

Dilemmas and Backwards in a Fast Track

Privatization of POEs in Kosovo

Research Report

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ABBREVIATIONS

ACI -Airports Council International
BOO – Build, own and operate
BOT - Build, operate and transfer
BPK - Banking and Payments Authority of Kosovo
 (now Central Bank of Kosovo)
BTD - Balkan Trust for Democracy
DBFOT - Design□Build□Finance□Operate□ Transfer
GPC Government Privatization Committee
IDC - International Dialling Code
IPO - Initial Public Offerings
ISO - Independent System Operator
JSC - Joint Stock Companies
KEK - Kosovo Energy Corporation
KOSTT -Transmission System and Market Operator
KTA - Kosovo Trust Agency
MEF- Ministry of Economy and Finance
MEM-Ministry of Energy and Mining
MTPT-Ministry of Transport and Post-Telecommunication
PAK - Privatization Agency of Kosovo
PIA - Prishtina International Airport
POE- Publicly Owned Enterprises
PPP - Public Private Partnerships
PPP-ISC Public Private Partnerships Inter-ministerial Steering Committee
PTK - Post and Telecom of Kosovo
SB - Single Buyer
SIP - Share Issue Privatization
SOE - Socially Owned Enterprises
TE - Transition Economies
TPA - Third Party Access
TSO - Transmission Systems Operators
UNMIK – United Nations Mission in Kosovo

EXECUTIVE SUMMARY

This research report aims at (a) improving information of policy makers and other stakeholders of the society about the current situation of POEs, the need for their privatization taking into account also experiences of other transition economies, and (b) to induce an improvement in transparency, accountability and especially encouraging public policies aimed at successful completion of this important process. The main motivation behind this report is that the government has move forward with this process without sufficient consultation resulting in many concerns during last two years. The Government first announced that privatization will be completed during 2008-2009. The public opinion and electronic press and media discussions have been pro et contra and raised questions such as: (1) Is this the best timing for fast privatization of three main POEs, having in mind the global financial crises ? (2) Is the government implementing the best models/methods and has it learnt enough from lessons and experience of other countries? (3) Are proper procedures for transparency and accountability in place? (4) How will the proceeds from privatization be used and finally (5) is there a necessary legal frame in place to ensure fair, transparent and accountable privatization.

Despite these concerns there has been no proper and well founded debate initiated by public institutions (the Assembly and Government) or by other stakeholders, civil society and academia. In fact there has been a feeling that government is trying to keep this issue within a relatively narrow circles. This has to be overcome and wide ranging debate have to be organized in the society. This debate should aim at building a basic consensus of key stakeholders related to this issue. This is a precondition for ensuring necessary political support for this important process and avoiding potential political and social tensions that could compromise the policy or delay the privatization of POEs. The authors of this report believe that the privatization of POEs is more than necessary and long overdue as they equally insist that it should be well embedded in appropriate legal framework which should ensure adequate procedures and policies, transparency and accountability and contribute to accelerating economic growth and sustainable development.

The report focused especially on three key enterprises Kosovo Energy Corporation (KEK), Post and Telecom of Kosovo (PTK) and Prishtina International Airport (PIA) having in mind their importance in economic and social development. It was prepared predominantly based on secondary data, desk research, augmented by semi-structured interviews with managers of POEs, line ministers and the Minister of Economy and Finance which is in charge of overseeing the process. Moreover, subject matter experts' opinions were taken into account. Secondary data sources included reports from Riinvest, Line Ministries, POEs, reports of other relevant institutions and academic papers which were used for the theoretical part of the report and experiences of other Transition Economies (TE). The report also employs two in-depth case studies that deal with the privatization of these strategic industries in Macedonia and Albania.

Until June 2008, Publicly Owned Enterprises in Kosovo were administered by the Kosovo Trust Agency but after the Constitution of Kosovo became effective, these enterprises were transferred under the administration of the Government of Kosovo. Following the current legal framework, Government of Kosovo has decided to

unbundle KEK and sell the distribution network and supply businesses which will be established as a separate legal entity beforehand. Government of Kosovo have also formally authorized the process of establishing a Public-Private-Partnership for the operation and expansion of PIA while it has shown its commitment to introduce private ownership in Post and Telecom of Kosovo for which a request for proposals for transaction advisory services was published lately by the Ministry of Economy and Finance

Key conclusions coming out from this research include:

- Government of Kosovo has clearly shown its commitment for energetic and fast privatization of three strategic POEs. Although this government determination should be acknowledged it seems that it is disproportionate with current level of preparations, creation of solid legal frame, creation of necessary political and public support and basic consensus in the Assembly and with other key stakeholders at the society. This has been proven as an environment that doesn't support government intentions and this is proven by the lack of substantial progress (except in the case of PIA) during last 18 months since government intentions were made public.
- Current legal frame provides only basic solutions for embarking on privatization POEs. The procedures, policies are not clear. It seems that Government Privatization Committee (GPC) Public Private Partnerships Inter-ministerial Steering Committee (PPP-ISC) have been granted with too much powers, without clear line or oversight and reporting to the Kosovo Assembly.
- Government has not clear policies in place regarding the restructuring the ownership structure of POEs after first round privatization respectively if is going to sell all shares to a private investor or will keep portion of that in public ownership for later eventual privatization or will embark on so-called 'golden share' approach.
- Government has not a policy in place regarding the use of proceeds from privatization of POEs. Certain key aspects of this should be part of debate in the society: Assembly, academia, civil society. As these corporations are to serve public interest in large, current and future generations we consider viable policies and solution should be determined;

Policy recommendations:

- We recommend that Kosovo government and Assembly in a near future complete legal frame for effective, transparent and accountable privatization of POEs through amending existing Law on POEs and Law on PPP and concessions or by passing a laws on privatization of each of three main POEs : KEK, PTK and PIA;
- The Kosovo Assembly should be more actively engaged and build its position in this process that could ensure transparency and accountability of Government and other bodies for the successful completion of this process. Authorizations of GPC and PPP-ISC should be carefully weighted and analyzed in this context. This should be clearly ensured through completion of legal frame;
- Following experiences in other transition economies we suggest that part

of shares to the extent that doesn't discourage strategic investors remain public at first round of privatization of POEs in order to eventually be privatized with much higher price later.

- Government and Assembly through inclusive debate with other stakeholders should build policies that ensure that great portion of proceeds other than transaction costs are used for public investment in infrastructure, education and health and not for current budget consumption for salaries, goods and services.
- We recommend that the length concession arrangements is determined carefully and that 40 years arrangements are an exception for specific projects (e.g. infrastructure networks, forestry etc) and that these arrangements in case of large transactions should have the approval of Kosovo Assembly in case that they exceed period of 20-25 years;

INTRODUCTION

Private ownership is to be introduced in three biggest central POEs in Kosovo namely KEK, PTK and PIA following the decision of the Government of Kosovo based on current legal framework. These POEs provides services that are essential for the quality of life of citizens of Kosovo. The way in which they are privatized and outcomes of this important process affects everyone. The Riinvest Institute has is presenting this Research Report, aiming at creating a foundation for active debate between relevant stakeholders such as the Assembly of Kosovo, Government of Kosovo, Civil Society, Academic circles and the public at large.

Riinvest Institute has been very actively involved with research and advocacy in favour of launching effective privatization process in Kosovo. During the period 2001 – 2008 it published five reports addressing the privatization process and its problems and achievements in Kosovo. These reports contain the theoretical and empirical arguments for privatization in Kosovo; they address negative effects of hesitations and delays, and outcomes of the privatization process in Kosovo. They also provide a comprehensive review of different privatization methods and the results of privatization in Kosovo and other transition economies.

Following the above reports, Riinvest has been engaged in research to highlight the process of POEs' privatization by producing this research report. The privatization of POEs which enjoyed complete monopoly position in Kosovo (except with the PTK after the introduction of competition) raises the issue of distributive efficiency along the issue of technical (operational) efficiency. In this regard, the importance of regulatory practices is to be reinforced ensuring that the monopoly power is not misused. This report has been prepared by Riinvest Institute with a generous support by Balkan Trust for Democracy (BTD - as part of German Marshal Fund). Also, this research report is in line with the programme of 'Forum 2015' regarding the creation of a solid ground for a constructive debate among key stakeholders in the Kosovo society.

This report aims at (a) improving information of policy makers and other stakeholders of the society about the current situation of POEs and the need for their privatization taking into account also experiences of other transition economies, and (b) to induce an improvement in transparency, accountability and especially encouraging public policies aimed at successful completion of this important process. Main motivation behind this report is that the government has move forward with this process without sufficient consultation resulting in many concerns during last two years . The Government first announced that privatization will be completed during 2008-2009. The public opinion and electronic press and media discussions have been pro et contra and raised questions such as: (1) Is this the best timing for fast privatization of three main POEs , having in mind the global financial crises ? (2) Is the government implementing the best model and has it learnt any lessons from the experience of other countries? (3) Are proper procedures for transparency and accountability in place? (4) How will the proceeds from privatization be used and finally (5) is there a necessary legal frame in place to ensure fair, transparent and accountable privatization.

Despite these concerns there has been no proper and well founded debate initiated by public institutions (the Assembly and Government) or by other stakeholders, civil society and academia. In fact there has been a feeling that government is trying to keep this issue within a relatively narrow circles. This has to be overcome and wide ranging debates have to be organized in the society. This debate should aim at building a basic consensus of key stakeholders related to this issue. This is a precondition for ensuring necessary political support for this important process and avoiding potential political and social tensions that could compromise the policy or delay the privatization of POEs. The authors of this report believe that the privatization of POEs is more than necessary and long overdue as they equally insist that it should be well embedded in appropriate legal framework which should ensure adequate procedures and policies, transparency and accountability and contribute to accelerating economic growth and sustainable development.

The report is organized as follows: The *second chapter* contains the legal framework for privatizing POEs in Kosovo. The *third chapter* describes the experiences of other Transition Economies in privatization and concession of similar industries and current situation in PTK, KEK and PIA. Appendices include two case studies from Albania and Macedonia on privatization of similar companies.

Methodology:

This Report is prepared based on primary and secondary data. We undertook a background search on relevant sources involving an initial review of existing reports and other available information from web-sites. We focused on the Kosovo Energy Corporation (KEK), Post and Telecom of Kosovo (PTK) and Prishtina International Airport (PIA). The desk research of each case then produced a series of questions which formed the basis for developing a questionnaire used in interviewing the managers of POEs and Ministers. Face-to-face semi-structured interviews were conducted with managers of POEs and line ministers based on the information needed to complete this report. The authors regret that during the preparation of this report, several of their attempts to meet with managing director of PTK or other persons in charge have failed.

We are grateful to ministers Ahmet Shala, MEF; Justina Pula, MEM; Fatmir Lima, MTPT and also to managing directors of POEs (Mr. Arben Gjukaj, KEK and Mr. Agron Mustafa, PIA) for sharing their thoughts and considerations about this issue. Two other case studies addressing the privatization in similar industries in Albania and Macedonia were compiled by our consultants (Entela Shehaj, PhD and Hyrija Abazi PhD Cand. respectively) in cooperation with the project team. Riinvest thanks all parties involved in preparation of this report for their contribution while it takes the entire responsibility for its findings and conclusions. We would also like to thank professor Iraj Hashi from Staffordshire University for his contribution in this project especially for his contribution in the part of the report that deals with privatization through concessions. We also thank BTD for supporting this project and also 'Forum 2015' for initiating this research and debate.

2. ANALYSIS OF THE LEGAL FRAMEWORK FOR PRIVATIZING PUBLICLY OWNED ENTERPRISES

General Introduction

Privatization of Publicly Owned Enterprises (POE) has proven to be a difficult process, regardless in which part of the world it has occurred. Nevertheless, when deemed necessary, POE must be privatized for several reasons, including but not limited to improving performance and efficiency, fostering improvements and strategies that are not necessarily politically safe, increasing accountability and hampering corruption, increasing market discipline and response, and reducing political influence.

The best way to alleviate potential difficulties with privatizing POE, is to prepare a proper legal framework and commitment by the governing institutions to implement same. Naturally, as with any other grand project, accountability and full transparency are paramount to achieving any kind of success.

The Republic of Kosovo has enacted some legislation with regard to privatization of POE and remains to be seen whether such legislation is sufficient and importantly, whether such legislation will be implemented fully. An analysis of the legislation that supports the aforementioned is provided in this writing. As it will be fathomed from the underlying analysis, the legal framework that is supposed to govern the privatization of the POE has its positive aspects and its downfalls.

Privatization of Socially Owned Enterprises

The Republic of Kosovo has had some experience with privatization, specifically with regard to the privatizing of Socially Owned Enterprises (SOE). The privatization of SOE has achieved considerable progress but also in several aspects it has been a dubious process, at best.[□] Indeed it occurred at a time of uncertainty with regard to ownership over SOE. Without delving into too much detail, the privatization of SOE was ordered by UNMIK (which prepared the necessary legal framework) and was exercised by the Kosovo Trust Agency (KTA), under the understanding that the SOE were property of Kosovo and to some degree of SOE's respective employees.

Majority of SOE have been already privatized under such legal framework and by the same entity. After the declaration of independence by the Republic of Kosovo, steps have been undertaken and the Law on Privatization Agency of Kosovo[□] was adopted, thereby creating the successor to the Kosovo Trust Agency, the Privatization Agency of Kosovo (PAK). Under this new law, PAK was given the authority to administer, and thereby privatize, SOE that exist in Kosovo. As a result, PAK continues privatizing the SOE that still need privatizing and have not been privatized by the KTA, therefore, it continues operating as a continuation of the work and processes that were once performed by the KTA. As it will be seen, the KTA does not have any authority with regard to POE. The authors consider that during the process of privatization of the SOEs important experience has been accumulated

and human capacities has been built that could be better used during the process of privatization of POEs.

2.1 LEGAL FRAMEWORK FOR PRIVATIZING PUBLICLY OWNED ENTERPRISES

There are two ways to place a POE into private ownership. First, the POE could go through the process of the traditional privatization, or better said undergo the sale of shares of a POE to a private entity. However, on the other hand, the POE could be placed into private hands through a public-private-partnership and/or concession to build, use, and/or exploit publicly owned infrastructure and to provide public services. These two methods are addressed respectively, with greater emphasis on the first.

2.1.1. Privatization

The legal basis for fully or partially privatizing a POE in the Republic of Kosovo can be found in the Law on Publicly Owned Enterprises ("Law on POE").¹ To wit, the Law on POE speaks of "sale of shares," that can be interpreted that this law permits the partial or full privatization of the POE in question, depending on the decision of the Government.

The sale of shares is possible because the Law on POE, specifically Article 4, requires that at this point in time all POE should be organized as Joint Stock Companies ("JSC"). Under the Law on Business Organizations,² namely Article 126, a JSC "is a legal person that is owned by its shareholders but is legally separate and distinct from its shareholders." The JSC under the Law on Business Organizations is similar to the corporations one may find in EU member states or the United States, with minor changes and less sophistication.

In the case of a POE, the only shareholder in Central POE is the Republic of Kosovo, whose shareholder rights are exercised by the Government of the Republic of Kosovo.³ The Law on Business Organizations does not restrict the transfer of shares by the Government of the Republic of Kosovo to any other entity.

Specifically, Article 9 of said law governs the privatization of Central POE.⁴ Thus, a covenant must be stated that the law does not speak as to the privatization of the Local POE, however, this problem does not concern this writing because its purpose is the analysis of the legal framework for privatizing Central POE.

1 Law No. 03/L-087.

2 Law No. 02/L-123.

3 Article 5 of the Law on POE.

4 Pursuant to Article 3.1 of the Law on POE, Central POE are enterprises identified in Schedule 1 that is attached to the Law on POE.

According to Article 9.1 of the Law on POE, the procedure for privatizing a Central POE is as follows: 1) the Government adopts a written decision authorizing a Government Privatization Committee (GPC) to proceed with the tendering and selling of POE's shares; 2) the Government's decision is approved by a simple majority vote of the Assembly of the Republic of Kosovo; and 3) the GPC proceeds with tendering and selling the shares, namely with the full or partial privatization of the POE.

Article 9.2 of the Law on POE determines that the GPC shall be comprised of five members, specifically 1) the Minister of Economy and Finance, who is also the Chair of the GPC; 2) the Minister of Trade and Industry; (3) the Minister of the Ministry having the POE in question under its policy-making authority; (4) two other Ministers that are appointed by the Government. One of the members of the GPC must come from a non-majority community. For the most part, the GPC operates within the Ministry of Economy and Finance and is supported by a Secretariat, which is also within the Ministry of Economy and Finance.⁵

Pursuant to this law, the tendering and sale of shares in a Central POE must be done in an open, transparent and competitive procedure; however, such procedure is left up to the GPC to determine.⁶ The law simply states that this procedure must be at a minimum in compliance with the procedural requirements of the Law on the Procedure for the Award of Concessions.

Resultantly, a GPC that is charged with the selling of the shares of a POE must develop a procedure that at least follows the procedure for the awarding of concession contracts by public authorities. The procedures for such concessions are detailed in Articles 5 through 27 of the Law on the Procedure for the Award of Concessions.⁷ According to those articles, among other things, 1) the GPC must pre-select the bidders, which could be consortia; 2) the bidders must meet the objectively justifiable criteria that the GPC considers appropriate in the particular proceeding; 3) the GPC must make a decision on pre-selection in accordance with the criteria; 4) the bidders must submit proposals, which shall include certain information; 5) the GPC must set the parameters for the bidders to put forth securities for their proposals; 6) the GPC presets the evaluation criteria for the bids, which are at minimum in conformity with Article 14 of the Law on the Procedure of the Award of Concessions; and 7) the GPC makes a decision based on those criteria and/or engages in further negotiations, as permitted by this law.⁸

As evident, the PAK has been eliminated from the procedure of privatizing POE, irrespective of its experience in privatizing large enterprises. The privatization of POE has been thus transferred to the Government, with significant powers to the Ministry of Economy and Finance. What is more, it seems that the Law on POE permits

5 Article 9.3 of the Law on POE.

6 Article 9.4 of the Law on POE.

7 Law No. 02/L-44.

8 For a detailed statement of the requirements for the award of concessions, and thereby by reference, for the privatization of a POE by the GPC, please see Articles 5 through 27 of the Law on the Procedure for the Award of Concessions.

the formation of respective GPC for the privatization of each POE.⁹ Therefore, the privatization of each POE will have its own GPC.

2.1.2. PPP and Concessions

Another way to have a POE privatized is through a Public-Private-Partnership or privatizing a POE short-term by giving it in concession. The Law on Public Private Partnerships and Concession in Infrastructure and the Procedures for their Award¹⁰ (“PPP Law”) deals specifically with this issue. The purpose of the PPP Law is to assign the legal framework for the granting public-private-partnership and concession to build, use, and/or exploit publicly owned infrastructure and to provide public services.¹¹ Specifically, the PPP Law “governs the rights to utilize and/or exploit publicly owned infrastructure and/or provide public services in all economic and social sectors.”¹²

As envisioned by Article 2, the PPP Law applies to a wide range of areas, including but not limited to transport, energy, heat, water, telecommunication, education, health, and many more. Resultantly, arrangements could be made between the Republic of Kosovo and a private entity to either enter into a partnership with regard to ownership and management of a certain public-private entity, or simply give the entire entity to a private person in concession, and each for up to forty years.¹³

The process for realizing a PPP or giving a POE in concession to a private party is strictly government run. According to Article 6.1 of the PPP Law, PPP and Concessions “shall be granted by the Public Authority¹⁴ which, based on the law, is directly responsible for the economic activity which is the object of the Agreement.” However, with prior approval of the Government, the Public Private Partnerships Inter-ministerial Steering Committee (PPP-ISC) has the authority “to act as a Contracting Authority and grant concession and other rights to build PPP, use, and/or exploit a public Infrastructure Facility.”¹⁵ The PPP-ISC is established to control and

9 According to Article 9.1 of the Law on POE, the “. . . Government adopts a written decision authorizing a Government Privatization Committee to proceed . . .” (emphasis added), which could be interpreted to mean that a different GPC must be formed for every respective privatization of a POE.

10 Law No. 03/L-090.

11 Article 1 of the PPP Law.

12 Article 2 of the PPP Law.

13 Article 8 of the PPP Law. Arguments have been made that the forty year period should be reduced to twenty-five year period because twenty five years are sufficient for a private entity to receive a healthy return on investment. This approach would avoid exposing the Republic of Kosovo to losses that stem from longer agreements without having the opportunity to reassess its position. See 15 April 2009 Letter to President of the Assembly, Mr. Jakup Krasniqi, from Prof. Muhamet Mustafa and Mr. Luan Shllaku (on behalf of Forum 2015).

14 Public Authority is defined in Article 4 of the PPP Law as “(i) a central, regional, municipal or other executive authority, public body, ministry, department, agency, or other authority that exercises pursuant to any normative or sub-normative act, executive, legislative, regulatory, public-administrative or judicial powers; (ii) a body governed by public law; and (iii) an association of one or more such authorities or bodies.”

15 Article 6.3 of the PPP Law.

coordinate PPP Projects in all economic and social sectors, which is chaired by the Minister of Economy and Finance, who also directs and coordinates the activities of the PPP-ISC.¹⁶

The PPP-ISC is a powerful body with regard to PPP and awarding of concession. Indeed, it is the decision-making authority in that regard.¹⁷ Pursuant to Article 12 of the PPP Law, the PPP-ISC provides leadership in the development of PPP policies and programs, and makes recommendations to the Government for its consideration and adoption. Furthermore, said body *inter alia* also manages the national PPP program, develops policies, issues implementing regulations regarding rules and standards for PPP projects and project documents, reviews and approves/disapproves project proposals on the basis of value-for-money and other considerations, acts as Contracting Authority on specific projects, etc.¹⁸ As with the GPC, the PPP-ISC is supported by a Secretariat within the Ministry of Economy and Finance, in accordance with Article 13 of the PPP Law.

Assembly role in the PPP and concessions procedure is non-existent, however, they do receive an annual report on Concessions and PPP. In accordance with Article 2.6 of the PPP Law, the Government through the Minister of Economy and Finance, as representative of the PPP-ISC, prepares an annual report on Concessions and PPP and submits it to the Assembly.

Simply put, the PPP partnership and concession is time limited method of privatizing fully or partially a POE. The decisions in this regard are made by the public authority in charge or, if it so chooses, the PPP-ISC. What approach the Government takes on privatizing a POE depends on many factors, including but not limited to economic, social and political factors.

2.2 ANALYSIS OF THE LEGAL FRAMEWORK WITH REGARD TO PRIVATIZATION

Now, the process of privatizing the POE has begun with the enactment of the Law on POE and the PPP Law. There are many benefits to having enacted both laws because they provide the basic necessary elements for beginning the privatization process for POE. The PPP Law is especially appropriate and well drafted, despite it giving too much power to the Government, specifically the Minister of Economy and Finance as the Chair of the PPP-ISC. Despite the imbalance of power, the PPP Law provides a good basis for initiating public-private-partnerships or awarding concessions. In fact, majority of the legislative defects come from the Law on POE, which deals with privatization of POE in the traditional sense, which have the possibility of marring the privatization of POE.

16 Article 11 of the PPP Law.

17 The Government becomes a decision-maker in this regard if there is a jurisdictional conflict between various public authorities. Such a conflict exists with the concession of the Prishtina Airport, where the public authority could be the Ministry of Post and Telecommunications, the Ministry of Internal Affairs, or the Ministry of Economy and Finance.

18 The rest of the competencies of the PPP-ISC are fully listed in Article 12.

To begin with the positive aspects of the Law on POE, it is absolutely necessary to provide the legal basis for transferring ownership of the POE from the government of the Republic of Kosovo, which have thus far either underperformed or have not reached their full potential. The legal framework allows for this process to begin, provided that the Republic of Kosovo decides that such POE should be transferred into private hands. If implemented properly, these laws have the potential to successfully carrying out the privatization of the POE.

On the other hand, there are several shortcomings that could potentially harm the privatization process for POE. First, the privatization of the POE has been completely removed from the body that already has substantial expertise with regard to privatization, which is PAK. Article 9 of the Law on POE, places the entire privatization process in the hands of the Government and envisions the formation of individual GPC for the privatization of each POE, and a Secretariat within the Ministry of Economy and Finance to support the work of the GPC. Indeed, Article 9 requires the formation of a new PAK (the Secretariat), within the Ministry of Economy and Finance, to manage strictly with the privatization of the POE.

Second, the Law on POE takes away the decision-making from a professional body (the PAK) and hands it over to a GPC, which is a political entity, comprised entirely of Government members, specifically ministers. This could harm the process of privatizing the POE and make it susceptible to political influence and improprieties. The process is in fact Government run, with the exception of an approval of decision on whether to embark on privatization or not by a simple majority vote¹⁹ in the Assembly, without any oversight later. There is no guidance as to what should be included in the Government proposal for the privatization of a POE that is sent to the Assembly for a vote. Nor is there any guidance as to what kind of decision should the Assembly make, simply provide a yes or no, or delve deeper by determining issues that are related to the privatization of specific POE, such as policy and strategy for privatizing said POE.

The Assembly therefore is removed from any debate on the issue and serves simply to rubber stamp decisions made by the Government, specifically the GPC. Considering the fact that the members of the Assembly are the only ones elected from the citizens of Kosovo, the removal of the Assembly from this process practically eliminates the only persons that are directly accountable to those that are supposed to benefit from the privatization of the POE, namely the people of Kosovo. Thus, an amendment to the law is necessary so that the role of the Assembly is enhanced with respect to making the decision on whether to privatize (or sell the shares) a POE, but also with regard to where the proceeds should go, what percentage of the POE should be privatized, etc.

¹⁹ In practice, the Assembly has voted on matters when they have one half of all 120 members, namely 61 members of the Assembly, present at the time of the voting. Once that quorum has been reached, the Assembly has made decisions based on the vote of the majority of the members that are present and voting. As a matter of practice, decisions by the Assembly require at least 31 members to vote for such a decision, however, it is conceivable that a decision to privatize a POE could be made by less than 31 members because although 61 members could be present, some of them may choose to not vote.

In the same manner, with regard to PPP and Concessions, the Assembly is even further removed from the process, to the extent that they are simply kept abreast of PPP and Concessions activity in Kosovo through an annual report that is presented to the Assembly by the Government, by way of the Minister of Economy and Finance as the head of the PPP-ISC. While Assembly's involvement in every PPP and/or concession contract would not be efficient, in areas that substantially affect Kosovo and its people, it would be appropriate to have Assembly's involvement to an appropriate level. Further more Assembly is not in a position to monitor properly the privatization process of POEs. The reporting of government via Assembly is not clear and well defined .

Third, in determining the procedures on how the POE privatization should be run, the Law on POE refers to the Law on the Procedure for the Award of Concessions as the minimum standard without providing any additional detail. The drafting of these important procedures is delegated down to the GPC.²⁰ As a result, this affords room for inconsistencies between procedures in privatizing different POE because individual GPC are formed for the privatization of each POE. Further, with no pre-set parameters, the privatization of a POE could potentially be done in an improper way, thereby requiring re-privatization, which reduces investor confidence and adds to the cost of privatization. With regard to PPP and concessions, the procedures are pre-set in the PPP law and the Law on the Procedure for the Award of Concessions.

Fourth, understanding the specifics of individual POE, many other countries have enacted specific laws to deal with the privatization of individual POE, as has been the case in Albania. Having made only one law, indeed only one Article, that deals with the privatization of POE, the legislators have ignored the need for targeted attention to individual POE. As in many other countries, the privatization of large and important companies should be undertaken according to specific legislation passed for each particular sector or company.²¹ The passage of specific laws allows a proposal to be debated not just in the Assembly but in the wider society by professional groups, academics, researchers and the media.

Fifth, neither the Law on POE nor the Law on PPP provides any guidance regarding how the proceeds from the privatization or PPP/concession of a POE should be allocated or expended. The Law on POE does not even mention anything with regard to this matter. On the other hand, the Law on PPP provides the PPP-ISC with sufficient latitude to inter alia manage the national PPP program and develop general PPP policies, which could be interpreted as allowing this body to make such decisions.

And last but not least, the SOE privatization process reduced investor confidence because it was plagued by accusations of corruption and conflicts of interest. The lack of implementation of anti-corruptive laws and measures affected the privatization of SOE and, if it continues the same, will negatively affect the privatization of POE as well. Thus, if investors are to be attracted, the authorities have to perform

20 Article 9.4 of the Law on POE.

21 In the United Kingdom, the country with the most successful privatization record, there were specific laws regulating the privatization of individual utilities (e.g., the bill entitled "New Opportunities for the Railways: The Privatisation of British Rail, 1992" that regulated the privatization of British Rail).

better in ensuring lack of corruption and eliminate all conflicts of interest. Furthermore, the Assembly role in privatization has to be increased in order to provide sufficient transparency and professional debate.

3. PRIVATIZATION AND CONCESSION OF STRATEGIC COMPANIES IN TRANSITION ECONOMIES

In the last two decades, many countries around the world (developed, developing and transition economies) initiated the reform of utility industries aiming at improving the efficiency of these companies through competition and private ownership (Lieberman, 2008). The reform of utilities refers to, and involves, a variety of measures ranging from vertical separation of different activities of integrated companies, introduction of competition at various levels of operation, and the privatisation of different parts of a utility, often to different owners. Traditionally, the 'natural monopoly' characteristic²² and the 'public service' feature of utilities meant that they were treated differently from other SOEs. In most transition economies the privatization of these industries, which were classified among 'strategic industries', took place later and proceeded more slowly than that of the other sectors of the economy. Furthermore, the privatization of utilities also created the need for an effective regulatory framework that will protect consumers from the exercise of monopoly power by private producers and the producers from future expropriation by the government (Megginson, 2005). In this section we will first present some features of the privatization through concessions (3.1) before we move on to consider the experience of other transition economies in the reform and privatisation of telecommunication in Transition Economies (3.2.1) and Kosovo (3.2.2), electricity supply in Transition Economies (3.3.1) in Kosovo (3.3.2) and airport concessions in Transition Economies (3.4.1) and Kosovo (3.4.2). The lessons of reform in these activities are equally applicable to other utilities too.

3.1 Privatisation of infrastructure services through Concessions²³

The restructuring and privatisation of infrastructure services (power generation, water treatment, roads, airports, ports, etc.), or the involvement of the private sector in the provision of these services, is now broadly accepted as a preferred option to their public ownership and provision. Over time, it has become clear that the state owned enterprises providing infrastructure services are unable to make efficient use of resources or produce high quality services. They are sometimes a major drain on public resources (despite their monopoly position) and usually in need of a large amount of resources to improve their conditions. A common feature of economic policy in most developed, developing and transition economies is that utilities

22 In many countries, it was believed that utilities had a significant natural monopoly element but developments in economic theory and technological innovations of the last two or three decades (in particular mobile telephony, digital technology, small and efficient electricity generators, etc.) have established that only a small part of the operation of utilities (the transmission and distribution networks) rather than production and sales, were associated with natural monopoly.

23 Terms such as 'leasing', 'franchise' or 'affermage', used in the privatisation literature, refer to the same concept and practice as 'concession'.

and other infrastructure projects should be subject to unbundling (restructuring and vertical separation) and eventual privatisation in order to improve efficiency, quality of services and consumer welfare. In some cases, especially in less developed countries, the existing infrastructure facilities are very poor and there is considerable uncertainty about private sector interest in their privatisation. The state may not be willing or able to divert its scarce resources from other needs and use them on large scale investment projects to upgrade or build these facilities.²⁴ In these cases, the 'concession route' presents an attractive opportunity to engage the private sector and to benefit from its involvement: the private sector will use its own financial, technical and managerial resources to build and operate the infrastructure facility for a period of time long enough to recoup a reasonable return on its investment.

Concessions became a popular method of attracting and utilising private sector resources for infrastructure projects in the 1980s, initially in Latin American and Caribbean countries and in many countries all around the world – some 2500 concessions were set up in this period.²⁵ In fact, between 1990 and 2000, the concession route was a much more prevalent and popular method than outright privatisation. Of 849 private sector participation projects in this period, 65% were through concession agreements. The proportion was much higher in areas such as transport activities (98% of all projects in this sector), water and sanitation projects (89%), energy facilities (54%); and much less in sectors such as telecommunications (only 3%).²⁶

Concession involves granting the exclusive right to operate a publicly owned infrastructure company and to benefit from it for an agreed period in return for an 'investment commitment' and 'a quality of service commitment'. Sometimes, the concessionaire is expected to build the project from scratch or rebuild and modernise an existing facility and operate it for a number of years before transferring it back to the state (build, operate and transfer –or BOT- projects). At other times, the concessionaire builds the project from scratch, owns and operates it under a license from the government (build, own and operate –or BOO- projects). The license has to be reapplied for at the end of the period of concessions.

How does concession work? A concession is governed by a long term contract between the state (or a state agency or a ministry) and the concessionaire according to which the concessionaire operates the facility exclusively for a period of time (which may be renewable), undertakes the necessary investment to ensure the provision of service at an appropriate (or agreed) quality level specified in the contract, obtain its required inputs at reasonable prices and can sell its output (or a part of it) also at reasonable prices subject to a regulatory process based on a rate of return or price-capping mechanism to ensure a fair return on its investment. The contract may stipulate that the concessionaire be compensated for the un-depreciated part of its investment in the latter phase of the project (in order to avoid underinvestment). At the end of the contract period, the facility will be returned to the state (or the agency) who may search for another concessionaire to develop and operate the facility.

24 Concessions are particularly attractive in countries where for political reasons, certain activities have to remain in the formal ownership of the state or where the Constitution prohibits their transfer to private ownership. This is, of course, not the case in Kosova.

25 Harris (2002)

26 See Guasch (2004), p. 25.

The criteria for bidding. The concession agreement establishes the criteria or bidding which may vary in different activities: it may be a 'transfer fee', an 'average tariff', or a 'reduction in subsidy' – together with an investment commitment and a quality of service commitment. If the facility is a profit making unit, then the criteria will often be the highest transfer fee (annual payment by the concessionaire to the government). If the facility is a loss making unit, the criteria will be who agrees to operate the facility with lowest subsidy or offer lowest tariffs. In some cases a combination of these criteria may be used. The selection process is complicated by the fact that the bidders not only have to make an offer for the specific criteria but also an investment offer. The terms of the concession should clearly indicate the weights attached to different elements of the bid.

Concession and competition. Although granting the exclusive right to operate an infrastructure facility is not compatible with competition, it is possible to generate a competitive outcome if the concessionaire is selected through competitive bidding: while it may not be possible to have 'competition in the market' for infrastructure services such as roads, airports, railroads, etc., it is possible to have 'competition for entry into the market' and ensure that the outcome is similar to that of a competitive (or contestable) market. This is achieved by choosing the concessionaire through bidding where companies compete with each other for the right to operate the facility, offering better prices, higher investment or better quality of output (or a combination of these).²⁷ Indeed, successful concessions include a 'pre-qualification' stage where, initially, on the basis of a number of conditions and criteria, a number of bidders are selected from a pool of applicants in order to eliminate unserious and rogue contenders. The selected bidders would then submit detailed bids on the level of investment, quality and prices.²⁸

Competitive bidding (and re-bidding) is the fundamental element of effective concession; if, for any reason, some of the short listed companies pull out of bidding, there is a serious danger that the remaining bidder(s) will take advantage of the situation and extract concessions unfavourable to the government.²⁹ For concessions of long duration, re-bidding is essential if regulatory capture and entrenchment is to be avoided (for example in the Argentinean power sector, the concession is for 95 years but there is re-bidding after 15 years and then after every 10 years). Re-bidding is necessary even for BOO schemes where the private company owns the assets. The company needs a license to operate the facility (such as airport) and it has to compete for it every 10-12 years to ensure that it does not act like a monopolist. If the license is revoked and offered to another company through competitive bidding, then the original company would be fairly compensated.

27 In his classic paper 'Why Regulate Utilities', Harold Demsetz (1967) suggested that goods or services regarded as natural monopolies can be produced by offering a franchise to private operators selected through competitive bidding. In the bidding process, the competitors will offer to produce the good or service at a competitive price and, provided the bidding process is repeated every few years, they will have an incentive to honour their agreement once they are given the license to produce that good or service.

28 See Newbery (2000) for a detailed discussion of different stages of the implementation of a concession agreement.

29 In some cases, especially when there is little interest from private investors for participation in an infrastructure project, direct negotiation between the government and the potential contractor(s) may replace competitive bidding. Although competitive bidding is preferable to direct negotiations, the latter may be inevitable in some cases. Here, the government should try to maximise transparency and ensure that the contract is designed well.

What are the pre-requisites of concessions? In order for a concession to work effectively, it must be preceded by restructuring and unbundling of integrated infrastructure companies (to identify clearly defined and technically independent units) and the establishment of an independent regulator. The experience of former socialist countries, and that of the developed market economies, has demonstrated that microeconomic reforms (for any company, particularly utilities) must begin with their restructuring: unbundling and vertical separation of integrated companies, and creating conditions to change their incentive system and thus their behaviour. On the other hand, the exclusive right to operate a facility for the duration of the concession bestows a monopoly position to the concessionaire. In most cases, the facility also involves some natural monopoly element which makes competition (in the sense of several operators competing with each other) undesirable or impractical. This calls for the establishment of an independent regulator to ensure that the concessionaire meets its investment and quality commitment and also earns a fair rate of return (with sufficient mechanisms to encourage efficiency).

The regulatory process. Given the monopoly nature of concessions, and the granting of exclusive rights to the concessionaire, it is essential that a suitable regulatory process is designed for a concession. The regulation may take the form of 'rate of return regulation' or 'price capping regulation'.³⁰ In some cases the concessionaire has to buy its inputs from another monopoly (often the state). The terms of the contract should specify the methodology for the way input prices are fixed or changed (to create certainty for concessionaires). For example in Albania, the concession agreement with the distribution company establishes that the state owned electricity generating company will be subject to regulation by rate of return, a maximum of 4%.

Given the advantages of regulation by price capping, it has been the main form of regulation in previous concessions, with the rate of return regulation used in a much smaller number of cases. In many cases, a combination of both methods was utilised – price capping with many automatic pass-throughs allowed.³¹

Hold-up and opportunistic behaviour. The most important problem in the operation of a concession is the possibility of hold-up and opportunistic behaviour. As concession contracts are long term and subject to many uncertainties, it would be very difficult to foresee all contingencies that may affect the relationship between the government and the concessionaire. The contract would, by nature, be an 'incomplete' contract with both sides able to engage in opportunistic behaviour, trying to renegotiate the terms of the original contract in their own favour. On the one hand, the market is served by one dominant provider who is in a position to exert pressure on the government by reducing or halting production (hold-up), claiming that changed conditions require a change in the terms of the original contract. On the other hand, the government (especially in the periods before or after elections) may find it opportune to accuse the provider, and/or the government which granted the

30 The former establishes a fair rate of return and allows the firm to charge prices which yield that return. The process is subject to a periodic review (3-5 years). The latter allows the firm to increase its tariffs in line with inflation minus an efficiency factor (to share any efficiency gain with consumers). This is referred to as 'RPI-X', with the value of X being set by the regulator every 3-5 years.

31 A study of concessions in Latin America and Caribbean countries showed that of 895 concessions between mid-1980s and 2000, price capping was used in 56% of cases, rate of return in 20% and mixed methods in 24%. For details, see Guasch, et al. (2004), p. 15.

concession in the first place, of malpractice and demand a change the renegotiation of terms of contract. The government may think that with a large sunk cost, the concessionaire is unlikely to leave the market early and therefore may be subject to pressure. An effective concession agreement should provide for periodic reviews and specific triggers that may require a review. Otherwise, in general, the contract renegotiation should be resisted.

Concession and outright privatisation. While the aims of the two methods are the same (higher efficiency through the engagement of the private sector and its technical and managerial know how and expertise), there are important differences in the operation of the two methods. Under concessions, the government retains the ownership of land and assets, and remains involved with the service through the process of compliance monitoring, tariff control, quality of service control and potential renegotiation. The responsibility for investment and for various risks (labour risk, revenue risk, cost risk, management risk) are assumed by the concessionaire. With privatisation, the ownership of the assets and the responsibility for their management, together with all risks fall completely on the private owner.

Is there an optimum length for concessions? The concessionaire undertaking large scale investment in an infrastructure expects to receive a reasonable return on its investment. A concession contract must be long enough to provide sufficient incentive for the concessionaire to make the required investment and to recoup its investment plus a reasonable return. If the contract period is too short, the incentive to invest a large amount is weak. If the period is too long, there are dangers of entrenchment (one producer establishing itself on the market and acting as a monopolist) and capture (a long term incumbent will establish close relations with the government agencies and ensure their policy is aligned to its interests). Usually concessions are of 15 to 20 years length, though longer ones are also in existence. For example, there are 30-50 year concessions for railways in Argentina, Brazil and Mexico, and 95 year concessions for large power sectors in Argentina (though the latter involves re-bidding for the license after 15 years and then every 10 years).³² Of course a company may not be able, and may not wish, to recoup all its investment by the end of the concession. In addition to its investment in facilities, the operator also increases the value of its business by developing its expertise and reputation and the human capital of its staff. Furthermore, given the fact that large scale projects require continuous investment, it would not be possible (or advantageous for either the company or the government) to allow the full depreciation of all investment. In order to ensure that the investor will maintain its commitment and good practice to the end of the period, the concession contract should provide for the compensation of the investor for its un-depreciated assets, know-how and reputation at the end of the concession.

Drawbacks of concessions. Because not all contingencies can be accounted for, some decisions have to be relegated to future negotiations, leaving room for bargaining, corruption, pressure from the stronger side, etc., resulting in inefficient outcomes. Governments (especially recently elected governments) can be put under pressure by the incumbent contractors (who have the experience of running the infrastructure and more detailed information than the government), using this as a lever to force renegotiation (which usually is not in favour of the government). Contracts are generally complex and allow room for negotiation and appeal to courts. Therefore the contract should stipulate clearly the situations that would require renegotiation of some parts of the contract.

32 See Cheviakhova, et al.(2007), p. 10 and Guasch (2004), p. 28

In the last years of the contract, the company may not have sufficient incentive to invest as it is not sure whether it will recoup its investment. The latter disadvantage can be overcome by ensuring compensation at the end of the period linked to undepreciated investment and the state of the company – an incentive for the private company to maintain the assets well).

Both the government and the concessionaire may also try to ignore the terms of the contract by charging excessive tariffs, being unresponsive to customers' complaints, producing low quality output, refusing to index prices or increase them as agreed. These are usually preparations for renegotiation. There is also the possibility that the concessionaire may abandon the business due to bankruptcy, or the government to take it over.

Concession operations are riskier than normal business activities, especially in countries where the institutions of a market economy are not well entrenched and where there is greater likelihood of state intervention. Concessions are riskier for concessionaires and their financiers. Land and assets cannot be used as collateral since they do not belong to the contractor. The only collateral is the right to future revenue; which depend on the degree to which the government honours the agreement. So the cost of capital is higher and a higher revenue stream is necessary for the provision of the service – that is, the service would be costlier to the government or the customers. It is estimated that these risks increase the cost of capital by 2-6%, depending on the country and sector.³³ Investors considering bidding for a concession are aware of these risks and will be persuaded to enter the process only if risks are explicitly recognised and taken into consideration when setting the criteria for bidding.

The biggest problem, however, remains the potential attempt to renegotiate the contract as it undermines the competitive bidding process on which the contract was based.

Which contracts are more likely to result in renegotiation? The experience of other countries shows that many concessions are renegotiated, usually in favour of the concessionaire and at a cost to the consumers or government. The study of over 1000 concessions in Latin America and Caribbean countries, referred to above, identified the elements contributing to the likelihood of renegotiation.³⁴ Most importantly, the study highlighted the drawbacks of concessions: 41% of concessions were involved in renegotiations; 61% of renegotiations were initiated by the operator, 20% by governments and 24% by both. Renegotiations were more likely if the concession contract awards: were based on the lowest proposed tariff rather than on the highest transfer fee; contained investment requirements than when they included performance indicators; were based on price-cap regulation than rate-of-return regulation; were agreed when a regulatory agency was not in place than when one was in place; were in the form of a contract than when embedded in a decree or a law. The following table shows summarises these factors quantitatively.

33 See Guasch and Spiller (2001)

34 The authors use a probit model to estimate the impact of a range of factors on the probability of renegotiation. See Guasch (2004), Chapter 6 and Guasch, Laffont and Straub (2003).

Table 1- Factors contribution to, and the frequency of, contract renegotiation

Specific feature of the contract	Frequency of renegotiation (%)
Award criteria based on:	
Lowest tariff	60
Highest transfer fee	11
Regulation criteria including:	
Investment requirements	70
Performance indicators	18
Method of regulation used:	
Price cap	42
Rate of return	13
Existence of regulatory body	
Regulatory body not in existence	61
Regulatory body in existence	17
Type of agreement	
Agreement embedded in contract	40
Agreement embedded in decree	28
Agreement embedded in law	17

Source: adopted from Guasch (2004), p. 86. The study is based on over 1000 concessions in Latin

America and Caribbean countries between mid-1980s and 2000.

To sum up: the experience of over twenty years of concession agreements around the world should enable countries like Kosova to engage in concessions as a form of privatisation more effectively. A successful concession agreement requires careful consideration of the incentives of both parties, effective pre-qualification criteria to weed out speculative and rogue contenders, competitive bidding by a number of competitors and the insistence of both parties on the implementation of the terms of contract. The contract should explicitly identify conditions under which renegotiations are reasonable. Agreements should be embedded in legislation rather than a contract signed by a ministry or the government. In that way, it will not only be scrutinised by the parliamentary process but will also be less likely to be the subject of bargaining when a new administration takes office. Bidders offering terms which are 'too good to be true' such as the lowest tariffs or much larger investment than their rivals should be vetted more carefully. The restructuring of the sector should precede the award of concession to ensure that different stages of production are well delineated and the lines of responsibility and accountability are clearly separated. The help of international financial institutions should be sought in designing the contract and establishing the criteria for the award of the contract. Finally, the

whole process should be carried out with full transparency to minimise the possibility of capture and corrupt practices and the biggest contracts should have also Assembly (Parliament) oversight and decision.

3.2 Privatizing Telecommunication Services

3.2.1 Lessons learned from privatisation of Telecom companies in Transition Economies

Telecommunications companies have been highly profitable in most countries and, therefore, were at the top of the list of utilities to be privatised (Newbery, 1999). But despite their profitability, revenue generation and contribution to employment, they provided poor quality services and their performance was substandard. The restructuring and reform of the telecommunication sector was an important prerequisite for the development of the sector and the economy as a whole (Berlage, 1995). Modern telecommunication being one of the key service sectors that contributes to productivity enhancement and growth in other sectors became an essential requirement for the transition from a centrally planned to a market economy. Following this, it was exposed to the need to be adopted with rapid speed, changing the opportunities, open to other firms beyond recognition and rapidly turning previous technologies obsolete in many countries (Sallai et al., 1996; Megginson, 2005). In order to implement, adopt and benefit from these developments, huge investments in new technology are required to develop the necessary infrastructure and facilities, something which can be provided only by the private sector (often from abroad). Foreign investors will not only supply the technology and expertise but also management skills and access to foreign capital.

Privatization was, of course, only the initial step of a long process and its success was linked to the establishment of an independent and strong regulator who will encourage private sector involvement in the sector, facilitate the creation of a competitive environment, and protect consumers from the possibility of misuse of market power derived from their strong market position (Choi, 1995; Levy and Spiller, 1993).

By now, many countries have successfully completed the privatization of their telecom companies. Governments have used two basic methods for selling telecom assets: direct sale of all or part of the company to a single buyer through negotiation, or selling a proportion of shares of the company through initial public offerings (IPOs)³⁵. A majority of Transition Economies employed direct sale as a divesting method for privatizing their telecoms while Share Issue Privatization (SIP) was used only in few cases (like in Czech Republic, Estonia, Hungary and Poland). The former method is more prone to political pressure and corruption while SIP is more transparent and fewer are accompanied by scandals (Megginson, 2005). The latter method, however, requires a minimum level of development in financial markets and a stock exchange. Most governments have retained a proportion of their telecom shares for their own benefit or for later privatisation – when prices would have

risen and the sale would generate larger revenue for the state. Others have been reluctant to allow their share to drop below a certain level, usually 20 to 25 percent required for being a “blocking minority” shareholder. Some of these are even constitutionally prohibited from allowing their share to drop below this level (European Commission - World Bank, 2007; Megginson, 2005 p. 308). Following table summarises the privatization of telecom companies in selected Transition Economies (for more detailed summary, refer to Appendix 3).

Table 2: Privatization of telecomm companies in selected countries

Countries	Method of sale	Fraction sold
Albania	Asset sale	85%
Bulgaria	Asset sale	51%
Croatia	Asset sale	35%
Hungary	SIP	30%
Macedonia	Asset sale	51%
Serbia	Asset sale	49%

Source: Parts form Table 8.4 (Megginson, 2005)

While most countries sold controlling stakes of their telecoms, others retained the majority of shares or a Golden Share. Almost always, the buyers were foreign telecom companies, i.e., companies with experience of the field and also funds to invest abroad. Albania, for example, sold 85% of shares to Cosmote/Telenor Company, a consortium of OTE (Greece) and Telenor (Norway) and the payment was made in two tranches. Hungary sold 17% of telecom shares to Deutsche Telecom (DT) as early as 1993 while in 2000 the ownership share of Deutsche Telekom’s in Matáv increased to 59.52%, the remaining 40.48% are held by the public, while the Golden Share is held by the Hungarian state. Macedonia and Montenegro sold controlling stakes to Magyar Telecom which is itself majority owned by Deutsche Telecom (DT) who also bought a controlling stake in Croatia’s main telephone company after initially buying 35% in October 1999. Serbia on the other hand sold only 49% of its telecom to OTE of Greece and Italy’s Stet in 1997. Bulgaria retained its Golden Share despite selling over 50% of shares of its telecom to OTE from Greece and KPN from Netherlands (European Commission - World Bank, 2007; Megginson, 2005). By retaining the golden share in the company, the government retains the right to veto any strategic decisions.

3.2.2. Activities and issues related to privatization of Telecommunication in Kosovo (Post and Telecommunications of Kosovo - PTK)³⁶

Post and Telecommunications of Kosovo (PTK) was established on year 1959. UN-MIK regulation 2005/18 has given to the Kosovo Trust Agency the authority to transform public enterprises into corporations. On year 2005, KTA resolved to transform PTK enterprise into a Joint Stock Group, named Post and Telecommunications of Kosovo JSC. Whereas, on year 2008 based on Article 65 (1) of the Constitution of the Republic of Kosovo the Government of the Republic of Kosovo becomes new shareholder of Post and Telecommunications of Kosovo. This year, PTK was awarded with the contract for Albania's forth mobile telephony license in partnership with a consortium of local business. PTK, will own 30 percent of the new mobile operator, with the remaining 70 percent subdivided among the Tirana-based Union Group, Infosoft, Albania Drink Distribution and ACI Engineering. This activity may result in increasing the overall value of PTK.

PTK has four main business units:

- Post of Kosovo,
- Telecom of Kosovo,
- Vala – the Mobile Operator and
- DardaNet – an internet service business unit.

The four business units of PTK are licensed by Telecommunication Regulation Authority of Kosovo (TRA). PTK is also organized in several support units, which are: Financial Directorate; Commercial Directorate; Legal Office Directorate; Human Resources Directory; Training & Development Directory and Public Relation Department.

Postal Unit: Banking and Payments Authority of Kosovo ("BPK") has issued to PTK a non-banking financial license which enables the Post to offer cash payment and receipt services to third parties. On 15 May 2006, the Ministry of Transport and Communications have issued the License for providing Universal Postal Services to PTK.

Fixed Telecommunications Unit: The Fixed Telecommunications Unit is the only licensed network and service provider of fixed telecommunication services in the territory of Kosovo. Fixed Telecommunications Unit is also offering internet services from the year 2001, and today is one of three operators offering internet services in Kosovo, authorized by the Telecommunications Regulation Agency. Fixed Telecommunications Unit serves around 200,000 land line costumers. Currently, the Fixed Telecommunications Unit is using Serbia's fixed line dialing code. Lack of own dialing code may also result in decreasing the value of this unit.

³⁶ This part was written based solely on secondary data as we were unable to meet PTK officials.

Mobile Telephony Unit ("Vala"): Vala is the GSM mobile operating unit and is currently one of two licensed networks and service providers of mobile telecommunication services in Kosovo. Currently, Vala's service covers approximately 90% of the geographical territory and more than 85% of the population in Kosovo. Mobile phone revenues present the major source of revenues of PTK, making up more than 70% of PTK revenues each year. The share of this component has increased each year, from 62% in 2002 to 68% in 2004 and currently more than 70%. Mobile Telephony Unit Vala serves more than a million mobile service clients. As a result, Vala is the key business unit of PTK and is very attractive to foreign investors.

PTK entered into an agreement in 2000, to provide mobile services in Kosovo, with Monaco Telecom International ("MTI") which entitles PTK to use the MTI international dialing code and enables PTK to connect its mobile network to international networks. As a component of this agreement PTK compensates MTI with a share of revenues and pays certain international traffic costs. The Agreement covers the use of Monaco's International Dialing Code, International traffic, Roaming and technical know-how transfer. In addition the Agreement provides for a termination clause in the event that Kosovo acquires an International Dialing Code (IDC) of its own. It is very important that the Ministry of Transport and Post Telecommunications solve the problem of dialing code as soon as possible. The lack of own dialing code results in huge financial losses for PTK and Kosovo. The lack of own dialing code may also result in decreasing the value of this unit and PTK in overall.

PTK has a strong influence on the operation of other sectors of the economy as a provider of crucial inputs such as telecommunications. As a result, any improvements in its performance will therefore have a direct and strong impact on the economy and society of Kosovo. PTK, with approximately 3,200 employees, is one of the largest employers in Kosovo and is also the most profitable public company in Kosovo (more than 80 million euros of operating profit for the year 2008), its revenues increased continuously up to year 2007, and its operating profit increased by 148 percent during the same period. While on the other hand, there is a decrease in operating profit for the period 2007 – 2008, of around 17 million euros³⁷. This may be as a result of a decrease in revenues due to an entrance of new mobile operators in the market. Until recently, PTK essentially had a monopoly over telecommunications services in Kosovo. In December 2007, the Government licensed a second mobile operator, IPKO, while in 2008 the Government licensed two additional mobile operators, Dardafone and D3 mobile.

PTK's profitability is to a large extent due to its previous monopoly position and the simplicity in collecting revenues for its services. Nevertheless, apart from this success story in profitability measures, PTK has a ten years history which was also followed by mismanagement and corruption affairs. There is a lack of transparency regarding tender procedures, regarding the employment procedures (PTK is considered to be over-staffed and hence inefficient) and management salaries. Only during the last 12 months around 700 new employees were employed. This in turn jeopardises its sustainability and the value of this company. Continuously, there

37 PTK financial statements, published in web page

have been difficulties and the process was mainly politically influenced. In several reports published in Kosovo recent years³⁸, PTK is perceived by public at large as one of the institutions tainted with corruption³⁹.

As a result of this situation, there is a consensus among the stakeholders and the society for privatizing this company, but there are questions mainly on how to privatize it, is it the best moment for privatization, and with what kind of procedures and models?

Even though the Government announced the decision for privatizing PTK among other publicly owned enterprises in Kosovo, there is a lack of information, other than that, in this issue. According to the Minister of Economy and Finance⁴⁰, the only step forward in this regard is the announcement for RFP (request for proposals) for offering transaction advisory services for the structuring and execution of PTK private sector participation. Until now, the Ministry have not selected the "transaction adviser", that will advise them on the model of privatization. Even when the ministries select transaction advisers, public has no access on the background of those advisers and on the documentation prepared by those advisers. PTK itself not responded on our several attempts to meet with them and discuss the issue of privatization. In that regard, we need to emphasize, that there has been no public debates regarding the privatization of PTK until now and there was a lack of transparency regarding this process. Questions such as, what will happen with proceeds of privatization, will the Government keep some percentage of the shares, will the process of privatization include only Vala or Vala plus other units, still remain. The Ministry of Economy and Finance in its last Mid-Term Expenditure Framework (2010 – 2012), stated that the PTK will be entirely sold in the near future and that this process may result in the sale of assets in value of around 500 million Euro⁴¹. According to this document, those finances may be used for financing future public expenditures. We believe that setting values prior to any process of privatization may be harmful for the process itself. Instead of estimating value of assets, we would suggest that proper conditions for transparent bidding and fair competition of bidders are created without prejudice of the market value, because this may lead to misinterpretations by investors.

Our main recommendation on the initial phase of the privatization of PTK is that the Government should keep considerable percentage of shares on its ownership, up to the level that does not dis-encourages the potential investors. The main argument behind keeping some percentage of shares on public ownership is gaining dividend form the profits of PTK for some time and selling those shares at another time, when the value of shares will be higher.

38 "Early warning reports" by UNDP, "Corruption report in Kosovo 2004" by UNDP)

39 Former Director of PTK is sentenced to four years in prison, for corruption affairs.

40 Interview with Minister of Economy and Finance, conducted by the project team

41 Some experts, including former director Etrur Rrustemaj, have estimated the value of PTK about 1 billion Euro, Koha Ditore, June 2009.

3.3 Privatizing Energy Sector

3.3.1 Lessons learned from privatisation of energy sector in Transition Economies

The case for privatizing electricity is less straightforward partly because of the vertically integrated nature of electricity companies and the consequent complexities of combining generation, transmission and distribution of electricity (and sometimes even earlier stages such as coal mining) in one company, and partly because many of these companies in transition economies were, and remain, non-profitable due to technical loss, theft, unpaid bills, etc. It is now generally accepted, and adopted as general government policy in EU countries is the need for vertical separation of different parts of the integrated whole and the introduction of competition at the generation and distribution levels.

Electricity can be produced in different ways and using different technologies. There is no technological justification for the production to be concentrated in one company. Free entry at the generation level, therefore, is regarded as an important early measure in the reform process. The transmission stage, however, consists of the national grid network which constitutes the main natural monopoly element of the industry. Duplicating such network would be economically wasteful and, therefore, in most countries, the transmission system is owned and operated by a single state owned company.⁴² Finally, the distribution stage, which delivers the electricity to its industrial, commercial and residential customers, has some natural monopoly characteristics as it uses a physical network of wires, transformers and other facilities to provide electricity to each individual customer. However, many of the tasks involved in this process (such as metering, billing, and servicing individual electricity customers) can be undertaken in a competitive environment and by different operators. Competition in distribution can be achieved by ensuring that individual trading companies have access to the distribution network and consumers at regulated prices.

The EU Electricity Directives aim at ensuring access to the distribution network for third parties to use it on the basis of fair sharing of capacities, at a fair and reasonable fee and on practical technical terms (Bielecki and Desta, 2004). Third Party Access (TPA) or its alternative Single Buyer (SB) systems developed in EU Electricity Directive, represent models that allow access to the transmission and distribution networks. TPA can be regulated or negotiated. Under the regulated TPA, third parties have access rights according to conditions pre-set by the regulator, while under negotiated TPA third parties negotiate with the transmission or distribution operators. On the other hand under the SB system all energy buying and selling is done by the transmission operator.

The privatization of the energy sector in the transition economies (Transition Economies) started in the early 1990s and a majority of them have embarked on some

⁴² The fact that there is a strong natural monopoly element in transmission does not automatically imply that it should remain in public ownership. It is possible for this stage to be privatised as a monopoly regulated by an independent regulator (as in the United Kingdom for example).

form of privatization in this sector. In many South East European countries, of course, most of the electricity supply industry is still owned by the state and the preparation for privatization not completed yet. For instance, in Bosnia and Herzegovina, three existing electricity company are still vertically integrated, however plans to unbundle and further restructure and privatize the power sector are underway. Likewise, in Serbia the power industry after deregulation, operates via two public enterprises, "Electric Power Industry of Serbia" (EPS) which is the only electricity provider in Serbia and "Elektromreza Srbije" (EMS) which is the only transmission operator which is completely unbundled. The Croatian electric energy industry is characterized by majority state ownership. While its transmission, system and market operator is legally unbundled, at least 51% of the Electric Energy Corporation (HEP) will remain in government ownership up until the Republic of Croatia joins the European Union.⁴³

Most of the governments in Transition Economies have retained control over, at least, the transmission component. For instance Hungarian Electricity Board (MVM) retained control over the transmission network which acts as a single buyer in the Hungarian electricity system while its distribution is mainly privatized and dominated by foreign companies. In Slovenia the transmission company remains under state ownership and acts as a single buyer in the electricity market while private ownership has developed in the generation and distribution stages. In Macedonia, the former national power utility 'Elektrostopanstvo na Makedonija' (ESM) has been split into separate companies for generation and distribution. In spring 2006, the Austrian utility EVN acquired 90 % of its distribution company. There are plans for privatizing generation, while transmission remains under state ownership. In Bulgaria until mid-2000, the national electric utility, 'Natsionalna Elektricheska Kompania' (NEK), set up in 1992, was responsible for power generation and transmission, as well as for energy trade. However, after restructuring in 2001, NEK remained responsible only for transmission. Other components, namely distribution and generation, have been privatized or are in process of privatization. In Romania, the former national electricity company CONEL was dissolved and replaced by several commercial companies which are responsible for generation, transmission and distribution. Access to network is ensured via regulated Third Party Access which is also used in other countries like Estonia or Czech Republic.

Vertically unbundling has experienced significant progress during the last years. Albania, Croatia, FYROM, Serbia and Kosovo have legally unbundled Transmission Systems Operators (TSO) and Bosnia and Herzegovina has a legally unbundled Independent System Operator (ISO), while Montenegro has a functionally unbundled TSO. However, in Croatia the HEP group is made up of multiple companies covering production, transmission and distribution, i.e., the transmission operations is part of the same group as the main generator. However, there is a separate market operator owned by the Republic of Croatia. The unbundling between generation and distribution (including supply) has however not reached as far. In Albania KESH Distribution is unbundled and privatized. However, KESH Generation is obliged to sell to the private supplier at regulated prices. In FYROM the distributor is now owned by Austrian EVN, but also here the dominant generator, ELEM, is required to sell at regulated prices. Among the remaining Parties generation and distribution/supply are conducted within the same company or group of companies that may be legally

43 Data regarding the energy market in TEs are obtained from Energy Country Profiles provided by the Austrian Energy Agency (<http://www.energyagency.at>); other sources include EBRD (various years)

unbundled. The following table summarizes the degree of vertical unbundling in Balkan countries.

Table 3. Degree of vertical unbundling

	Transmission, system and market operator	Generation and distribution
Albania	100% state owned legally unbundled TSO	KESH Distribution unbundled and about to be privatized. Additional distributors selling in "non-KESH" areas. KESH Generation obliged to sell to the wholesale supplier.
Bosnia and Herzegovina	Independent ISO	3 vertically integrated regional monopolies.
Croatia	Legally unbundled transmission company, but part of the HEP group. Market operator 100% state owned (legally unbundled).	HEP a group with multiple affiliated companies in the energy value chain
FYROM	100% state owned legally unbundled transmission system and market operator	Distributor privatized (Austrian EVN). Main generator, ELEM, obliged to sell at regulated prices.
Montenegro	Functionally unbundled TSO	Functionally unbundled with four divisions (generation, transmission, distribution and supply)
Serbia	100% state owned legally unbundled TSO	Generation and distribution/supply integrated. Legally independent subsidiaries. DSO function legally unbundled from other operations.
Kosovo	100% state owned legally unbundled TSO	Generation and distribution/supply integrated.

Source: South East Europe Wholesale Market Opening, Pöyry Energy Consulting and Nord Pool Consulting, March 2009

Another point that should be mentioned in this section is that the reform of electricity must be based on cost recovery and that the welfare function of the government must be separated from its electricity policy.

3.3.2 Activities and issues related to privatization of energy sector in Kosovo (Kosovo Energy Corporation - KEK)

KEK is the sole electricity provider company in Kosovo, vertically integrated with four core divisions: Coal production, Generation, Distribution and Supply. Partial restructuring was completed in November 2005 and resulted in separating the Transmission System and Market Operator (KOSTT) which operates independently of KEK. Last September the Government of Kosovo, as the only shareholder, advanced the process of unbundling by dividing the company into two companies: Generation Company (to produce coal and electricity) and Distribution Company (to distribute power and deal with sales). The last will then further go through the process of privatization.

KEK inherited very poor conditions in 1999 after a decade of mismanagement and disinvestment. After the war, a lot of investments were made mainly by international donors. The initial steps of involving private sector rooted from that period when management contracts were signed. According to the managing director of KEK, these contracts did not give the best possible result as there was a lack of coordination between the stakeholders. This in turn resulted in delays and there was no clear information about the investments made by donors. According to the same source, these information were not shared with the beneficiary, i.e. KEK in this case. The problems were twofold, firstly, local staff was left aside in most of the cases and there was a miss setting of milestones to be achieved. Management contracts, *per se*, had low results as they mainly focused on achieving milestones while not utilizing local expertise.

KEK has approximately 372,000 customers most of which are household consumers and the Company employs 7.500 employees in variety of functions. According to managing director of KEK, the workers union of this company has agreed with the process of privatization while they show their commitment to closely cooperate with the Government in preparing remuneration packages for those that will lose their jobs due to the privatization process.

Billing and collection remains a major problem in KEK. In 2008, through April, KEK's technical losses were around 18%. Of the total energy available, only 76% was billed, of which only 61% was collected, for a total collections of supplied energy of only 46.3%. Customer debt amounts to around €400 million of which nearly half is the debt of Serbian enclaves. According to the managing director of KEK the company is constantly improving the cash collection figures but it has not achieved the best yet, as it lacks the much needed support of the courts in processing in time all the court cases which KEK has filed with them. KEK in 2008 has registered an increase in cash collection, billing and production compared to 2007 while has managed decrease its commercial loses by 5% only within a year. According to the managing director of KEK, the current price does not cover the production cost. Due to poor operational and financial performance of KEK, the energy sector has not only become an obstacle to growth but also a fiscal burden. Government have spent a considerable budget funds for keeping a live KEK operations and for the

import of energy. During the period 2000-2007, Kosovo Consolidated Budget spent over 273 million Euros as subsidies for KEK which amounted over 85% of the total amount paid as subsidies to POEs⁴⁴. During the first semester of 2009, subsidies to KEK amounted at 37.15 million Euros which is 25.4% higher than the amount paid during the same period in 2008⁴⁵. Despite the fact that power cuts have been reduced, they still prevail especially in rural areas, where collection percentage is low. KEK is also perceived as an institution which is highly tainted in corruption (EWS, various numbers). Privatization of power generation, distribution and supply should be considered and implemented as a gate way from this situation. Scarce budget resources to support investment in infrastructure, education and health should be of better use for these purposes instead being used for KEK subventions and electricity imports. IMF in its last memorandums also insisted in privatizing these parts.

The unbundling of KEK's mining, generation and distribution/supply divisions is required under EC Directives and the Energy Charter Treaty, and the Government of Kosovo issued Decision N. 03/14 on 3 April 2008 requiring that the Energy Strategy of Kosovo result in a privatized distribution network. Kosovo is a signatory to *The Athens Memorandum 2002* and *The Athens Memorandum 2003*, which establish the Energy Community of Southeast Europe (ECSEE). UNMIK, on behalf of Kosovo, has signed the legally binding *ECSEE Treaty*. This treaty demands from signing parties to comply with *acquis communautaire* of the European Commission based on the timeline which offers a sufficient time for proper reform implementation.

According to the managing director of KEK, they expect that the privatization process of distribution and supply will result in increasing the level of investment in this field and a more qualitative service towards the customers. They further argue that this business can be used not just for selling electricity, but to provide other services as well. Telecommunications Companies can use these assets to sell internet, TV cables, digital area coverage, etc. This in turn makes distribution assets very attractive. However, according to Medium Term Expenditure Framework (MTEF) it is anticipated that the proceeds from privatization of distribution and supply will be around 30-50 million Euros. Riinvest's project team considers that, as in the case of PTK, presuming the price before any appraisal is made is, at best, negligence of these institutions.

The privatization will be carried out in accordance with the energy strategy, Law No. 03/L-087 on Publicly Owned Enterprises, the procedures for tender in Law No. 02/L-44 on the Procedure for the Award of Concessions, government decisions to date and the Medium Term Expenditure Framework (MTEF), relating to KEK unbundling and privatization. The distribution network and supply businesses after being unbundled from KEK will be put into a new separate legal entity ("Disco"). Disco will be the distribution system operator and will own, maintain and expand the Kosovo distribution network system. Supply will purchase electricity and resell to consumers.

The Government has approved the unbundling of KEK (Decision No. 04/36), the privatization by sale of shares of KEK Distribution and Supply (Decision No. 03/38), and has appointed the Privatization Committee (PC) to implement the privatization

44 Treasury Department; MEF, Expenditures From Kosovo Consolidated Budget to POEs Year 1999-2007

45 Treasury Department; MEF, Semi-annual report, 2009

(Decision No. 08/39). To implement the privatization, the government has created and authorized the PC, which will establish policy and ensure inter-ministerial coordination during all phases of the project. It shall oversee the timely implementation of the project. The PC shall appoint advisors and experts to provide technical assistance and/or advisory services relating to the project. These advisors shall collectively be known as the Project Advisory Committee (PAC). Members of the PAC shall be empowered to make recommendations, to advise on project implementation, and to provide assistance to the PC.

The Transaction Advisor (TA) is being engaged by international tender and will provide strategic, legal, technical, and financial advisory services to PC regarding the structuring and implementation of all stages of the project. However, the tender for Transaction Advisor was recently cancelled in absence of at least three sound and technically acceptable offers. The procedure therefore is lasting almost a year. The Government decision to embark on privatization of distribution network and supply so far has not been discussed and approved by Kosovo Assembly. There is not a clear policy if the privatization of distribution network and supply will be offered in the same package and how the competition will be ensured through involving more private operators in electricity supply.

Privatization of "Kosovo B" also has been discussed recently as a transaction within, or out, of the project "Kosova e re", a new power generation capacity to be built in partnership with a private investor. There is not enough clear the government policy regarding procedures and models to be used for privatization of distribution, supply and power generation in Kosovo B units . More precisely it is not clear whether government will retain and which % of shares will retain publicly owned. Everything is left to the advice of transaction advisor selected by MEF, but their reports remains confidential and exposed to any debate out of narrow government bodies. We would advice that models, procedures and other key elements of policies are presented to the opinion and interested stakeholders before final decisions and that key elements regarding policies, procedures and models are discussed and approved by Kosovo Assembly. In this regard current legal frame should be completed and revised.

3.4 Airports' Concessions

3.4.1 Lessons learned from concession of airports in Transition Economies

The demand for air travel, and thus airport infrastructure, has been growing faster than the economy as a whole and is likely to continue this pattern in the near future (Andrew and Dochia, 1999). The air transport sector, therefore, has become an important sector in all economies, especially transition economies, contributing to employment generation and economic growth. The inherited infrastructure and facilities were generally old and in need of large capital investment for modernization and for meeting the increasing demand of the businesses and individual citizens. These large investments together with a redefined role for the state, have transformed this sector altogether (Juan, 1996). Governments in Transition Economies

have been interested in engaging the private sector in the modernization of airport infrastructure for two main reasons: the private sector would handle more efficiently with the provision of services required in the airport (landing and slots for domestic and foreign airlines, baggage handling, maintenance, airport shops, and adequate capacity expansion) and a reduction in the burden on government budget (given that airports have traditionally required a contribution from the government, though not in all cases) that emerged under government provision. On the other hand, this move also reduces fiscal burden and risks and can improve the government balance sheet.

Given the long term nature of investment in airports and their infrastructure, the private sector would find such investment projects viable if it can be guaranteed a reasonable and fair rate of return. Private sector participation in airports, through ownership, management, or new investment programmes, can take many forms, including outright sale of shares or assets, concessions, and long-term leases (Juan, 1996). In Transition Economies governments have preferred concessions rather than full divestiture, which would ensure their continued ownership and a steady income from concession contracts. 'Build Operate and Transfer' (BOT) concessions have remained the most common form of private participation in airport infrastructure in Transition Economies. In contrast to a sale or permanent concession, the government retains strategic control over the project which is often a political gain. This model was used in Albania⁴⁶, Hungary and Turkey.

According to EBRD (2008), private sector participation arrangements for airports in Transition Economies have remained rather limited. Apart from partial privatization of airports in Russia, other Transition Economies have chosen BOT type concession agreements. These kinds of projects have been concentrated in a few countries including Armenia, Hungary, Poland, Russia, and Albania. A similar arrangement is currently underway in Macedonia.

This limited experience with privatization of airports, especially in Transition Economies, makes it hard to draw unambiguous lessons. Obviously, governments will be unable to finance the necessary investment in airport infrastructure and, therefore, private sector participation will remain essential and unavoidable apart from air traffic control system. The governments will continue to face the challenge of engaging the private sector in this important area of activity and promoting its active involvement.

3.4.2. Activities and Issues Related to Concession of Prishtina International Airport (PIA)

Prishtina International Airport is the only international airport in the Republic of Kosovo holding monopoly of airport facilities. PIA is located approximately 15 km southwest of the capital city Prishtina. PIA operated under the Kosovo Trust Agency (KTA) administration until the independence of Kosovo. Currently, the Airport is owned and operated by PIA, JSC, an enterprise wholly owned by the Government of Kosovo.

46 See appendix 1 for detailed analysis.

PIA has a huge number of passengers in relation to population and the number of passengers is continuously increasing. This is mainly because of large Kosovo Diaspora who uses PIA for their flights. PIA handles over a million passengers, a number that this airport reached and surpassed last year. Altogether, in 2008, there were 1,137,000 civilian passengers and approximately a hundred thousand military passengers. PIA is one of the busiest airports in Balkans. PIA carries out airport services such as receiving and sending off planes and passengers, cargo depot, catering, selling goods, as well as performing other commercial activities for airport users such as renting business premises, parking facilities and other. As of April 2009, PIA became operational 24 hours a day offering non-stop services. The decision followed the increased interest of airlines to operate around the clock.

Prishtina International Airport received several acknowledgements for its performance and conditions. In 2006 Prishtina International Airport was awarded the Best Airport 2006 Award, an honour presented by Airports Council International (ACI). Winning airports were selected for excellence and achievement across a range of criteria including airport development, operations, facilities, security and safety, and customer service. Later it was selected by the prestigious company "British Airways", as 'golden station', in a competition with many other international airports of various countries.

There are several world-wide renowned companies that operate in Kosovo such as: British Airways, Austrian Airlines, Malev, Swiss, Turkish Airlines, Hamburg International, Bell Air, Adria Airways, and Croatia Airlines. Prishtina International Airport was the first airport in the region to offer direct flights to USA. During 2008, PIA managed to increase its revenues and improve its services. In 2009, PIA experienced growth in flight and passengers figure despite the adverse effects of global economic turmoil. In January there was an increase in number of passengers by 6 percent whereas during the month of February 2 percent. Flights, during these two months, in comparison with the last year have increased for 15 percent. PIA is a large public employer. It employs over 700 employees. In 2008 PIA had a turnover of around 25 million with a net profit margin of over 30%. This high profit margin, which can be even higher with a more conservative expenditure regime, makes PIA an attractive destination for potential investors. The profits of PIA are mainly derived from aeronautical rates and charges (around 89%) while commercial activities contribute with around 11% of PIA's revenues.

Managing director of PIA, who favours private participation, confirmed that large companies are showing interest in investing in PIA. He further argued that with proper investments, PIA can become an important hub between East and West. According to him, PIA has continued its restructuring efforts despite the fact that the government has shown its commitment to introduce private participation. However, he notes that employees fear job losses which he thinks is unlikely given the specific skills that the staff possesses and the growth potential of the Airport in the future.

Besides their operational improvements, such as those in reducing time for aircraft handling, baggage handling, working under hard weather conditions, PIA has introduced incentive packages for airline companies in order to further improve the Airport.

While it is evident that PIA can function adequately as a publicly owned and operated enterprise, the Government of Kosovo seeks to ensure that the Airport meets its full economic and operational potential. Therefore on June 12, 2009, the Government of Kosovo with its decision number 05/68, formally authorized proceeding with a Public-Private-

Partnership for the operation and expansion of PIA. In an interview with the research team, the minister of the Ministry of Transport, Post and Telecomm of Kosovo showed the commitment to proceed rapidly with this process. According to him, the level of investments is expected to be around 85.6 million Euros. While the procurement process up to the contract award, which will be based on a competitive international procurement process, is expected to be completed by December 2009 the anticipated transaction structure includes the following features among others; the contract structure will be Design-Build-Finance-Operate- Transfer (DBFOT) while the contract duration will be 20 years. Except from the Air Navigation Services, all other services offered by the airport will be subject of this contract. The concession fee will be paid in form of a percentage of gross revenues while the aeronautical rates and charges are to be capped at current levels over the term of the contract, with potential inflation adjustments subject to regulatory approvals. As for current employees, the private operator will have to honour existing employment contracts for a predefined period of time. We consider that this point might deter investors or will be reflected in conditions offered by potential investors as PIA is already overstaffed. PIA has over 700 employees while Tirana Airport which handles similar number of passengers exceeded 300 employees just last year. The concession contract also anticipates a required minimum investment plan.⁴⁷ The outcome of concession agreement aims at modernizing the Airport while keeping the pace with its competitors in the region.

47 Visit www.pppkosova.org for an extensive summary about the transaction structure of PIA Concession.

4. SUMMARY OF CONCLUSIONS:

1. Legal frame provides only basic solutions for embarking on privatizations POEs. The procedures , polices are not clear . It seems that Government Privatization Committee (GPC) Public Private Partnerships Inter-ministerial Steering Committee (PPP-ISC) have been granted with to much powers , without clear line or oversight and reporting to the Kosovo Assembly. This implies that legal frame should be completed in a near future by amending existing Law on POEs and Law on PPP and Concessions or by passing a laws on privatization of each of three main POEs : KEK, PTK and PIA;
2. Government has not clear policies in place regarding the restructuring the ownership structure of POEs after first round privatization respectively if is going to sell all shares to a private investor or will keep portion of that in public ownership. Following experiences it might be considered option that part of shares remain public in a percent that would not discourage strategic investors. This should be determined after a careful market and feasibility study which have to support government decisions. Experiences has also shown that these shares could be privatized with much higher price compared to those of first round. Also there is not a clear government policy regarding so called "golden share". Golden share, per se, were introduced nearly 25 years ago (for British Petroleum and a couple of other companies), when the government was not sure how the privatisation would proceed and what may happen to the companies under private ownership. The idea of a golden share was to allow the government to intervene in strategic situations such as the closure of company or its takeover by some unwanted foreign buyer. The advantage still remains the same in Transition Economies, giving the government the chance to intervene in decisions regarding issues which are of national importance. Its disadvantage is that it may be used for political reasons, influencing the company in favour of one party or other.
3. Government of Kosovo has clearly shown its commitment for energetic and fast privatization of three strategic POEs. Although this government determination should be acknowledged it seems that it is disproportionate with current level of preparations, creation of solid legal frame, creation of necessary political and public support and basic consensus in a Assembly and with other key stakeholders at the society. This has been proven as an environment that doesn't support government intentions and this is proven by the lack of substantial progress during more that 18 months since government intentions were made public.
 - It seems that Government is relying mostly or heavily at transaction advisors regarding policies, procedures and models. This might be good to the extent that doesn't hamper transparency and public debate at the Assembly, academic circles and civil society. We would suggest that feasibility studies for PTK, KEK distribution and supply, Kosovo B thermo- power plant are prepared to support government policies and strengthen its negotiation position.
 - Government has not a policy in place regarding the use of proceeds from privatization of POEs. Certain key aspects of this should be part of debate in the society: Assembly, academia, civil society. As these corporations are to serve public interest at large, current and future generations, we consider

viable solution that would provide that great portion of proceeds other than transaction costs are used for public investment in infrastructure, education and health and not for current budget consumption for salaries, goods and services.

APPENDICES

Appendix 1:

Strategic Sector Privatisation in Albania
(The Case of Albtelecom, Mother Tereza Airport and Electricity Distribution -OSSH)

By: Entela Shehaj⁴⁸ - Albanian Energy Regulator

Strategic Sector privatisation in Albania

Privatisation in general and privatisation of state-owned enterprises in particular was one of the main elements of the reform process in Albania to transform the economy from planned to a market system. It was the law No. 7512 "On sanction and Protection of private Property" that sanctioned and provided legal protection for private property and foreign investment, legalised private employment of workers and privatisation of state property. Until 1997 the privatisation process was mostly regulated by decrees or Decisions of the Council of Ministers (CMD). After that time, and given the importance of the strategic sector, the government prepared a strategy where privatisation was regulated by laws. The privatisation strategy was approved by the law No. 8306 in March 1998, named "Strategy of Privatising Sectors of Special Importance". According to this strategy every public company was to be privatised by a specific law. Strategic sectors included energy, mining, oil and gas, post, telecommunication, forests and water reserves, railroads and rail transport, sea ports, airports and air transport as well as totally state-owned second tier banks and insurance companies. According to the law (No. 8306, 1998), a 'strategic investor' is any juridical person who holds a financial guarantee and has a licence of an economic activity at a special sector and not less than 30% of shares of companies to be privatised are offered to them.

The restructuring and privatisation of these sectors needed large investments which could be undertaken only by strategic investors. International institutions such as IMF and the World Bank have closely monitored the process of strategic privatisation in Albania. In order to make these sectors more attractive, enterprises underwent some restructuring activities before privatisation. They were to be transformed into joint-stock companies and then some of them (especially the vertically integrated ones) were broken into smaller units.

The Consultancy and Transparency Committee (created by the CMD No. 621 in September 1998) was charged with directing, supervising and monitoring the privatisation process. This Committee was headed by the Ministry of Public Affairs and Privatisation (Ministry of the Economy after the amendment of the CMD no.621 in

48 The content of the paper is the sole responsibility of the author and do not represent the views of the institution it represents.

January 2002) and includes representatives of the Ministry of Finance, Ministry of Justice, line Ministries, local governments as well as foreign consultants and donors (Pano, 2001).

The main objective of privatisation in developed economies was to improve firm's efficiency. In Albania, however, the situation was different and more complex, and privatisation was mainly expected to facilitate the transformation of a planned economy to a market economy. Apart from firm's efficiency, attracting new investment, reducing budgetary expenditures (reducing state subsidies made to loss-making enterprises), increasing the effectiveness of the market system, the creation of conditions for a capital market and creating new employment were other objectives of the privatisation of state-owned enterprises in Albania. Attracting foreign investors was one of the overall objectives during the privatisation of SOEs in Albania. However, this objective became the prime and the most important one during the strategic privatisation.

In the following sections we describe three cases of the strategic privatisation in Albania. There we give in detail the privatisation path of 'Mother Teresa' international airport, Albtelecom and Electricity Distribution (OSSH).

Privatisation of 'Mother Tereza' International Airport

The establishment of the Tirana International Airport goes back into the socialist period during years 1955-1957. However, at that time and until the end of 80's the airport was characterized by a very low number of flights per day. The number of flights and companies operating increased rapidly during the 90's. Facing the need for further improvement of the airport, by the end of year 2002 the government decided to announce an invitation to the international investors for building a new terminal and airport operation as well. The tender procedure for the concession of the Tirana International airport started at 17th of December 2002 and continued during the year 2003. The winner, a consortium of three companies⁴⁹, was announced in January 2004. The Concession Agreement of type BOOT was signed in 15th of October 2004 between the government of Albania and the winner.

Law no. 7973 " On Concessions and Private Sector Participation in Public Services and Infrastructure", in July 1995, open the green light for the concession of the Tirana airport. This law aimed at the creation of the legal framework for the participation of the private sector (domestic or foreign) through concessions and other forms of state-private partnerships in public services and infrastructure. This law has been amended 6 times, starting with the first amendment in March 1996 and the last one was in February 2005. In December 2006 this law has been suspended by the law no. 9663. However, the process of the privatisation of the Tirana International Airport was guided through with several Council of Ministers Decisions (CMDs). Through CMDs was approved the master plan and the feasibility study for the concession of building the new terminal of Rinas Airport, was appointed the Authorised State Entity for the preparation and execution of the concession contract, was decided the treatment of employees that lost their job during the restructuring of Albtransport sh.a, for the selection of the winner of the tender, was approved the

⁴⁹ The shareholders of Tirana International Airport were HOCHTIEF AirPort GmbH (HTA), Deutsche Investitions- und Entwicklungs-gesellschaft (DEG) and Albanian-American Enterprise Fund (AAEF).

Guaranty Agreement between the Republic of Albania and the EBRD for the loan given to Tirana Airport Partners (TAP) by EBRD. The CMD no.479 (dated August 2000) announced the starting of tender procedures for building the new terminal with the BOOT type concession. An open international tender with two phases (the first one was the prequalification phase) was launched. It was decided that an international consultant will realize the procedures for building the new terminal with the concession of type BOOT.

The Concession Agreement was ratified by the parliament through the law no. 9312 in November 2004. This law gave the company the right to be excluded by the custom taxes and the value added tax (VAT) during the period of improvement of the existing terminal, during the phase of building the new terminal and for the extension of the flying field and the road to the airport.

The concession agreement is a relatively complex document with 38 articles and 70 annexes. For the purpose of this presentation I will briefly discuss the main points of the contract. The concession was given for 20 years and during this period no airport will be authorised or licensed for commercial international flights in the Republic of Albania (apart from the emergency landings). Regarding the payment to the Government of Albania, the first concession payment was 3, 000, 000 Euro. The Government of Albania will take also 30% of the company's profit (the dividend) annually. The anticipated values and timetable of these payments are given in the Annex 43 of the concession agreement.⁵⁰ The company has also the obligation to repay to the Government of Albania all previous loans during the period of concession. In the agreement there is a special article regarding disputes. According to this article if any disagreement arises and this is not solved with a mutual understanding between the parties of the contract, then the dispute will go to the arbitration in Vienna (Austria).

The agreement has a detailed timetable for building and completion of the new terminal. According to this timetable the company had 386 days to construct the new terminal. During the phase A of building the new terminal and before the start of phase B, the company had the obligation to cope with at least 1 million passengers per year. The company has respected the deadlines stipulated by the agreement. In March 2007 the new terminal was inaugurated and in September this year was inaugurated the extension of the new terminal (phase B of the building process).

Privatisation of Albtelecom

Telecom has been part of the Post Telecommunication Company until year 1992. In February 1992 the Albanian telecom has been established as a separated company and the Albtelecom sh.a. (as a joint stock company) with 100% state capital was created in February 1999.

⁵⁰ It is anticipated that during the concession period the Government of Albania will take from the company, apart from the first payment, Euro 44, 077, 000.

Like other strategic sector enterprises, it was the law no. 8306 in March 1998 that opened the road for the privatisation of Albtelecom. In June 1999 (with the CMD no. 288, a decision that has been amended 4 times until July 2003) the government approved the document of the Development Policies of Telecommunication in the Republic of Albania. This document has a separated section regarding the privatisation of Albtelecom and stated that privatisation of Albtelecom was planned in year 2001. There were also established several objectives (such as expanding the national grid and fulfilling the demand for new connections, to accelerate the modernization of grid infrastructure, etc.) for the strategic investor in exchange to the exclusivity of international phone services until 31st December 2004. The government decided that Albtelecom will be offered to the strategic investor together with a licence for a GSM service. It was also highlighted that operators in monopoly position will be subject of tariff regulation based on a price cap mechanism.

It was the Law no. 8810, in May 2001, which decided the form and the formula of privatisation of Albtelecom. Not less than 51% and not more than 76% of shares of Albtelecom were decided to be transferred to the strategic investor through an international open tender. Apart from 3% of shares that were decided to be transferred free to Albapost sh.a., the remaining shares were decided to be offered to former owners of land and buildings and Albtelecom employees in exchange of privatisation vouchers. Only in July 2004 the government (through CMD no. 416) decided that 76% of the shares of Albtelecom were to be offered to the strategic investors. Part of the package was also the GSM service (Eagle mobile).

After the tender announcement of selling 76% of shares of Albtelecom, CETEL was announced as the winner with the CMD no. 359 of May 26, 2005 and the contract was signed on 23 of June 2005. Due to non fulfilment of precursory conditions anticipated in the Share Purchase Agreement (SPA) the closing transactions related to the SPA were not finalised. The government of Albania, through the CMD no.7 in October 2005, required an international expertise regarding the form of the SPA and the validity of the procedures of the privatisation process. It was June 2007 when the SPA between CETEL and the government of Albania was finalized. In the SPA is highlighted that CETEL had the obligation to establish a partnership with Turk Telekomunikasyon A.S. where Turk Telekomunikasyon will own not less than 20% of the shares of this partnership.

Among other buyer commitments in the contract it is worth mentioning that if after five years the buyer has not achieved at least 80% of the value of investment as anticipated in the business plan then the buyer will pay to the seller 20% of the value of unrealized investments for each year. In case that after 5 years from closing of the contract the buyer has achieved at least 80% of the investment anticipated in the business plan the buyer will pay to the seller 2% of the value of the unrealized investment for each year

The Law no.8810 has described the use of privatization proceeds in article 4. According to this law the proceeds from the privatisation of Albtelecom will be used for covering the expenses for tender organization, to pay the tariff to the foreign consultant and for the treatment of laid-off employees. The remaining part was decided to go to the state budget. According to the existing formula, 50% of the proceeds will be used to reduce domestic debt and the rest will be used to investment projects. The dispute resolution article of the contract states that any dispute between

the parties will be resolved according to the rules of the International Chamber of Commerce in Paris.

Privatisation of Electricity Distribution (OSSH)

Distribution Business in Albania was part of a vertically integrated company named Albanian Power Corporation (KESH)⁵¹ until December 2006. The unbundling of Distribution Division from KESH and the establishment of Distribution System Operator (DSO) was approved in December 2006 by the CMD No.862 'On the Establishment of the Company OSSH sh.a'. On the 30th of May 2007 KESH supervisory board approved the creation of OSSH sh.a. and on 19th of June 2007 OSSH was registered in the Tirana district court.

The International Finance Corporation (IFC) was selected as a transaction adviser to assist the government of Albania during the process of restructuring and privatisation of OSSH. After Due-Diligence process the IFC submitted a report with recommendations to the Ministry of Economy Trade and Energy (METE), KESH, and the Albanian Energy Regulator (ERE) on the tasks to be carried out regarding the process of privatisation.

The ERE had the obligation to prepare and submit to the government the new Albanian Market Model (AMM) as well as to revise all secondary legislation in order to be compatible with the new AMM. The AMM was approved by the government in March 2008. According to the AMM, OSSH sh.a will perform two main activities; distribution activity (maintaining, expanding and operating the distribution system in the territory of Albania) and the Retail Public Supplier activity (selling electricity only to tariff customers). The form and the formula of privatisation of OSSH sh.a. were defined in the law no. 9889 dated March 2008. According to this law, the form of privatisation was an international open tender with prequalification phase and not less than 51% and not more than 76% of shares were to be offered to the strategic investor. The remaining shares were to be offered to the ex-owners of the land and OSSH employees in exchange of the privatisation vouchers.

After the prequalification phase, in May 2008, it was announced that only four companies were prequalified. According to the above mentioned law the procedures of evaluating the offers and the criteria for the selection of the winner for the privatisation of OSSH sh.a were to be defined with CMDs. In June 2008 the CMD no. 835 decided that 76% of shares of the company were to be offered for privatisation and attached as an annex were instructions for the realization of the privatization tender. The bid took place on 29th of September 2008 and out of four prequalified companies only two of them submitted their bid. A month latter the government announced the winner of the tender (CEZ). Negotiations between the winner and the government of Albanian for the Share Purchase Agreement (SPA) and the Regulatory Statement (which was in the annex of the SPA) started in November 2008 and ended in March 2009.

51 KESH was established as a Joint Stock Company with 100% state ownership in year 1994 and has operated as a vertically integrated company until year 2004. The unbundling of KESH started with the establishment of the Transmission System Operator in August 2004.

There are also two important documents associated with the privatisation of OSSH, the Government Support Agreement (between Ministry of Finance of the Republic of Albania, the Ministry of Economy, Trade and Energy and OSSH sh.a) and Partial Risk Guaranty Agreement (between the government of Albania and International Bank for Reconstruction and Development). Both documents are related to each other. The Partial Risk Guarantee by the IBRD is to cover certain regulatory risks associated with the activity of OSSH sh.a. as a private company. The Ministry of Finance (the guarantor) the Ministry of Economy Trade and Energy (the Technical Support Party) and the beneficiary (the OSSH sh.a.) were therefore required to enter into the GSA. Both documents are approved by the parliament in May 2009. The overall process ended in 29th of May 2009.

The SPA was ratified by the parliament by the end of April, and as mentioned above the Regulatory Statement (RS) was in the annex of SPA. However, the RS was a crucial element of the overall privatisation process. The RS covers three regulatory periods starting from next year until the end of 2014 and its aim was to make possible the calculation of the tariff of publicly owned generation, wholesale supply, distribution and retail supply. According to the AMM, the Wholesale Public Supplier (which is state owned) buys electricity from the publicly owned generation, other small producers and import and sells this mix to the Retail Public Supplier with a regulated price. The rate of return for the public generation is set as the percentage yield on short term Treasury Bonds of Central Bank of Albania.

The distribution company operates on the basis of a price cap formula and the X- factor is set at zero for the first three regulatory periods. The calculation of the weighted average cost of capital (WAAC) is an important element of the RS. The assumed gearing for the purpose of calculating the distribution tariff will be 60% debt and 40% equity. The Rate of Return on Equity (ROE) is fixed to 16.44% for the first three regulatory periods. Regarding the cost of debt, no figure has been set in the RS but the ERE, for the purpose of calculation of WAAC, will use the most recent estimation of the weighted average cost of new debt obtained via transparent tender procedures of OSSH.

Despite the efforts to reduce losses, their total level in the distribution network has been relatively high for a long period. According to the AMM the distribution company will buy the energy to cover losses in the free market and not with a regulated price, otherwise the company will have less incentive to reduce them. The level of losses in the distribution network in year 2008 was 32.7% of the electricity injected into the network. The division of this total figure in technical and non- technical losses is also given by the company but it requires a study to decide upon the accurate level of technical losses. This study, according to the RS, will be carried out by the company and will be submitted to the ERE for approval. As losses are a crucial part of the electricity tariff, the ERE has put targets on losses reduction for the first three regulatory periods (4% reduction for the first two regulatory periods and 9%, for the third regulatory period). In total the company has to reduce losses by 17% until year 2014. The company will benefit from any over performance in reducing losses, but also will bear the cost of any under performance.

Bad debt or debtors with no hope of collection are also an important issue of the company. It was negotiated that for the first tariff application a level of 14% (of RPS revenues) of bad debt will be included in the tariff. However, the company will

undertake a study to accurately define the level of bad debt and the results of this study will be approved by the ERE. If it shows that the level of bad debt is higher than 14%, then the company will be compensated in the next year, and vice versa if it shows to be lower the ERE will claim it back. The RS has also targets to reduce the bad debt level during the first three regulatory periods. Both losses and bad debt has contributed into the bad financial performance of the OSSH. It is expected that the improvement in the losses and bad debt level will have a downward pressure on the future tariff.

Another important part of the RS is the compensation mechanism. It has been negotiated that if the weighted average end user tariff should be increased by more than 15% in real terms, the minimum average tariff increase will be 15% in real terms. The portion of required revenues that was not taken into account by the regulator in that specific year will form the compensation account and will be given to the company in the following years. The company is entitled to the regulated return on this amount. Through this mechanism the tariffs of electricity will be smoothly increased (if they are to be increased).

Law no. 9889, mentioned previously, in article 5 has also decided the use of the privatisation proceeds. According to this law the proceeds of privatisation of OSSH sh.a. will be used for, covering the expenses for organizing the bid procedure, paying the transaction adviser contracted by METE, to remunerate the committee of bid evaluation, the consultants and transparency committee as well as the negotiation team and the remuneration of employees retired during the restructuring process of OSSH sh.a.. The remaining part will go to the state budget. The same formula as the one mentioned in the Albtelecom case is also used for the use of income of OSSH privatisation.

Conclusions

Given the importance of the strategic sector, a special attention was paid to the preparation of the companies to be privatised, the laws and other secondary legislations as well as the involvement of international institutions and foreign consultant. Due to the importance and specific conditions of each company to be privatised the privatisation procedures of such companies has taken in some cases several years. The privatisation of Albtelecom, as discussed in section 3, took almost 6 years to be finalised.

The three examples given in this article are in different sectors of the economy and therefore there are differences in the overall process to privatize such companies. Despite the differences there are certain issues that have taken relatively similar treatment in the three cases. The method used to privatise both Albtelecom and OSSH was the international open tender where 76% of the shares were offered to the strategic investor. In the case of the airport the concession contract of type BOOT was used. An important element of the privatisation process in two of our cases is the exclusivity given to the strategic investor. In the case of airport the concessionaire has the exclusivity of international commercial flights during the whole period of concession. The whole territory of Albania was decided to be one distribution zone and this was given just to one strategic investor that privatised the distribution electricity (OSSH). In the case of Albtelecom privatisation there were

some exclusivity rights anticipated to be given to the strategic investor for a certain period. But because privatisation took longer than the anticipated time only the Al-telecom as a state owned company benefited from those exclusivity rights. In the three cases discussed here any dispute between the parties will be resolved in the arbitration court, one in Paris and the other two in Vienna.

Appendix 2:

Strategic Sector Privatisation in Macedonia

The case of Electricity Distribution, Macedonian Telecom and the Concession of the airports

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Introduction

This aim of this paper is to give an overall picture of privatisation process in a number of nationally important and publicly owned enterprises (referred to as 'strategic enterprises') in the Republic of Macedonia. More specifically we will discuss the privatization process in the energy and telecommunication sectors and the airport concession. In this respect the issues of legal framework, privatisation process and the models that are implemented and the destination of the fund after privatising the companies, will be elaborated.

Status of the privatisation process in the energy sector

At the end of November 2002 the Government of the Republic of Macedonia gave the responsibility to the Ministry of Economy, together with "*Electrostopanstvo na Makedonija*" (ESM) and other institutions involved, in cooperation with the Government Consultant for reformation of the AD ESM to continue with the realization of the activities in accordance with the Project duties and Agreement with the Consultant. With the specification of the fundamental characteristics of the market model, adoption of the European directive principles 2003/54/EC through the specifications defined when signing the Athens memorandum of 2002 and 2003, and with the adoption of the ESM restructuring model prepared by the Consultant, there was a need for preparing law framework for implementing the new structure of the Energy sector in the RM. On 19.03.2004 the Parliament brought the *Law for reformation of the ESM Macedonia*, corporation for production, transmission and distribution of the electrical energy with state ownership. With article 1 and 2 the Law defines the objective that is achieved by the Law – restructuring and privatization of ESM. Article 3 defines this Law as of *Lex Specialis* nature in relation to the Law for companies. Articles 4, 5 and 6 arrange the restructuring of ESM by dividing it into two corporations in state ownership, together with the division of the assets, employers, the rights and responsibilities, in the following way:

- AD for production, distribution and supplying with electrical energy ("ESM"), and
- AD for transmission of the electrical energy and managing with the electro-energy system ("MEPSO"),

52 The content of the paper is the sole responsibility of the author and do not represent the views of the institution it represents.

Article 7 defines the conditions with which ESM AD can get privatised (but not "MEPSO" AD) and/or of the corporation created by them, by selling part or all the shares, in one or more transactions, to the investor (domestic or foreign owner, or international financial institution with multiple state ownership where Macedonia is a member):

- By signing a selling contract on minority shares with international financial institution, and/or
- Through public invitation in which the pre-qualification is included, in accordance with the rules set by the Government of the Republic of Macedonia, or
- In other way defined with the Law.

Privatisation Strategies

The Consultant prepared a proposition of the Privatisation Strategy and also gave the first valuation. Out of these strategies some suggestions and conclusions are brought for the realisation of the privatisation process of ESM AD: i) regarding the method of privatisation, it is suggested to offer the shares of ESM AD through one or two (same time) international public invitation; ii) regarding the potential investors it is suggested the privatisation to be realised through the selling of shares to one dominant strategic foreign investor, either to a consortium of strategic and financial investors (including the already agreed share that will be sold to EBRD); iii) regarding the percentage of the dominant owner, it is suggested to give 51% of the ownership to the dominant owner. After these Consultant suggestions were taken into consideration by the Government, the Commission concludes that the privatisation can be realized by selling the shares to the strategic investor:

- Sole, vertical integrated enterprise;
- Holding company from both companies (to sole investor)
- Any of the both companies individually.

According to the decision brought the privatisation will be realised through the selling of at least 51% of the ESM AD shares on a public invitation to a foreign investor. On the 16.05.2005 the Government supported the privatisation process, and gave the obligation to the ESM AD to administer the restructuring in the two above mentioned companies. After the restructuring in 2005, the electricity generation domain is covered by the state owned company ELEM, and a single, 210 MW oil fired thermal power plant TEC Negotino.

The privatisation in the electricity sector took a major step forward in March 2006 with the privatisation of the 90% of the shares in the national distribution company "*Electrostopanstvo na Makedonija*" (ESM) to the Austrian utility EVN AG. The rest of the shares (10%) remain for now in state ownership.

In the course of ESM pre-privatisation, since October 2004 the EBRD acted as a partner to the Government by acquiring the right to purchase up to 19.9% of the ESM shares, under the same conditions obtained in tender. In April 2006 the sale and purchase transaction was settled for 70.1% of the ESM shares, while the EBRD reserved shares remained in escrow, subject to the EBRD decisions. Later in 2006

the Bank waived its right on purchasing any shares in ESM, and on 04.01.2007 the ESM privatisation transaction was closed with EVN AG for all 90% of the shares. EVN represents a reputable power utility company in Austria, and it won the tender at a very good price of EUR 225 million and EUR 96 million for investments.

After the restructuring in 2005, the electricity generation domain is covered by the state owned company ELEM, and a single, 210 MW oil fired thermal power plant TEC Negotino.

The outcome of the privatisation

The independent auditing house KPMG revision confirmed that the EVN Macedonia investments for the last three years have reached 108, 3 million euros which is 12, 3 million euros more than the obligatory 96 millions, in accordance with the sale-purchase contract for ESM. As they confirm together with Ernst & Young the investments are in the distribution network and in all of its segments, by which the quality of the supply with electric energy has improved.

"The investment contributed for the improvement of the distribution network and reduced the period of defects for 50 %, whereas the technical performances of the network are also improved. Around 960 local companies are engaged as co-operators, contractors and subcontractors for EVN. At the same time, the investments have opened several hundreds of working places in the company, which gave chance to the young qualified personnel", the EVN announcement says.

The procedure of privatizing the 45,125% remaining shares of Macedonian Telecommunication AD Skopje

Before 1st January 1997 this companies' ancestor was providing telecommunication, post office, banking and other services in the Republic of Macedonia named 'PTT Makedonija'. The Ministry of Transport and communications, on behalf of the Government of the Republic of Macedonia, has appointed CIBC Wood Gundy Oppenheimer as its adviser on the privatisation of 'Makedonski Telekomunikacii'. The privatisation involved the sale of a significant shareholding to a strategic investor. CIBC Wood Gundy Oppenheimer, a major international investment bank with a significant presence in Central and Eastern Europe, formed a consortium comprising Squire Sanders L.L.P. & Dempsey and Coopers & Lybrand to carry out all aspects of the privatisation assignment. Squire, Sanders & Dempsey is the premier international law firm in telecommunications privatisation transactions. Coopers & Lybrand is the world's leading telecommunications accounting and consultancy firm. The Macedonian telecom was sold to the Hungarian telecom company MATAV. According to the decision brought by the Government of the Republic of Macedonia in 1996, 'PTT Macedonia' was divided in two entities -1) AD Macedonian Telecommunication and 2) AD Macedonian Post Office, that entry into force from 1st of January 1997. This has resulted with the division of the post office from the telecommunication and telegraph, and with the division of its assets and responsibilities. In March 1998 the company was registered in state ownership in order to start the preparations for getting privatised.

On 15 January 2000 the Government of the Republic of Macedonia and the Consortium lead by the Hungarian telecommunication operator MATAV, member of Deutsche Telecom group, signed a sale and purchase contract for stocks of Macedonian Telecommunication, which makes MATAV shareholder of the 51% of the shares, and by default the major shareholder of the company (Table 1).

Starting with the 1st July 2001 the operations and assets of the sector for mobile telephone of the Macedonian Telecommunication AD Skopje was transferred into the newly founded corporation Mobimak AD Skopje (Daughter Company with 100% ownership of the Macedonian Telecommunication AD Skopje)

The Privatisation Commission of the Government of The Republic of Macedonia, on the 17.04.2006 brought the decision for selling the shares of state ownership in Macedonian Telecommunication AD Skopje. Subject of the purchase were 43,247,250 common shares with participation of 45,125% (remaining from the purchase by MATAV) from the nominal capital of Macedonian Telecommunication AD Skopje.

TABLE 1: Ownership structure of the Macedonian Telecommunication AD Skopje and the participation in the counted value is as follows

	Number of stocks	Participation in %	Participation in 000 EUR
MATAV – common shares	48,877,780	51.00	310,834
International Financial Corporate – common shares	1,796,980	1.875	11,428
RM – common shares	45,164,020	47.125	287,217
RM – golden shares	1		1
Total – common shares	95,838,780	100.00	609,479
Golden share	1		1

The state ownership shares are sold through public stock exchange auction. The payment was supposed to be realized in cash. If the buyer is foreigner, then the shares are paid in foreign currency. The sale of the shares was realized in the period 5 – 9 June 2006 through the Macedonian stock exchange AD Skopje. The limitation in the shareholders agreement is that the Government of RM cannot sell more than 10% of the remaining capital. After the privatisation the RM remained owner of the 1,916,770 common shares or 2% of the total number of shares of Macedonian Telecommunication, and also owner of the golden share. The income from the privatisation of Macedonian Telecommunication was decided to go to the state budget. This generated a surplus on the 2001 budget.

In 2009 the Ministry of Transport and communications has announced the second tender by which it is looking for a consultant which will prepare the study for the most favourable model for the partial privatisation of the posts. The consultant should propose the model for the privatization within the period of 6 months.

This is the second announcement, the previous one which ended at the end of last year, was cancelled because the six applied companies did not fully comply with the terms and conditions prescribed.

Their interest then to enter into the Macedonian posts was announced by the German and the Slovenian posts, and the Canadian one was also mentioned as a candidate. Six companies had submitted their offers but the Commission for the procedure for issuing of the contract for the public tender did not chose the most favourable candidate because the companies did not fully fulfilled the conditions prescribed. In compliance with the Law for public tenders, the second tender has been announced for the election of consultancy team, the Ministry informs.

The Ministry had planned that the sale is carried in two phases and to finish until the end of 2009 or in the first quarter of 2010. The plan was that a minority part of the shares is sold, and according to the plan in the first phase 20,5 of the shares would be sold. The second phase of the partial privatization will be to sell the rest of the 49 % of the shares, whereas the majority part of 51 % to remain within the property of the country's government. The management would be taken over by the foreign company, and the Government would have its own share in the company.

Concession of the airport "Alexander the Great" – Skopje and the airport "St. Paul the Apostle" – Ohrid, and construction of a new cargo airport in Shtip

The Minister of the Transport and Communication at the beginning of July 2007 brought a decision for choosing the most favourable bid for hiring a consultant team for preparation of a Study with a concession model for development of the airports "Alexander the Great" – Skopje, and the airport "St. Paul the Apostle" – Ohrid. In accordance with Articles 33, 43 and 44 of the Law on Concessions and other types of PublicPrivate Partnership („Official Gazette of the Republic of Macedonia" No.07/08), the Decision of the Government of the Republic of Macedonia for commencement of a procedure for awarding the concession for construction, reconstruction and operation of the airports, the Commission for concession awarding procedure, established with Decision No.02-5084 by the Minister of Transport and Communications, announced a public invitation⁵³.

In September 2007 the Contact for consulting services was signed with the most favourable bidder-the company NACO B.V from Netherlands which is obliged, within a period of 6 months after the contract becomes effective, to prepare a Study with a concession model for development of the two airports in the region, possibilities for financial support of the development and strategy for the investment needs of the airports. Apart from this, the consultant is obliged to check the spatial-urbanistic and aviation-traffic possibilities for construction for construction of smaller cargo airport in Shtip, class 3D and visual access.

53 The public invitation is given in Appendix I

In December 2007 the consultant sent a draft report to the Ministry of Transport and Communications and it was adopted by the Government of the Republic of Macedonia. The Government of the Republic of Macedonia started the procedure for awarding concession for construction, reconstruction and use of the both airports in the Republic of Macedonia as well as, for construction of a new cargo airport in Shtip. The procedures took part in the year of 2008. On 29.02.2008 and 01.03.2008 was published *Expression of interest* for all participants interested in participating in the procedure for awarding concession for the two airports and construction of a new cargo airport in Shtip, issued by the Ministry of Transport and Communication. On 10.04.2008 was issued a *Public call* to all interested entities to submit a request for participation in the procedure for awarding concession for the two airports and construction of a new cargo airport in Shtip. On 19. 05. 2008 was announced a *Public opening* of the tender documentation in the first phase (See Appendix I).

The information on the tender dossier for Phase II " Request for Offer" regarding the procedure for awarding of the concession is adopted by the Government of the Republic of Macedonia at the 104th session on 12 July 2008. On 15th of July were undertaken the following activities:

- Issuance of the Request for Proposal
- Submission of tender documentation for phase II RFP and
- Data Room access granted to Qualified Bidders.

The submission deadline for Qualified Bidder questions on RFP was set for the 6th of August, and within these two days a conference was held in Skopje for *Qualified Bidders and Site visit*. The decision for selection of a concessionaire in the procedure for awarding a concession for the airports and for construction of a new cargo airport in Shtip is adopted on the session of the Government of Republic of Macedonia on 29 August 2008 and published in the Official Gazette of the Republic of Macedonia No 108/08. The notification of the tender winner was announced on 02 September 2008, registered as "TAV Macedonia" DOOEL. The Turkish company TAV has signed an agreement with the Macedonian Government being the sole bidder for the tender. The Concession Agreement will entry into force within a period of 341 days as of the date of signing the agreement. The signed Concession agreement refers to a concession with duration of 20 years. The airports should be ready within three years.

With the tender, TAV obtained the right to operate Macedonian's two largest international airports for 20 years. The company has promised to invest 200 million euros in the airports. It is estimated that the modernization work will be finished in 20 months at the Skopje airport and in 12 months at the Ohrid airport. The construction of the Shtip cargo terminal will be completed in three years.

As an investment worth more than EUR 250 million, the concession of the construction airport of the airports in Skopje, Ohrid and Stip presents an important reform in the field of infrastructure. Thus, air traffic in the Republic of Macedonia can maintain the already commenced trend of strong growth of the traffic, and such investment will also contribute to growth in the construction sector of the Republic of Macedonia.

Appendix 3:

Table 1. Summary of telecom privatization in different Transition Economies between 1993 and the end of 2002

Country	Company	Date	(US\$ Millions)	Method of Sale	Fraction Sold
Albania	Albanian Mobile Communication	Aug 00	\$128.6	Asset sale ¹	85%
Bulgaria	Bulgarian Telecommunications Company	Apr 00	\$600	Asset sale	51% ²
Croatia	Croatian Telecom	Oct 99	\$850	Asset sale	35% ³
Czech Republic	Cesky Telecom	Jul 95	\$1,460	Asset sale	27% ⁴
Czech Republic	Ceske Radiokomunikace	Sep 97	\$11.5	Asset sale	20.8%
Czech Republic	Ceske Radiokomunikace	Jun 98	\$134	SIP	19%
Estonia	Estonian Telecom	Feb 99	\$221	SIP	23.7%
Hungary	Matav	93	\$875	Asset sale	30%
Hungary	Matav	95	\$852	Asset sale	—
Hungary	Matav	Nov 97	\$1,200	SIP	17%
Kazakhstan	Kazakhtelecom	97	\$370	Asset sale	—
Latvia	Lattelecom	Jan 94	\$160	Asset sale	49%
Lithuania	Lithuanian Telecom	Jun 00	\$160	SIP	25%
Macedonia	Macedonian Telecommunications	Dec 00	\$326 ⁵	Asset sale	51%
Poland	PZT Telekom; Teletra	93	\$37	Asset sale	80%
Poland	Telekomunikacja Polska (TPSA)	Nov 98	\$1,020	SIP	15%
Poland	TPSA	Jul 00	\$4,300	Asset sale	35% ⁶
Romania	Rom Telecom	Nov 98	\$675	Asset sale	35% ⁷
Russia	Svyazinvest	97	\$1,870	Asset sale	25% ⁸
Russia	Mobile Telesystems (MTS)	Jun 00	\$384	SIP	—
Serbia	Serbia Telecom	Jun 97	\$869	Asset sale	49% ⁹
Slovakia	Slovak Telecom	Jul 00	\$950	Asset sale	51% ¹⁰
Ukraine	Ukrainian Mobile Communication	Nov 02	\$194	Asset sale	57.67% ¹¹

Source: Parts form Table 8.4 (Megginson, 2005)

Note: This table presents key information about telecommunications privatizations executed by governments in several Transition Economies. The method of sale refers to whether the company was divested via a share issue privatization (SIP) or asset sale.

(Footnotes)

- 1 Payment made in two tranches: \$85.6 million initially and then \$85.6 million six months later. Stake sold to a Cosmote/Telenor company, a consortium of OTE (Greece) and Telenor (Norway). Buyers also pledged to invest an additional \$120 million to expand the network and improve service quality.
- 2 Stake sold to consortium of OTE (Greece) and KPN (Netherlands). Buyers also agreed to invest in additional \$350 million over three years and to share \$200 million in profits with local government authorities.
- 3 Stake sold to Deutsche Telekom.
- 4 Stake sold to consortium of Swisscom and KPN.
- 5 The buyer, Hungary's Matav, also promised to make capital investments of \$229 million.
- 6 Stake sold to France Telecom-led consortium. France Telecom acquired a 25% stake, while its Polish partner, the private conglomerate Kulczyk Holding, purchased the remaining 10% stake.
- 7 Stake sold to Greece's OTE, which will gain management control of Rom Telecom.
- 8 25 percent plus one share sold to the Mustcom consortium, which includes George Soros, and to the Interos financial group headed by "oligarch" Vladimir Potanin.
- 9 Stake sold to OTE of Greece and Italy's Stet.
- 10 Stake sold to Deutsche Telekom
- 11 The Russian company Mobile Tele Systems (MTS) bought this stake, which includes 25% of Ukrtelecom shares, and signed option agreement to buy the remaining 42.33% for \$142.6 million in 2003-2005.

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