €30 million, and to invest 20 percent of its annual profits into a fund for the workers. In the buoyant cement market, this was an attractive deal.

According to projections prepared by independent experts, Holderbank stands to turn a healthy profit on its investment in Sharr, with its capacity to produce up to half a million tons of cement per year.<sup>32</sup> On the other hand, in the fierce struggle for dominance of European cement markets, Holderbank may well consider its investment justified even if Sharr produces nothing at all. In short, this was an investment with its own peculiar logic, which was unlikely to be replicated for other Kosovar SOEs.

Since then, twelve commercialisation contracts have been concluded by DTI. Reviewing the field, three are clearly failures and five appear to be successful. In two cases, both of them brick factories, the investment is too recent to evaluate. Two more fall into a special category which merits careful examination – more like complicated real-estate transactions than concession agreements.

Two of the three failures are also in the concrete industry, a market heavily dependent on large-scale public infrastructure projects. Mirusha in Klina municipality in Western Kosovo was the first company to be commercialised by the newly established DTI, and also the first contract to be cancelled. After failing to pay the workers for more than six months, the Italian investor pulled out in April 2002, leaving UNMIK to appoint an interim manager and consider its options for legal action for breach of contract. Betonjerka, a Mitrovica company which produces various concrete products, has remained idle since its commercialisation in June 2001. It has employed seven security guards, but there has been no sign of any other investment. Both companies are located on riverbanks with plentiful reserves of sand and gravel – resources in demand during a construction boom. However, there has been no apparent interest in using these companies for manufacturing. The third unsuccessful case, Artizanati, is a centre for handicrafts in Prizren which has been leased to a private company linked to its former managing director. The commercialisation process has become bogged down in disputes between the workers and the investor, and it remains to be seen whether the most recent compromise brokered in June 2002 by DTI will hold.

The five successful cases of commercialisation all follow a clear pattern. They are all agro-processing enterprises, and former production units of the giant *agro-kombinat* Agrokosova. Each produces and distributes products on the open market under its own label. Jam and canned vegetables from Abi-Elif-19, sausage from Fructus, eggs from Adi, sunflower oil bottled by Alcon and pretzels from Nerakond can be found in most Kosovo supermarkets today.

All of these companies continued operating through the 1990s under Serb management, and escaped the war without serious damage, enabling them to resume production rapidly in 2000, albeit at reduced capacity.<sup>33</sup> As flagships of Kosovo's agricultural sector, they control unique

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<sup>32</sup> Consultants from CemPro wrote: "if sales can be increased the plant will be an extremely good investment. I expect all of the major European cement manufacturers to bid on the Leasing of the plans, plus some of the minor players... The main deficiencies of the plant are of a relatively minor nature, i.e. mainly a matter of spare parts and instrumentation." CemPro Plant analysis, 18 February 2000.

<sup>33</sup> The poultry farm was the only business which did not resume production until after commercialisation.

assets and enjoy dominant positions within the domestic market. Progress-Export has Kosovo's only fully functional cold-storage facility, with a capacity of 5,000 tons, together with a monopoly in processed fruits and vegetables and a brand name recognised widely by Kosovar consumers. Alcon is the only producer of sunflower oil, with new production facilities dating from just before the war. Fructus has the only active industrial-scale slaughterhouse in Kosovo, and the only one ever to receive a health and sanitation certificate from the European Union.

Interestingly, there is a clear pattern among the investors in these companies. All five were Kosovo companies which had been wholesale traders during the 1990s, in some cases enjoying close commercial relationships with the enterprises they later leased. ADI operated four warehouses and a chain of retail outlets in Lipjan, holding supply contracts with many of Kosovo's principal SOEs. Neraimpex was a food wholesaler operating in Ferizaj, Kaqanik, Vitina and Shtime, with a monthly turnover of €1 million in 1997-8. ABI was originally a producer of dairy products, branching out during the 1990s into supermarkets in and around Prizren. The lessors of Fructus managed a network of more than 500 individual stores across Kosovo in the early 1990s, with a combined turnover of €15,000 per day.

These investors were a natural match with the agro-processing plants they acquired, bringing both marketing expertise and an established distribution network. They were well acquainted with the SOEs in question, their products and their market position. As a result of their trading activities in the 1990s, they had cash on hand to invest. Notably, there were almost no other investors in a position to take advantage of these commercial opportunities. Of the five successful commercialisation cases, four of them attracted only a single bidder.

Leaving aside the two brick factories, which cannot yet be evaluated, the remaining two cases could be labelled 'real estate commercialisations'. FAPOL was a manufacturer of polyester pylons in Podujevo. The investor, a local businessmen, made clear from the outset that he had no intention of restarting this business. His interest was in FAPOL's land which, as sole bidder, he acquired for a monthly concession fee of €750 for just under 7 hectares. Taking into consideration his obligation to pay 85 workers at salaries of €175 per month, his effective rent is €0.23 per m<sup>2</sup>, approximately a third of the market price for serviced land. With a location close to the Administrative Boundary Line with Serbia, he has invested €1.2 million in building a new customs terminal. He has also established an assembly line for bathtubs imported from Turkey.

Termovent in Lipjan was a similar case. The investor has no intention of resuming the core business of making ventilators. Instead, in a joint undertaking with an Italian partner, he has begun to develop a plant for producing polyethylene parts for furniture, destined for export to Italy. In both cases, the investor openly admits that the total financial obligations under the concession agreement – the annual fee plus the workers' salaries – added up to a good price for acquiring an attractive piece of land. Both investors would prefer to have purchased the land outright, if given the opportunity.

In total, of more than 330 SOEs then known to DTI, only 65 were put to tender for commercialisation by the end of 2001. Investor interest was generally low: only 34 tenders attracted a credible offer; of these, only 7 attracted more than one bid. In the end, 12 concession agreements were concluded, the latest (Minex) in February 2002. Since then, although DTI has continued to announce tenders, no further concession agreements have been signed by UNMIK, and the policy now appears to be abandoned.

The patterns emerging from the commercialisation process are clear enough to suggest a number of important lessons for future privatisation efforts. First, there have been a number of successes in leasing out SOEs as going concerns. However, these successes depended on quite specific circumstances which are absent for the great majority of Kosovo's SOEs. Achieving these six successful cases (if we include Sharr cement) absorbed a great deal of international resources, including the preparation of 65 companies for tender. The main sectors which attracted serious bids were in agro-processing and construction. The successful cases were all companies which were producing successfully at the time of tender, or ready to resume production immediately. They were all in a position to command a monopoly or dominant position in the Kosovo market, and therefore to earn an early profit for the investor. The successful investors were all trading companies which had already been working in the food and/or construction sectors during the 1990s, and had well-established distribution networks.

The implication is that, where these underlying conditions are present, SOEs may be attractive to serious investors. However, the overwhelming majority of SOEs do not meet these conditions, and have no value as going concerns.

The two 'real estate commercialisations' of Fapol and Termovent offer a different lesson. Generally speaking, even the most decrepit SOEs have valuable assets, principally buildings and land serviced by infrastructure. The high demand from the private sector for scarce business property has resulted in an over-heated property market, turning many of the SOEs into rental businesses. Prizing these assets out of the SOE sector and putting them into circulation on the open market is clearly a key economic policy objective.

The question is whether lease or sale of SOEs as going concerns is the appropriate strategy for achieving this objective. In the two cases examined above, the investors were obliged to go through an elaborate concession procedure in order to acquire an attractive piece of real estate. Instead of purchasing the land outright, they took on a ten-year obligation to the company and its workers. As the sole bidder, they were able to acquire the company as a whole more cheaply than the market price for the land on its own. In effect, UNMIK has leased the land at enough of a discount to cover the liabilities associated with assuming responsibility for the SOE. The question is: is this a rational method of getting SOE assets onto the open market?

A fourth lesson of commercialisation concerns the limits of international authority. Not a single concession agreement was concluded in the face of opposition from either the workers or the municipality. In Gjilane and Peja, the municipalities openly and successfully opposed the entire commercialisation policy, calling for a halt to 'this unacceptable centralization tendency and wild dictation from the central level'.<sup>34</sup> Wherever an elected workers' council was in place, negotiations to lease the company were protracted and ultimately unsuccessful, with the workers predictably reluctant to relinquish control over the company to an external investor. Experience showed that UNMIK has little capacity to bring about change in the SOE sector in the face of concerted opposition.

A final point to note about commercialisation is that the Kosovo 'state', in the form of UNMIK, has shown curiously little interest in ensuring that investors meet their financial

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<sup>34</sup> Letter from the Gjilane Municipal President, 19 April 2001

obligations under the concession agreements. By June 2002, the 12 concessions had generated €137,779 in annual fees and tender deposits, held on designated accounts managed by the Central Fiscal Authority and the Banking and Payments Authority.<sup>35</sup> According to the contracts, some €1,800,000<sup>36</sup> should have been paid by early June this year, on pain of cancellation of the concessions.<sup>37</sup> The lack of interest in collecting this revenue may be linked to the fact that the money is not destined for the Kosovo Consolidated Budget. Unless Kosovo's public institutions have a compelling interest in pressing the commercialisation process forward, the elaborate obligations established in the concession agreements will count for little.

#### **IV. THE OTTOMAN DILEMMA**

An assessment of three years of international policy towards SOEs is sobering:

- €# By the end of 2000, UNMIK municipal administrators in some parts of Kosovo managed to establish a limited degree of oversight over certain SOEs in their areas of responsibility. This control mechanism was subsequently dismantled.
- €# DTI's practice of installing interim international managers never amounted to anything more than a stopgap measure for resolving disputes, before returning SOEs to the control of insiders.
- €# The reintroduction of workers' self-management under the 1988 Law on Enterprises reinforced existing power relations within SOEs, while partially re-establishing a form of corporate governance which was severely dysfunctional in the old Yugoslavia.
- €# Finally, the commercialisation policy absorbed the largest part of international resources in this sector over two years, but brought benefits to no more than 6 of Kosovo's 339 SOEs. Leaving aside the case of Sharr Cement, it has produced a limited amount of fresh investment capital, no revenue for the Kosovo Consolidated Budget, few additional jobs and only modest enterprise restructuring.

Across the board, UNMIK's policy towards SOEs has been one of grudging acceptance of the *status quo* in terms of economic power and control. This *status quo* is one where property relations are subordinate to power relations, and therefore vary from municipality to municipality, and from one enterprise to the next.

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<sup>35</sup> On the recommendation of DTI Finance, this number has been taken directly from original bank statements held by the CFA Cash Management Unit and the Banking and Payments Authority. On 11 June 2002, the total sum of cash actually held on designated accounts for concession payments, tender administration fees and bid deposits in Germany and Kosovo was €137,779. By contrast, according to invoices submitted by the investors, €1,260,662 have already been paid to DTI accounts (including invoices for the payment of KEK bills, refundable tender deposits and other past liabilities).

<sup>36</sup> In concession payments or payment of past liabilities as specified in the contracts.

<sup>37</sup> According to the commercialisation contracts the concession fees are to be kept on bank accounts supervised by DTI, not the CFA, on behalf of possible future creditors. This is in contradiction to the Finance Administration Instruction 5/2000 issued by the Central Fiscal Authority, which argues that concessions and lease agreements "are intended to generate revenue for the public good of Kosovo. Such revenue shall be deposited in the Kosovo Consolidate Fund".

UNMIK's problem resembles the dilemma which faced the Ottoman rulers in the Balkan provinces when they attempted to introduce a new land code 150 years ago. During the mid-19<sup>th</sup> century, the Empire sought to reform its economic structures by introducing individual property rights. A reform edict of 1839 linked security of title with more productive use of land, which was considered essential to the economic well-being of the Empire. The Ottoman Land Code of 1858 established clear title to land as the basis for uniform bureaucratic practices across the Empire. This was a new, revolutionary understanding of state power, inspired in large part by the need to keep pace with contemporary developments in Western Europe. Governmental power was to be used to ensure certainty in property transactions. In return, with every asset clearly assigned by law to a single individual or legal entity, the government would have the wherewithal to measure and register the wealth of the Empire, and therefore to tax it effectively.<sup>38</sup>

This ideal of modern statecraft came into sharp conflict with the social reality of the Ottoman Balkans. Property rights were defined by customary practices and deeply embedded in local power relations, as modified here and there by individual decrees and ordinances (*irades*) issued by the Ottoman rulers in response to localised disputes. It was a system where the ruler used his prerogative of absolute title to distribute land and revenues among different social groups, so as to consolidate his power. The logic of the system was not economic efficiency, but social stability. When the Empire attempted to reform this system from above, the result was bitter disputes over property rights between different groups across its territories, from Albania to Bosnia. By 1875, Cevdet Pasa, one of the principal crafters of the reforms, wrote that if the Code were implemented to the letter in the Balkan provinces, the population would rise up in arms. In short, establishing uniformity of rules over property – the essential foundation of a modern, free-market economy – was nothing less than revolutionary.

The experience of the last three years in Kosovo has shown the difficulty of combining an overriding interest in stability ('peacekeeping') with the challenge of building modern institutions of government and preparing the ground for economic development. Like its Ottoman predecessor, UNMIK is hamstrung by a severe lack of reliable information about the reality on the ground, by its own limited administrative resources, and by the difficulty of facing down those with vested interests in the *status quo*. It has had no capacity to translate its general mandate as trustee of social property into effective supervision or administration of some 370 SOEs. It has therefore limited its role to preserving social peace by intervening only where a dispute comes to its attention. The result is a series of *ad hoc*, localised solutions, which do not add up to a coherent or consistent system of property rights.

What is becoming increasingly clear, however, is that this approach is beginning to undermine the basic goals of the international mission in Kosovo. Instead of ensuring social peace, the absence of the rule of law in the field of commercial property is leading to bitter struggles for control of SOEs and their most valuable assets, with potentially dangerous social consequences. Moreover, the lack of a consistent system of property rights is acting as a serious constraint on the development of Kosovo's economy, creating a barrier to market entry and a disincentive to business investment. In the coming period, as direct international budgetary support declines, Kosovo's private sector must bear the considerable burden of

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<sup>38</sup> For an account of this process in the mid-19<sup>th</sup> century Ottoman Empire in the Balkans, see Roger Owen (ed.), *New Perspectives on Property and Land in the Middle East*, Harvard Middle Eastern Monographs, Cambridge, 2000, in particular Huri Islamoglu, 'Property as a contested domain: a re-evaluation of the Ottoman Land Code of 1858'.

financing the development of new public institutions, through the creation of an effective tax regime. It should not be required to bear the costs of subsidising the remnants of socialist industries.

## **V. TOWARDS PROPERTY CREATION IN KOSOVO**

In early 2002 the Special Representative of the Secretary-General in Kosovo, Michael Steiner, announced three basic priorities for UNMIK: employment creation; building the rule of law; and establishing a fair and safe society in which returns become possible. Two of these objectives cannot be accomplished without addressing Kosovo's anarchic property regime and the legal vacuum in which its socially owned enterprises now operate. As Steiner himself put it in a recent address at the University of Prishtina in April 2002: "the most urgent goal is establishing clear ownership. Clear legal title is the basis for both economic development and the rule of law."<sup>39</sup>

At present, as reflected in the KTA regulation, UNMIK's strategy anticipates three approaches towards SOEs:

- €# privatisation of the most promising;
- €# liquidation of the least promising;
- €# continuing powers of administration of SOEs pending privatisation or liquidation.

Concerning privatisation, experience shows that the material which the KTA has to work with is not very promising. There are probably no more than a handful of SOEs which are attractive to an investor in their present form. Others may be made attractive by taking promising divisions of larger SOEs and conducting a 'spin-off', as envisaged in the KTA regulation. Such cases will consume a considerable amount of international resources.

Some of the developments over the past two years count against the KTA. In particular, the restoration of workers' self-management means that workers will demand an active role in deciding on privatisation. Although the KTA has all the authority on paper to proceed without their agreement, its effective power over the SOEs will be no greater than DTI's. No legitimate investor would risk becoming caught up in disputes with the workers over physical control of assets. As with commercialisation, the KTA may have little choice but to proceed at the pace that the SOEs themselves permit. All told, it will rank as a considerable success if the KTA manages to privatise more than 5 percent of Kosovo's SOEs within the next two years.

The KTA regulation also anticipates bankruptcy of SOEs, with the KTA using its authority to take decisions on behalf of SOEs to place them in 'voluntary liquidation'. Liquidation is also likely to encounter stiff resistance from within the SOEs, and will require considerable efforts from the international side. Given the limited resources at KTA's disposal and the priority which will be given to the privatisation of promising SOEs, there is a risk that liquidation will proceed even more slowly than privatisation, if at all.

As concerns interim management of SOEs, on paper the powers of the KTA are virtually unlimited. It can install new boards and managers, or even convert the SOE into a stock

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<sup>39</sup> Michael Steiner, Address at the University of Prishtina, 18 April 2002.

company owned by the KTA itself, effectively dissolving the workers' collective. However, it is doubtful that it could wield its powers effectively in the face of any concerted opposition from within the SOE itself. Like DTI before it, it is likely to use its powers of intervention only where necessary to prevent the escalation of a particular dispute. It is not likely to undertake the laborious task of restoring order in the corporate governance of SOEs or of detecting and preventing the misuse of assets.

In sum, given the resources foreseen for the KTA, the present UNMIK strategy is likely to achieve a small number of successful privatisations, and perhaps a few liquidations. But the great majority of SOEs will be left to struggle on in their present state. In short, at present UNMIK has no strategy to deal with the property chaos described in this paper.

What is needed is a property creation strategy which applies to SOEs immediately, until such time as they are ready for privatisation or liquidation. This strategy must address the two most serious problems observable at present across Kosovo:

€# the fact that rules governing socially owned property and the revenue streams generated by socially owned property are not settled according to general laws, but vary from one location to the next depending on local power structures and the different degrees of UNMIK involvement;

€# the fact that the small group of individuals who presently control SOEs are able to draw an unearned income not from the use of the assets, but from illicit rental activities, in what amounts to a modern day feudal levy on the private sector.

A strategy which aims to change the *status quo*, in the face of opposition from the small but influential groups who benefit from it, must meet a number of conditions. It will require the systematic collection of detailed information by Kosovo's public institutions (both UNMIK agencies and the provisional institutions) on SOEs and their assets, revenues and activities. The benefits of the policy must be effectively communicated to different sectors of Kosovar society in order to build a broad coalition in favour of changing the status quo. UNMIK must ensure that adequate administrative resources are in place for a sustained campaign. These three preconditions – access to information, coalition building and effective implementation – are closely linked. Without hard information, it is impossible to communicate effectively; building effective coalitions provides the means of gathering this information; without broad support from within Kosovo, no international administrative structure will have the resources to bring the problem under control.

There are three basic elements which need to be part of a broad property-creation strategy:

- a) Make SOEs subject to the same laws as private enterprises, particularly in the areas of tax and employment relations. Require them to pay public utility bills, as a key step towards hardening budget constraints. Use these legal mechanisms both to begin the process of collecting systematic information on SOEs, and for determining which SOEs are viable as going concerns and which should ultimately proceed to liquidation.
- b) Enforce the rules in the applicable law against leasing social property. By reducing the scope for SOE managers to extract unearned cash revenues, this

would help to defuse conflicts over control of SOEs and limit resistance to eventual privatisation or liquidation.

- c) Begin a process of small-scale privatisation of individual socially owned assets.

*A. Make SOEs subject to the law*

At the moment, SOEs are operating in legal limbo. The old legal regime governing the use of social property no longer applies. However, many of the new rules on commercial activity introduced by UNMIK, on issues such as taxation and employment relations, are not being applied to SOEs either. This gives them a distinct advantage over the new private sector, which is neither economically justifiable nor, in plain terms, fair.

The concept of the fair society is basic to building a coalition of forces to end the anomalous status of SOEs. In concrete terms, it would mean ending SOE privileges in the following areas.

*Taxation:* Historically speaking, it was the need of the state for effective revenue collection which drove the development of modern property systems. Conversely, the lack of interest by Kosovo's revenue agencies in the SOE sector is one of the main reasons why UNMIK has so little information about it. Since 1999, one of UNMIK's most important institution-building achievements has been the Central Fiscal Authority (CFA). If the tax rules are applied systematically to this sector, the resources of the CFA would become engaged in the task of collecting systematic information on the activities, assets and revenues of SOEs – a precondition not just to bringing them within the law, but also to privatising or liquidating them.

*Profit tax:* Applying this new tax to SOEs will require them to disclose information on income and expenditure, and to prepare financial statements in accordance with CFA accounting standards. Implementing regular corporate disclosure requirements would help to build a picture of current activities in the SOE sector. Ensuring compliance by SOEs would require a reinforced compliance unit within the tax administration, which is already overwhelmingly Kosovar in personnel but will continue to require strong international backing.

*Income tax on SOE workers:* Requiring SOEs to pay income tax on their workers will help to bring about a fundamental change in the way SOEs are organised. At present, there is no reliable information on the composition of the workforce in many SOEs. Legally, however, SOEs are now subject to UNMIK's regulation on labour relations. They should provide each of their workers with individual employment contracts and register them for the purpose of income tax and pension contributions. Enforcing the rules will require co-operation between the revenue authorities and the Ministry of Labor and Social Welfare, which administers the labour regulation. Forcing the SOEs to go through the purpose of identifying and registering their employees will bring a range of problems to the surface which must be resolved before privatisation could proceed.

*Property tax:* This new tax is being developed through pilot projects in seven (out of a total of 30) municipalities, and is expected to raise €40-50 million a year in the future. This will go a long way towards building up sustainable municipal finances. Levying property tax

systematically, particularly on commercial property, will bring about a natural coalition between the municipalities and other revenue authorities to establish what property exists and who is presently using it.

*Utilities:* Only very recently have the utility companies began efforts to force SOEs to pay their utilities bills. They still have rather more lenient treatment than the private sector or ordinary citizens. Unpaid utility bills represent a form of subsidy by the general public to the SOE sector. They decrease the resources available to service providers to develop their service and expand infrastructure. Public utility providers should be under clear obligations to cut services to non-paying SOEs. This in turn provides a very quick indication of which SOEs are no longer able to generate legitimate revenues.

These steps would help to bring to an end the privileged status of SOEs. They can all be accomplished by taking regulations which are already in force, but which no-one has sought to apply to SOEs. By hardening the budget constraints, they would begin to sort out the deadwood from the promising candidates for privatisation. At the same time, as an invaluable by-product, they would set in motion a systematic process of collecting information on the SOE sector. For the first time, the information available to UNMIK and Kosovo's public institution on the SOE sector would no longer be limited by the resources available to a single agency – the Department of Trade and Industry or its successor the KTA. Instead, a number of other bodies, particular the revenue agencies, would have a direct interest in participating in the project.

#### *B. End the misuse of social property*

Under the applicable law (the 1988 Law on Enterprises), it is unlawful for SOEs to rent out socially owned assets. If they fail to use the assets for the purpose for which they were allocated, and especially if they abuse social property by using it to generate illicit private income, the user right can be cancelled.

Extracting individual assets from SOEs by cancelling user rights could be accomplished far more rapidly and cost-effectively than either privatisation (spin-offs) or liquidation. Under the applicable law, the municipality has the right to allocate socially owned property on its territory. If the user right is cancelled, the allocation right reverts to the municipality. As the municipality has an obvious interest in reasserting its control over the property, it would be a natural ally of the KTA. The responsible municipal body (namely the office for property-legal affairs) could perform the task of investigating where socially owned property on its territory is no longer being used by the SOE which holds the user right.

If appropriate, the KTA could be given a supervisory role to guard against unwarranted interference by municipalities in viable SOEs. The procedure might, for example, require the municipality to request approval from KTA before cancelling the right of use. The KTA could use its authority as trustee of social property to consent to the municipality's proposal on behalf of the SOE.

In practice, this would mean that current lessees of SOEs would become tenants of the municipality. This would bring a number of advantages. Most importantly, it would create the possibility for standard lease terms set out in municipal (or KTA) regulations. These might include fixed rental rates according to urban zones, minimum notice periods and legal

rules governing protection of investments in property made by tenants. It would immediately terminate the anomalous practice of private tenants being forced to hire unproductive SOE workers. These benefits would go a long way towards improving the climate for private business development.

Removing the source of illegal subsidies from SOEs would carry significant benefits for the KTA in carrying out its tasks. First, it would help to determine which SOEs have viable core businesses, and which have nothing left but their real estate. Second, by removing the illicit cash income, it would take the heat out of struggles for control of SOEs. Once this property is removed from SOEs, both privatisation and liquidation are likely to encounter far less resistance.

### *C. Prepare for small-scale privatisation*

Individual business premises that are recovered from SOEs in this manner can ultimately be privatised through the kind of small-scale privatisation which has been implemented successfully in other Balkan countries with relatively weak institutions, including Bosnia and Herzegovina. In a review of a decade of privatisation efforts in the former Soviet Union, the economist Anders Aslund noted:

“The easiest privatisation in every country involved small shops and kiosks... Once the process started it was completed within two years, as everybody realised it was the only time they could get a piece of property cheaply... Today, few discuss small-scale privatisation, underscoring its success.”<sup>40</sup>

Whether it is the KTA or the municipality which is tasked with selling off socially owned properties, the revenue should be directed back into the local community in the form of development of local infrastructure, a measure which impacts directly on the local economy by boosting the construction industry and helps to create a better environment for private sector development. By contrast to enterprise privatisation under the KTA regulation, there would be no need to reserve the proceeds of these sale for potential creditors. Under Yugoslav law, creditors of SOEs were unable to secure debts against socially owned property, or to liquidate it in the case of the winding up of an SOE. Allowing the creditors to do so now would be to grant them stronger rights than they held at the time the debt was created. Under the applicable law, where an SOE ceases to exist or the user right is cancelled, the property simply reverts to the municipality. There is, however, no legal limitation on the CFA to tax the proceeds of small scale privatisation, and to use some of these proceeds, for instance, to finance retraining or social assistance for present or displaced workers.

There are obvious economic benefits from such a strategy, which would spread real estate property widely and directly benefit the new private sector by reducing uncertainty of property title. There are also obvious political benefits for UNMIK and the KTA. Small-scale privatisation would be the first element of the wider privatisation strategy to deliver a tangible public benefit. It would also strengthen UNMIK's rule of law agenda. Once the property is in private hands, it would become possible to distinguish between legitimate rent collectors and racketeers.

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<sup>40</sup> Anders Aslund, *Building Capitalism: The Transformation of the Former Soviet Bloc*, Cambridge University Press, 2002, p. 167-8.

*D. A property reform coalition*

Policy development must focus not just on outcomes, but also on the limitations of international influence and the real difficulties of implementation. Inevitably, progress in the area of property reform will entail a degree of trial and error – a learning process which is credible only to the extent that the lessons are in fact learnt. The most important lesson from the past three years concerns the need to invest up front in field-based information gathering, analysis and knowledge management. This includes knowledge about the state of the socially owned enterprise sector, about the reality of how commercial property is managed and used across Kosovo, and the impact of concrete international initiatives. It involves knowing which actors in the new private sector and among Kosovo's institutions stand to benefit from the introduction of a fair and transparent system, so that they can be drawn into an effective reform coalition. It also involves a much better understanding of the capacities of municipal administrations across Kosovo.

Rent-seeking institutions everywhere have an interest in diffuse, ambiguous and inconclusive information about their activities. Conversely, the most basic tool of the modern state apparatus is the capacity to collect detailed, accurate information about economic actors, which in turn allows for effective revenue collection. As a former Executive Director of the World Bank has written, inefficient economic institutions are often the norm, rather than the exception. There is “no process of evolutionary selection that results in efficient institutions weeding out the inefficient ones. It is rather the contrary in most cases.”<sup>41</sup>

Creating a consistent system of property rights in Kosovo will therefore require a broad and well-structured alliance of institutions, involving the Central Fiscal Authority (CFA), the Kosovo Trust Agency (KTA) and the Ministry of Labour and Social Welfare, as well as municipal bodies, cadastral agencies and others organisations providing international technical support in this area. The sharing of information between these actors must not be left to chance but must be at the heart of any property reform strategy.

Given the size of the challenge, taking property reform seriously would require it to become a centrepiece of UNMIK's efforts in Kosovo – much as a broad-based campaign to restore the rule of law in the field of residential property became the most intensive operation of the international mission in Bosnia-Herzegovina. In Bosnia, the resources and expertise of various institutional actors were harnessed together through the creation of an inter-agency Return and Reconstruction Task Force (RRTF) and an elaborate Property Law Implementation Plan (PLIP).

UNMIK might also consider the creation of an inter-pillar co-ordination mechanism – a ‘property creation task force’ – which would bring together key international and Kosovar actors as well as international donors. This would help to bring the many different tasks (legislative, regulatory, fiscal, institutional development) within an overall campaign.

It is important to underline, however, that the challenge is not simply a return to a pre-war *status quo*, as it was in Bosnia. Rather, it requires the creation of a new legal and institutional

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<sup>41</sup> Eduardo Wiesner, former Executive Director of the World Bank. *Transaction cost economics and public rent-seeking in developing countries: towards a theory of government failure*. In: Robert Picciotto and Eduardo Wiesner, ed., *Evaluation and Development – the Institutional Dimension*, Transaction Publishers, 1988, p. 117.

regime, replacing the socialist legal experiment whose collapse has led to the anarchic situation described in this report.

An UNMIK property creation campaign will also require a rethinking of international priorities in allocating resources for technical assistance and institution building. A number of institutions – from the tax administration in the Central Fiscal Authority to the Ministry of Labour and Social Welfare – would need additional human resources for the duration of the campaign. Agencies with a field presence across Kosovo would also play an important role, as they do in Bosnia within the RRTF, in gathering crucial information and monitoring policy implementation.

Most importantly, property creation is about communication. It requires a sophisticated political campaign to convince broad sections of Kosovar society of the benefits of such a policy. One of the most important lessons of the past three years of international efforts is that ambitious policies formulated within UNMIK must be communicated effectively, so as to build a broad coalition of interests, if they are to change the behaviour of real economic actors in the field. Ultimately, it is the people of Kosovo who must be persuaded of the merits of a fair, efficient and universal property regime, if their economy and society are to prosper beyond the phase of massive international assistance.