2015

STATE AND BUDGET
Mind the Bill!

Instituti Riinvest

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CONTENT

ABBREVIATIONS

KTA - Kosovo Tax Administration
WB - World Bank
EU - European Union
EBRD – European Bank for Reconstruction and Development
GDP - Gross Domestic Product
SIK - Statistical Institute of Kosovo
IMF – International Monetary Fund
IPA - Instrument for Pre-Accession Assistance in EU
MTEF - Middle-Term Expenditure Framework
KEC – Kosovo Energetic Corporation
MEF – Ministry of Economy and Finance
MTPT – Ministry of Transport, Post and Telecommunication
PTK – Post and Telecommunication of Kosovo
SBA - Stand-by Agreement
SMF - Staff Monitored Program

EXECUTIVE SUMMARY

This policy paper is focused on the issue of budget sustainability, and the interlink with major projects like privatization of Post and Telecommunication of Kosovo (PTK) and construction of the highway "Ibrahim Rugova". This policy paper was drafted by using primary data gathered for the purpose of this research and other secondary data from the research fund of Riinvest Institute and other agencies.

This paper aims to (a) improve the information of policy makers and other interested stakeholders of the society regarding the issue of budget sustainability in following years regarding unsafe resources for financing big capital project already contracted and (b) to improve the decision-makers' transparency and accountability in these processes, as well as (c) to help the process of budget review for the second half of 2011. The main motive for drafting this policy paper was on the actions of the Government of Kosovo towards the implementation of these projects in circumstances when no necessary cost benefit analyses were made. There was also a lack of meaningful debate initiated especially by public institutions (Parliament and Government) but also by other interested parties. In absence of these debates the following questions are raised: (1) what are profits and losses from these capital projects; (2) how to find secure resources of financing these projects; (3) how to increase our credibility in relation to international organizations and who should take responsibility for damaging of these relations lately; (4) and last but not least important, how to ensure active participation of the parliament?

These questions should be clarified through broad public debates in society which aim at establishing of a basic consensus between interested key stakeholders. This consensus is a precondition to ensure the necessary political support for these important processes, the effects of which will be experienced not only from us but also from the future generations, as well as avoidance of possible political and social tensions that could compromise this policy and these projects. The authors of this policy paper believe that construction of the road infrastructure that would provide opportunities for increase and integration of regional markets is essential for development of the country. However, this process should be based on appropriate legal framework which ensures adequate policies and procedures, ensures transparency and accountability and contributes in accelerating of economical growth and sustainable development of the country. These projects should be based on previous analysis that measure the costs and profits of the country and implications they have on budget sustainability.

Policy paper is organized as following: The first chapter includes analysis on budget planning and sustainability of Kosovo, implications that are a result of country's relation with International Monetary Fund (IMF), budget planning and possible scenarios of financial situation. The second chapter describes the history of construction of the highway "Ibrahim Rugova", budgetary and legal implications as a result of it, analysis on financing of the Highway, a case study from construction of a highway in Romania and possible scenarios of highway management. The last chapter includes analysis on

PTK performance and implications that result from the strategy of its privatization, a case study on privatization of Turk Telecom and privatization scenarios of PTK.

Key conclusions drawn from this policy paper are as following:

- Parameters of budget sustainability in Kosovo have shown degradation by moving within few years from enormous surpluses to deep deficits. Kosovo is spending more financial means then generating by creating thus budgetary gaps that could be financed from bank balances or one-time incomes[1]. Parliament approved the budget that provides budgetary deficit of 5% of GDP, and which is above the maximal limit of 3% foreseen by Maastrich criteria. Moreover the unreasonable populist policies based on electoral effects have deteriorated county's budgetary situation and have degraded Kosovo's relations with International Monetary Fund. This degradation decreases Kosovo's state credibility towards international agreements and constrains integration of Kosovo in important institutions (especially in short term period it jeopardizes country's membership in European Bank for Reconstruction and Development (EBRD) and International Trade Organization).
- Redesigning of the agreement with IMF from the contractual beneficiary relation in a non-beneficiary and informal relation is a step back for Kosovo in all integration processes, in the macro-fiscal sustainability and in attracting potential investors. This redesigning of the agreement leaves the deficit of Kosovo uncovered for 2011, thus postponing the need to utilize the bank balance gathered for years and the one-time income from selling of national assets.
- Such management of public money is unsustainable since it is sustained by permanent generation versus one-time income generation. While Kosovo might cover the deficit of 2011 with money coming from bank balance, it might as well close up 2012 with money coming from PTK privatization, the following years will be quite a challenge for generating of any income for covering of planned deficits.
- The biggest part of the state budget provided by country's strategic documents (Budget and Middle-term Expenditure Framework) is expendable and with low possibility of investment in new capital projects. Even though participation of capital investments in Kosovo's budget is relatively higher in relation to other countries in the region, this is related to only one project, the highway one, and does not allow space for new capital investments. Regarding goods and services, Kosovo spends relatively more than Serbia and Macedonia compared to its budget. Increase of expenditure on wages in contradiction to the international agreements deteriorated this situation even more.

1 Government plans utilization of bank balance, which is 244 million Euros in 2011 to cover the budgetary gaps of this year. At the same time PTK is considered as sufficient for covering of following deficit.

- Highway “Ibrahim Rugova” is expected to be finished within three years. However, the whole process did not proceed without problems. During this process, on 27 April 2011 Government of Kosovo decided to change the track of the road. This change of the track will reflect on the total cost of the highway, the value of which is unknown since the official expenditure projection was not published by the Government of Kosovo.
- The Highway will shorten the road from Kosovo to the seaside, but will also provide opportunities for increase of economical cooperation between two countries. Moreover, it will provide the opportunity for using the Albanian port by other countries of the region. This surely creates an added value for the country and provides an opportunity for Kosovo to become from a country of final destination of product transport into a transit country for goods of neighboring countries.
- Construction of the highway “Ibrahim Rugova” carries legal implications as well, which come mainly from two aspects, lack of Strategic Evaluation of the Environment, as well as the decision for changing the track of the highway. Government did not take into account the Strategic Evaluation of the Environment of the project for road construction, which is provided by Law No. 03/L-015 announced in Official Gazette on 24 March 2009. More precisely, it has violated almost all articles and paragraphs of this law - article 7, 13, 16, 20, 21, 22, 24. The second implication was caused by the decision to change the track of the highway. Government of Kosovo reached the decision for changing the track of the highway during its meeting on 27 April 2011. Such a decision is in contradiction with the decision of Government no. 13/10 reached on 7 March 2008, by which it recommends to the Parliament to approve the track of highway Vermice-Merdare as a zone of special economic interest, a decision that was approved by the Parliament of Kosovo on 2 June 2008. Also, according to the Law on Spatial Planning, article 12.6, following the drafting of spatial plans for special interest zones, ministry delivered the to the Government for preliminary approval and Government proceeds them to the Parliament for final approval, which never happened.
- Financing of the highway “Ibrahim Rugova” was mainly based on means of the budget of Kosovo, by risking thus the country to enter into a deep budgetary deficit and by making it impossible for other capital investments.
- Construction of the highway “Ibrahim Rugova” does not have an independent professional supervision, and this fact creates the possibility of over-reporting of the volume of engaged input in construction by the contracted party, as well as the possibility of incorrect reporting regarding the quality of works.
- According to the current planning, highway “Ibrahim Rugova” will be constructed mainly from the budget of Kosovo through one time income (income planned from privatization), as well as through loans that may be internal or external. However, the current situation Kosovo is in, without an international loan ranking, with degrading relations with IMF and loss of foreseen loans due to the violation of

previous agreement, does not create the space for loan support from external financial institutions, even commercial ones.

- Strategy for privatization of PTK presents ambiguity in relation to the position that Post of Kosovo has in the transaction. Non-clarity regarding division of shares between private investor and Government of Kosovo produces three potential scenarios with different variations of final property.
- Selling of PTK to cover the trade deficit and pay the contracted projects, formalized with the agreement with IMF, lowers the negotiating position of Kosovo towards investors and decreases the potential value of this public asset.
- PTK had a degradation of its performance which resulted with two directions. First, entering of the competition in mobile operator and second the mismanagement as a consequence of political interventions in this public enterprise. Board members and management appointment was made on party basis who allowed an over-employment during last years. This will reflect on the offer that private investor will make for this enterprise.

RECOMMENDATIONS

- Qeveria pas ridizajnimit të marëdhënieve me FMN-ën, duhet të • Following the redesign of relations with IMF, Government should reflect on review of financial documents for the semi-annual period, with special emphasis on 2011 Budget and Middle Term Expenditure Framework (MTEF). Financial implications resulting from redesigning impact country's financial planning. Financial documents with current financial parameters are unreal.
- Capital projects should be lead by a cost and benefit analysis. Such analysis aims to create a basic consensus for capital projects and budget implications in long-term periods. Absence of these analysis raise suspicions of interested parties for abuses and mismanagement.
- Government should make public the contracts of capital projects that are financed through citizens' taxes. Such a practice increases transparency, accountability and informs equally all interested parties. Thus, cost and benefit analysis by a project as well as progress supervision becomes easier.
- Government should look for opportunities of re-negotiation of the contract with Bechtel and Enka and to postpone the payment of the first installment for the completion of the first part of the highway. Such an act has precedent in Romania.
- Government should, as soon as possible, contract a professional private company, which would conduct the control of quality and quantity of works on highway completed by construction company Bechtel & Enka. Control of quality and quantity of works would prevent the possibility of over-reporting of volume and quality of works done by

the construction company.

- To make further budgetary reductions with the aim of reduction of planned deficit for the following years.
- Should use the possibility of capital investment financing through involvement of private sector in a public-private partnership. This would ease the budgetary burden and would enable a long-term budget sustainability.
- Government of Kosovo should make clear the ambiguity regarding PTK privatization and participation of Post of Kosovo in this process, prior to closing up the process.
- Government should respect international contracts and should be careful in taking decisions that harm the country's contractual credibility and risk the integrative perspective of Kosovo.
- Parliament of Kosovo should be more active to hold the government accountable for the situations when the later risks international agreements. Parliament should also not approve laws (like the case of draft project) that are in contradiction with international agreements.

METHODOLOGY

This report is prepared by Riinvest Institute based on primary and secondary data. We have undertaken a survey by using relevant sources, including the analysis of existing reports and other information available from various institutions and research fund of Riinvest Institute. We were focused on the issue of budget sustainability and its interlink with major projects, such as privatization of Post and Telecommunication of Kosovo (PTK) and construction of the highway "Ibrahim Rugova". Research of each case resulted with a series of questions that compile the basis of the semi-structured questionnaire which was used during the interviews with the most responsible officials in respective ministries and public enterprises. Riinvest institute expresses its gratitude for minister Besim Beqaj, MZHE, former minister Fatmir Limaj, MTPT, former minister Haki Shatri MEF, executive director of the Kosovo Foundation for Open Society (KFOS), Luan Shllaku, directorate of the department of road Infrastructure within the Ministry of Infrastructure, Rame Qupeva, PTK officials (Menduh Abazi, Seremb Gjergji and Arsim Bilalli), Members of Parliament (Myzejene Selmani, Hykmete Bajrami, Visar Ymeri), Agron Demi, director of GAP Institute, as well as Besnik Bislimi, expert of economy who shared with us their opinions and considerations on these issues. The report also includes two case studies that address the privatization in the industry of telecommunication in Turkey and construction of the highway in Romania. Riinvest thanks all parties involved in development of this report for their contribution, while taking all the responsibilities for findings and conclusions in the report. We also want to thank Kosovo Foundation for Open Society (KFOS) for the support in this project as well as "Forum 2015" for initiation of this research and this debate.

1. BUDGET SUSTAINABILITY

Parameters of budgetary sustainability in Kosovo have shown oscillations within years, with a tendency of surpluses during the first years and deficits increasing during the last years (fig 1). While first surpluses were created from lack of planning skills for budgetary projections, constraints in law on public procurement and stagnation on budgetary expenditure, later deficits happened as a result of hyper-expenditure against a restrictive increase of income although law on public procurement has been amended. This transfer from redundancy of public money in absence is an indicator that Kosovo is spending more than it is generating, by creating budgetary gaps which may be financed by bank balances or one time incomes[2] .

Fig. 1. Budgetary developments of Kosovo 2000-2013 (surplus / deficit as percentage of GDP

Source: International Monetary Fund * (2011-2013) Planned ** (in milliard €)

Government of Kosovo plans to collect 1.2 billion euro with the budget of 2011, or 140 million more then last year, and to have a record expenditure for the country of 1.4 billion euro, or 230 million more then the previous year. In these lines draft budget shows a primary deficit of 170 million euro. If loans for public enterprises are added to this, with special emphasis to Kosovo Energetic Corporation (KEC), the overall deficit for 2011 is 226 million euro. According to projections of International Monetary Fund (IMF), Kosovo plans to have e Gross Domestic Product (GDP) of 4.6 billion euro for this year. Deficit of 226 million euro is equal to 5% of country's GDP.

2 Government plans utilization of bank balance, which is 244 million Euros in 2011 to cover the budgetary gap for this year. At the same time PTK is considered as sufficient for covering of following deficit.

Approved parameters in Law on 2011 Budget, by Parliament of Republic of Kosovo, clearly violate the most important financial rules of European Union, by almost a double overpass of limits. If Kosovo was an EU member state, such a budgetary approval would be impossible.

KTA and fiscal evasion:

"Kosovo Tax Administration has 700 fiscal inspectors in total, out of which 350 work on the field. Their wages and complementary capacities are modest in comparison with the power of fiscal evasion."

Assumption of the relation 5% of GDP is built under the expectation that Kosovo Tax Administration (KTA) and Customs of Republic of Kosovo will collect on average over 18% of incomes more than last year. This objective seams high if one has in mind the annual rhythm of budgetary income increase which does not go over 10%. Moreover, country has the lowest number of tax inspectors per citizen in whole of Europe.

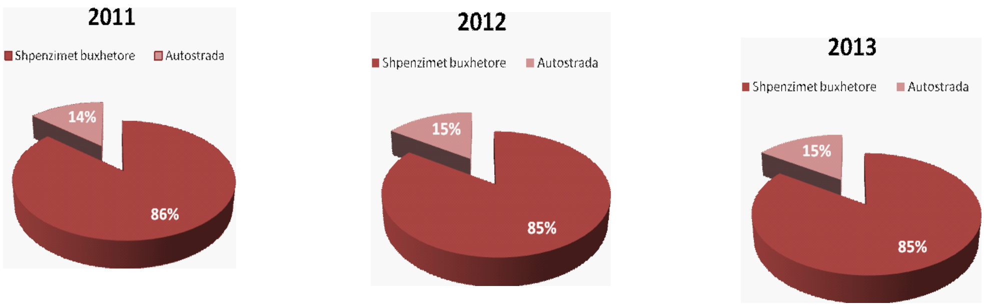
KTA has 700 fiscal inspectors in total, out of which only 350 work on the field. Their wages and complementary capacities are modest in comparison with other countries in the region. Limited capacities of fiscal inspectors and high level of corruption in Kosovo creates a high possibility for them to be involved in corruption. According to Global Corruption Barometer of 2010 from Transparency International, Kosovo was ranked with the highest level of corruption in the region, with a coefficient of 2.8 (countries qualified with extended level of corruption were the ones that have a coefficient of 0.8). Moreover, country continues to be the only one without Financial Police. On the other had, Customs are not able to extend their control in 17% of the country, in points 1 and 31, which are the constant sources of informality and fiscal evasion. Solving of these customs' problems is more a political issue than a technical one, and the same leaves no space for optimism during 2011, period when Government plans to have a double rhythm of incomes. The first perception established by collecting mechanisms, Customs and KTA, tried to make optimistic objective relative. During first two months of 2010, both mechanisms reported increase of income for 34% compared to the same months of previous year. However, this increase has a real base on increase of customs fees which was applied from July 2010 in some products like cigarettes, alcohol, new and old vehicles, oil and gas. Comparison of January 2011 that has this customs fees with January 2010 without this customs fees, statistically is irrelevant, therefore increase on performance of KTA and Customs should be seen on real ciphers and not nominal ones.

Maastricht II Criteria:

"Governmental annual deficit: Norm of governmental annual deficit with Gross Domestic Product (GDP) should not exceed 3% at the end of the fiscal year. If not, it is demanded to at least reach near 3%. Only extraordinary cases and temporary exceeding may be allowed."

On the expenditure side, Government of Kosovo has left little space for insurances in case of any risk. Year 2011 is a record year regarding capital investments. They were planned to have a value of 572 million euro, from which 448 million euro are invested from central level and 124 million euro from municipal level. Ministry of Infrastructure leads with the capital investment pot of 263 million euro in total; from which 225 million are planned for the first installment of the highway and 30 million for road investments remained from 2010. Saying this, new investments in road infrastructure will be only 8 million euro, this being a drastic decrease compared with previous years. Since the major part of capital investments are already contracted for following years, their reduction in case of financial risks is impossible.

Fig. 2. Cost participation of highway "Ibrahim Rugova" in budget expenditure



Source: Budget of Kosovo 2011

Highway "Ibrahim Rugova" (fig 2) takes the biggest part of the expenditure pot even in the following years. Cost of highway for three following years is planned to be shared in 225 million for 2011, 265 million for 2012 and 269 million euro for 2013. These forecasts may be even higher if the contracting company performs better than the work plan. While, reduction of highway's yearly cost will happen only in case of re-negotiation of the contract by the Government of Kosovo with construction company Bechtel & Enka.

1.1 BACKGROUND OF THE RELATION WITH IMF

According to the budget of 2011, agreement with International Monetary Fund, presents the core source of deficit financing. Not due to the fact that all external financial resources are based on IMF money, but due to the fact that even financial resources from other international institutions (European Commission and World Bank) are interconnected with IMF committed funds and agreements with it.

IMF and Kosovo:
"Violation of the agreement raised the need for redesigning of the relation between IMF and Kosovo. Macro-fiscal un-sustainability, mainly based on one-time income and long-term expenditure made the Fund to lower the level of cooperation with Kosovo on monitoring level"

In July 2010 Parliament of Kosovo ratified the previous agreement of Government of Kosovo with IMF and World Bank. The approval for membership in IMF was reached following political pressure from most contributing countries in this fund. This acceptance was seen as the biggest achievement of the Government after declaration of independence. Approval of 2011 Budget and one-sided violation of program agreement of 2010 contributed for this achievement to be put under a serious risk. In 2010, pushed by the budgetary conservatism, Government of Kosovo signed an international agreement with IMF, known as "Stand-By Agreement". From this agreement, implementation of which requires a budgetary conservatism, 3 key elements are worth mentioning: a) wages in public sector can not exceed 7.4% of GDP, or 290 million euro; b) selling of PTK should generate 300 million euro to cover the deficit; and c) budgetary deficit should be kept within EU framework. While budgetary deficit for 2010 was kept within these limits, beginning of 2011 showed extra expenditure which over-passed limits of the previous agreement. Increase of wages in 378 million euro over-passed limits of IMF for 35%, contrary to the increase of GDP for only 4.6%. Such an increase was one-sided violation of an important financial agreement, which had a guarantee of 110 million euro financial aid from IMF[3] . Violation of the agreement raised the need for a redesign of the relation between IMF and Kosovo. Macro-fiscal un-sustainability, based manly on one-time incomes and long-term expenditure resulted with the Fund decreasing the level of cooperation with Kosovo in the monitoring level, with a new agreement in May 2011 "Staff Monitored Program". According to the same, Kosovo should go through six months of strict reporting to have the right, in the most optimistic case, in

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STAND BY ARRANGEMENT (SBA) vs. STAFF MONITORED PROGRAM (SMP)

SBA is a form of financing of countries with the aim of overcoming short-term problems over financial balances. Established on 1952, this program mainly serves for emergent economies, such as Kosovo's, and in most cases has symbolic interest rates. Kosovo signed such a program last year, and in return, 110 million euro were guaranteed only for 2011. This program as a necessity has constant and very strict controls. Kosovo was supposed to pass four controls, but did not pass any due to the one-side deviation by the case of wage increase and non-implementation of the income on time. This shortcoming resulted with the country's re-negotiation of the program with International Monetary Fund. Re-negotiation did not find any convincing basis due to the planned hyper-expenditure, thus ending at a lower level relation with Fund known as "Staff Monitored Program". The same is offered to countries that are part of IMF, but due to eventual disagreements and the need to fulfill given criteria, don't benefit financially from the Fund. SAP is an informal agreement, which establishes country's relations with local Staff of the Fund (despite SBA that has relations with Board of Washington) and does not include any financial assistance. The idea behind such programs is enabling the countries through following of strict rules and periodic evaluations, in order to reach a financial sustainability. The same is offered to mainly problematic countries. Programs like these have countries such as Zimbabwe, Swaziland, Sudan and Congo (IMF 2011).

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3 From IMF planned aid from IMF Kosovo already received the first installment of 21 million. The second and third installments were conditioned with the regular reviews that should be conducted by the Fund.

March 2012 to go back to a formal relation and a beneficiary contract, like the one of 2010.

In general, violation of the first agreement reached with IMF has three losses:

- First loss, and the most immediate one is the one of financial aid for this year, which in the approved budget translates into 167 million euro. This sum was planned to finance the deficit of this year from 2011 Budget approved by the Parliament of Kosovo. In its absence, Kosovo finances the deficit out of bank balance, or money collected throughout the years, which is 244 million euro. As a result, by the end of the year Kosovo might be a country with very low liquidity.
- Second loss is linked with integration of Kosovo in stabilization and European processes. Inflation of relation with IMF inevitably impacts country's progress towards integration processes in international mechanisms. First damages might reflect on integration of Kosovo in European Bank for Reconstruction and Development, the importance of which is vital for financing the development capital in Kosovo. Besides this, degradation of relation with IMF translates into a regress on inspections of European Commission in the Regress Report.
- Third loss derives in the relation with foreign investors. Our country is seen as unstable, unsafe and unable for strengthening the agreements and contracts. This uncertainty makes Kosovo less attractive for bringing foreign capital. Besides this, potential non-liquidity of the country increases the risk of making business.

Monitoring period with IMF will demand fulfillment of several strict rules. According to the Fund's declaration, Kosovo should ensure a decrease of the deficit on allowed norms of 3.5% (Point 16 of the Final Declaration 2011). Fund will also request decrease of budget expenditures alongside increase of the income. All new capital investments will have to include a cost-benefit analysis with special emphasis on specification of financial resources (including the Highway Prishtina-Skopje). Fund also forbids the use of privatization money and retirement fund with the aim of filling in the budgetary gaps.

Redesigning of the relations with IMF creates the need for budgetary reflections in two financial documents of the country: Law on 2011 Budget and Middle Term Framework of Expenditure. Non-acceptance of financial assistance from IMF, World Bank and European Commission reduces the bank balance and thus the possibility for financing the following deficits. At the same time, financial possibilities of Kosovo to finance Law on Veterans and Law on Political Prisoners are minimal.

Along these restrictive lines of expenditure of public money, becomes impossible the reflection of public servant wages in inflation rates, and which are expected to be from 5-8% for period 2011-2013 (ESK 2011). On the other hand, freezing of wages in 2011 and two following years implicates that all non-beneficiaries of this raise will have lower purchasing power towards forecasted inflation rates. Warnings for protests by non-beneficiaries could be a potential risk of social dissatisfaction.]

1.2 BUDGET PLANNING

Table 1. Budgetary structure in Kosovo and region

	RKS	ALB	SRB	MK
Wages and Salaries	26.70%	16.95%	23.22%	14.55%
Goods and Services	12.83%		5.56%	10.74%
Subventions and Transfers	18.96%	0.41%*	46.78%	6.85%
Capital Expenditure	39.88%	20.15%	3.75%	14.59%

Source: State budgets of Kosovo, Albania, Serbia and Macedonia for 2011
***Only subventions**

Based on the data presented on table 1 from budgets of four countries in the region Kosovo must have oriented main part of the budget on capital expenditure by allocating around 40% of the budget in this segment, while from other countries in the region only Albania has allocated around 20% of the budget for capital investments, while Serbia and Macedonia have allocated less than 15% of their budget. Regarding the budget line of Wages and Salaries, in the budget of Kosovo this line comprises 26.7% of the budget, while in other countries of the region the proportion of wages and salaries varies from 14.55% to 23.22%. Regarding goods and services as well, Kosovo spends relatively more than Serbia and Macedonia in relation to the budget they have. These indications give a picture on financing sources of country's capital projects that seem to be based mainly on government investments. On the other hand, the level of capital investments in the neighboring country, Republic of Macedonia, in 2006 was as much as 3.8% of GDP, in 2008 around 6% of GDP, while in 2009 around 7% of GDP, approximately as same as the level of EU new member states. From total public investments in Republic of Macedonia, less than half of this sum (around 49%) was financed by the state budget. The other part of investments was financed from funds and grants outside state budget, including EU funds offered as supporting instruments for preparation of countries to fulfill the accession conditions. Moreover, the investment trend from 2009-2011 has a decreasing tendency by reducing for around 17% (Public Investment Program in Macedonia, 2009-2011[4]).

Kosovo budget structure seems to be an extreme case in relation with countries in the region since two budget lines, wages and salaries as well as capital expenditure comprise around 66% of the budget for 2011, while in countries of the region, Albania has allocated the closest proportion of its budget regarding these two lines, which does not exceed 38% of the total budget of the country. Such an indicator shows that government of Kosovo is more ambitious in its projects. However, such an ambition should be well managed since its cost in the future could be high for citizens of the country.

The possibility of financing public investments through inclusion of private sector in a public-private partnership was not used by the Government of Kosovo, while all public investments were supported by budget incomes. Moreover, breaking of the agreement with IMF will have a negative impact on the possibility of receiving external loans. In

4 www.investinmacedonia.com

such a situation, public capital investments will mainly rely on budget incomes which are limited, and as such will limit the investments as well.

1.3 FINANCIAL SCENARIOS

Financial stability of Kosovo is linked with many public capital projects in one hand, and the cooperation with international financial institutions which present key supporting factor for such processes. End of year 2011, will determine for Kosovo the financial sustainability frameworks in short and medium term. Flow of public capital investments like Highway "Ibrahim Rugova", selling of PTK and fulfillment of agreement with IMF are three key factors that will determine the performance of Kosovo institutions in implementation of financial sustainability. Possible scenarios of Kosovo's financial situation are as following:

Scenario 1: PTK is sold, Agreement with IMF is Re-negotiated

If all the projects foreseen by the budget of Kosovo are implemented, by the end of 2011 will be spent all means coming from bank balance of Kosovo. On the other hand, privatization of PTK will compensate spent bank balance, and by the end of the year on 31 December 2011, Kosovo will have at least 300 million Euro in its balance. This will enable the fulfillment of the condition of the agreement with IMF (point 15), which obliges Government of Kosovo to keep at least 300 million Euro in its treasure. Fulfillment of the agreement with IMF will create the main precondition for receiving assistance from IMF in 2012. IMF assistance creates conditions for partial financing of budgetary deficit in middle-term period.

Scenario 2: PTK is not sold, Agreement with IMF is broken

By the end of 2011 Kosovo will spend its entire means from Bank Balance, as a result of public expenditure without financial coverage. PTK privatization process, planned to complete during the year, could stagnate and fail entirely, leaving the Government of Kosovo without reserves. In such a scenario the reached agreement with IMF will not be fulfilled, and as a consequence will fail also the possibility of receiving financial assistance from IMF in 2012. Thus, Kosovo will enter a financial crisis by loosing the ability of liquidity. Reducing the capital expenditure, unfavorable loans and swift selling of assets will become a necessity.

Scenario 3. PTK is not sold, Agreement with IMF is renegotiated

During 2011 Government of Kosovo will not complete all its public projects and will not fulfill the expenditure planned norm. Also, the privatization process of PTK will not be able to be completed until the end of 2011 due to the possibility of delays in transactions from private investor. However, delays in transaction from selling of PTK, will compensate from restructuring of payment installments for highway construction which would be a result of contract's renegotiation process. As a result of contract renegotiation the payment of 2011 installment will be postponed, in order for Kosovo Bank balance to be conserved in a value of at least 300 million Euro. As a result, the agreement with IMF and possibilities to receive financial assistance in 2012, is kept. IMF assistance in 2012 creates conditions for partial financing of budgetary deficit for middle-term period.

2. . HIGHWAY "IBRAHIM RUGOVA"

Highway "Ibrahim Rugova" is the major capital project of Government of Kosovo. The decision to construct the highway was reached in 2009 by Government of Kosovo, a project analyzed also by the previous government, but which was only in the level of analysis until 2009. According to the initial project, the road should pass through eight municipalities and cover around 1,062 hectare of land. From Prishtina to Vermica, in the boarder with Albania, and from Prishtina to Merdare, in the boarder crossing point with Serbia. Government gave arguments that Kosovo will benefit from the project since it will open European corridors, and at the same time employment opportunities would be created[5] .

On 19 January 2009, Reuters agency reported that company for construction and energy Enka Insaat and American engineering company Bechtel were nominated as preferred bidders of Kosovo for the highway project. According to the report, government officials valued that road will cost around 800 million Euro. According to the same source, the news impacted directly Enka Insaat company share values, which increased for 2.1%. Such an effect on shares of the winning company gives indications on the high value of the project. In the beginning of the year 2010, Government of Kosovo announced the American-Turkish consortium Bechtel & Enka as the most appropriate company for construction of the highway, which was chosen as the winner company. In order to enable the beginning of the work, it was necessary to expropriate private properties through which the highway would pass. Parliament of Kosovo, approved the law on expropriation of immovable property No. 03/L-139, supplemented by law No. 03/L-205 on 28 October 2010.

Highway "Ibrahim Rugova", the major capital project in country is expected to be completed within three years. Initially it was planned that the road would cover around 1,062 hectare of land. However, high cost of the project impacted the Government of Kosovo to change the tract of the road, the total cost of which is not determined

Despite the approval of the Law on Expropriation of Private Property, this process was manifested with many problems. Many of residents of Vermice filed appeals with the Supreme Court over expropriation price to them by Government in zones where the highway was being constructed[6] . Similar problem, due to dissatisfaction of evaluation of properties appeared also in the region of Suhareka. This indicates possible irregularities during the evaluation process, while a revision of property evaluation by Supreme Court will have additional implications on the budget of Kosovo.

The biggest capital project in country is expected to be completed within three years. However, the whole process did not pass without problems. In order to reduce the cost and prevent difficult mountain terrains, Government of Kosovo on 27 April 2011 reached a decision to change the track of the road. This change of the track will reflect on total cost of highway, the value of which is not known, since feasibility studies that would determine the costs and benefit of the project were not published.

Highway will shorten the road from Kosovo to the seaside, but will also enable increase of economic cooperation between two countries. Moreover, it will provide opportunities for utilization of Albanian port from other countries in the region as

5 Source: South East European Times Agency me date 01/02/2010 – www.setimes.com
6 Source: Newspaper Expres, 15 January 2011.

well. This surely will create an added value for the country and enables Kosovo to become from a country of final destination of product transport into a transit country for neighboring countries' goods. However, the value of each asset is measured in relation with costs that we need to pay, and Highway "Ibrahim Rugova" as well carries in itself a cost which in relation with country's economic situation is qualified to be quite a heavy burden for the country's budget, for which each citizen contributes through tax burden.

If construction of the highway "Ibrahim Rugova" enters in the fourth year of building, its cost for the remained works will increase for 12%.

2.1. HIGHWAY BUDGETARY IMPLICATIONS

Total amount expected to cost Kosovo for this project is around 700 million Euro (Evaluation given by the Prime-minister of Kosovo[7]). Even though, official expenditure projection was not published by the Government of Kosovo. This project, which has a huge financial weight compared to Kosovo's possibilities, demands secure financing resources. Bid bearers had this in mind since in the offer it was foreseen that winning company will also facilitate government of Kosovo in taking bank loans through which, in case of other financial inabilities, would pay the loan installments. Possibility of taking loans was foreseen to prevent eventual problems that may rise.

Government planned to allocate 765 million euro during the three year period in its budgetary projections. Highway will be constructed in 8 sections, and in case that government of Kosovo will not be able to pay for the works in any of the road sections, the works could be stopped. However, stopping or delay of works from the side of Government does not pass without costs. For every such a delay, Government of Kosovo will have to pay penalty fees that apply due to the opportune costs of technology and human resources of the contracting company[8] .

On the other hand, contracted prices per building kilometer are not fixed but rather determined per production factor units. Setting of the unit price and not of the amount that will be used, leaves an open option of excessive use of producing factor by the construction company. The contract, as such, exposes the budget of Kosovo towards even higher financial burdens from highway construction than the foreseen ones.

Moreover, on 16 May 2011, parliamentarian party Vetevendosje, in the Parliament of Kosovo made public a copy of the contract between Government and consortium "Bechtel-Enka" for construction of the highway "Ibrahim Rugova". According to the contract, prices for input unit are much higher than the local market price. Such a contracting position creates an opportunity for contracting enterprise for excessive investments that increases thus its profits on the prejudice of the ones that pay the bill. The deadline for finishing the highway within 36 months also exposes Government of Kosovo to a situation in which it might not be able to fulfill contracting aspects due to the non-sufficient financial potential. The deadline for completing the works has additional financial implications. If work on highway construction are delayed due to

7 Source: Newspaper Expres, date 12 May 2011 – www.gazetaexpress.com
8 Opportune cost of technology and human power is equal with the value of their alternative use.

the problems coming from the side of Kosovo government, then all the work that enter the fourth year of the project, will have an increased cost of 12% in order to reflect on the inflation and changes of the trade factor. Such a situation will aggravate even more the budget of Kosovo.

Besides general statements of government officials regarding the process, there is no official publication of parts of the contract which would prove such a thing, under the justification that publication of the contract is forbidden by one of the clauses included in the agreement with the winning company. Due to the official non-publication of the contract, one may not tell exactly the deadline for completion of work and neither the total cost of the highway.

On the other hand, a feasibility study was never presented which would offer the analysis of the cost-benefit through which the profits would be supported as well as costs that would be caused by such a capital investment. Principles of cost-benefit analysis offer a theoretical framework valuable for maximizing of the economical efficiency made by decision-makers (Bateman, et al., 2005).
Even if such an analysis would not offer positive values from the economical aspect, kosovars would have it clear how much is the real cost of the emotional, patriotic and integrating values translated in financial value in cultural and national aspect. A cost-benefit analysis would include all elements and factors that have a direct or indirect impact in possible costs and profits of the highway in many aspects, tangible and intangible. Besides others, this analysis would specify: construction cost, land cost, amortization cost, maintenance cost, compensation cot, vehicle operation cost, value of saved time, value of accident decrease as well as incomes that would emerge from the project as general profits (Bateman, et al., 2005).

Value of savings from change (shortening) of the highway track can not be determined due to the non-determination of the fixed price of the highway for any of the versions of the track.

Non-determination of fixed price of the highway impacted that project cost increases up to unbearable ciphers. Unbearable burdens for budget of Kosovo, as well as over-passing of costs above initial planning, seamed to have pushed Government of Kosovo to analyze alternative tracks of the highway which would have a lower cost. However, since the quantity of inputs that will be spent for construction of the road is not determined, even the alternative track, for which Government of Kosovo has decided, does not have a specified fixed price.

Details for changing the track were reviled by prime-minister of Kosovo, who emphasized that this change will save around 350 million euro to the budget of Kosovo. Change of the track will implicate additional 15 km of road or around 7 minutes more time for passengers who will use this highway in the future (quote from the prime-minister’s speech in Parliament of Kosovo, 28.04.2011).

Moreover, such a change of the track increases the traveling time, traveling cost, as well as the land opportune cost (additional part of 15 km) which would be used for other maybe more productive activities, as agricultural or industrial land. Also, this change impacts on extension of the road which would cover from Merdar to Morine from its initial version, while the length of the highway which will be constructed according to the new version is significantly shortened. Although the final track project is not finalized, the constructed highway will not pass over 90 km of length [9].

As a result, comparison between the two alternatives, for which there is no fixed value of total costs, makes impossible the evaluation of general savings. Decrease of expenditure for construction of the highway may ease part of the burden over the budget of Kosovo, but it does not mean that a kilometer of highway will cost cheaper than in the first version, since the total cost will partly be reflected from the shortening of the highway length.

The whole process of construction of the highway continued without supervision of works by an independent company. The first process of tendering a supervising company was annulled. Annulment of the process was done by Ministry of Transport, Post and Telecommunication with the reasoning that in the bank statement of the winning company "Merlino-Progretti & Politeknika", existed no data on the value of the company. Procurement reviewing body found this decision of the Ministry as illegal and fined the Ministry with 20 thousand Euro[10] . Re-tendering process continued until 18 May 2011, and the phase of evaluating the operator that will supervise the works has started. On the other hand, despite the lack of the works supervising operator, according to the directorate of roads within the Ministry of Infrastructure, the project is in constant supervision from the engineers of this ministry.

Continuation of works on highway "Ibrahim Rugova", the biggest capital project of Kosovo, without an independent professional supervision creates the opportunity of over-reporting of the volume of engaged inputs in construction by the contracting company, as well as the opportunity of incorrect reporting on the quality of work. Despite the close supervision of the works by engineers of the Ministry of Infrastructure, limited technical capacity does not enable the professional verification of the reporting done by the construction company. If Government of Kosovo does not act quickly in contracting an independent supervising company, highway installments will be paid based only on the reporting of the contracting company.

Above all, highway "Ibrahim Rugova" has a high cost which burdens the budget of Kosovo, and thus producing successive deficits during this and two following years. Moreover, fixed cost of the highway is not known due to the determination of prices for works unit, which quantity is also unclear. As a result, savings from change of the track of the road can not be evaluated. Moreover, lack of an independent supervising operator of the quantity and quality of works in the highway creates the opportunity of justifying high costs by the construction company as a constructor and verifier of the works. In order to prevent such opportunities, professional evaluation by an independent operator who would verify the engaged capacity and quality of inputs and completed works is necessary.

9 Source: Ministry of Infrastructure, Director of road directorate, Ramë Qupeva
10 Published in Newspaper Express on 22 May 2011

2.2. HIGHWAY AND LEGAL IMPLICATIONS

Construction of the highway “Ibrahim Rugova” except many problems that have followed it since the beginning of the project, carries legal implications as well, which mainly come from two aspects: lack of Strategic Evaluation of the Environment, as well as decision to change the track of the highway.

According to the laws of Republic of Kosovo in power, strategic evaluation of the environment for highway construction should have been done. Government did not take into consideration the Strategic Evaluation of the Environment for the project of constricting the road that is provided by Law 03/L-015 announced in the Official Gazette on 24 March 2009. More precisely it violated almost all articles and paragraphs of this law – article 7, 13, 16, 20, 21, 22, 24. Due to the absence of Strategic Evaluation of the Environment, Ministry of Environment gave a principled affirmation that construction of the highway may proceed forward, which is in contradiction with laws in power. This principled affirmation from the Ministry of Environment on continuation of works, is worthless and very far from the obligations that government had in implementing this important law. (Luan Shllaku, FORUM 2015).

The second implication was caused by the decision for changing the track of the highway. The decision on changing the track of the highway, Government of Republic of Kosovo reached in its meeting held on 27 April 2011. Such a decision is in contradiction with the decision of the Government 13/19 reached on 7 March 2008 by which was recommended to the Parliament to approve the track of the highway Vermice-Merdare as a zone of special economic interest, decision which was approved by the Parliament of Kosovo on 2 June 2008. The track of the highway approved by the Government and the Parliament on 2008 foresaw that the track of the highway passes from Vermice in Duhel, then through Shtime to pass through Prishtina up to Merdare. The length of the track from Vermica to Merdare was 117 kilometers, while the highest costs were expected to cause construction of 105 bridges and three tunnels with a total length of 5 kilometers[11] .

According to the Law on Spatial Planning, article 12.6, after drafting of spatial plans for special interest zones, ministry sends them to Government for preliminary approval, and Government proceeds them to the Parliament for final approval. As a result, this decision of the Government of Kosovo is against the regulations and laws in power, since special interest zones may be announced only by a decision of Parliament of Kosovo, following a proposal from the Government, and in this case such a thing was not done.

Having in mind a contract of international character, entering in a contractual agreement which have legal implications may create obstacles for continuation of works. Such implications may cause financial damage for the budget of Republic of Kosovo, as well as could have consequences on the image and credibility by international companies towards institutions of the country.

11 Source: Gap Monitor Report2011

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CASE STUDY
CONSTRUCTION OF TRANSYLVANIA HIGHWAY IN ROMANIA

Construction of "Transylvania" highway in Romania was followed by many problems since 2003, where like in the Kosovo case was contracted the company "Bechtel & Enka". Due to the many contractual problems and laws that were not taken into consideration, including the lack of Strategic Evaluation of the Environment, all promised aids to Romania by European Union were suspended. In a report conducted by European Union is stated that the contract of the Transylvania highway signed by the Romanian government presents a black hole of the country, which refers to the disregard of laws as well as the report of the country's economic potential towards contractual obligations it entered in by this contract. Disregard of European Union's recommendations, as well as other problems such as non-provision of basic material "ballast" by the Romanian government for construction of the highway impacted with big stagnation on construction of the road until 2007. According to the contract, Romanian government was obliged to provide the company with areas where it can excavate needed material, which was not done on time due to expropriation problems. If this would fail, then the contract provided the possibility for the contracting company to buy the needed material on the free market. In Romanian case, the company Bechtel & Enka did this, but the prices seam to have been very expensive.

Like in the case of Kosovo, also in the contract for construction of the highway of "Transylvania", construction company collects the means only for the completed segments of the road, and not for the works which are not finished. However, every delay has additional financial burdens in case it is done by the fault of the local government. While, the contract has no fixed cost, according to the conducted analysis its cost may vary from 2.2 billion euro up to 7.2 billion euro, depending on the number of invested units. Payments for construction of each segment, Romanian government according to the contract made only after a control company from France "Scetaroute" verified the quality and quantity of the completed work. While, in order to ensure the quality of works, Company Bechtel & Enka after signing the contract, issued a bank guarantee letter, which Romanian government could reimburse in case the lack of quality would be proved.

National company for constructing roads in Romania suggested termination of the contract with company Bechtel & Enka after construction of two road segments since according to them the value of the contract with lack of fixed costs as well as possibility of their restructuring imposed by clauses of the contract, makes it very unfavorable for the country.

On the other hand, officials of the company Bechtel & Enka, like in the case of highway construction of Kosovo, give special importance to the transfer of knowledge from the company to local workers and companies that complete a considerable part of the work. While in the case of Romania, problems of special emphasis distinguished by the construction company were the logistical ones, such as problems with expropriation and reallocation of municipal services that caused considerable obstacles during the construction.

Having in mind many flaws of the contract which created a high financial cost for the Romanian state, after two years of signing the contract and as a result of new government in power lead by the prime-minister Tariceanu, government started renegotiating the contract with company Bechtel & Enka on some clauses of the contract. However, renegotiation of the contract, which was closed at the end of 2005, did not achieve the main aim of Romanian government, decreasing the cost of the highway, but it managed to renegotiate and re-regulate some disadvantages of the contract, as well as the deadline for completion of the highway which was extended for one year. Extension of the deadline for completion of work comprises a decrease of the cost of the project due to fact that each postponement of works caused by the government would increase the cost of the project due to the penalties provided by the contract.

However, it seems that for company Bechtel & Enka, extension of the deadline of the work did not present a big problem as a renegotiable part of the contract, a contract which according to the Romanian government officials was done in such a way that made every renegotiation very difficult.

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2.3. FINANCING OF THE HIGHWAY "IBRAHIM RUGOVA"

Highway "Ibrahim Rugova" according to the actual planning will be done mainly from the budget of Kosovo through one-time income (income planned from privatization), as well as trough loans which may be internal and external. One-time income and eventual loans will be used to cover the budgetary deficit. According to the Minister of Economic Development, Besim Beqaj, budgetary deficits are problems every country faces, and for this reason Kosovo can take internal and external loans. However, current situation Kosovo is in, without an international loan ranking, with degrading relations with IMF and loss of foreseen loans due to the violation of the previous agreement, does not create much of a space for loan support by external financial institutions, be them commercial, with favorable interest rates. Despite the fact that highway will serve as an international corridor, soft long-term loans used by other countries in the region from international financial institutions, are not part of current financing planning in Kosovo. A special role in this regard takes European Bank for Reconstruction and Development (EBRD), which financed most of road projects in countries of the region, mainly due to the international character of the roads.

When Kosovo will be eligible to use IPA funds (Instrument of Assistance on Pre-Aderim in EU) for building of the infrastructure, might happen that such projects are not part of capital expenditure.

Projects of such roads like Corridor 5c in Bosnia and Herzegovina were financed from EBRD and from European Bank for Investments. Project of the Pan-European road of corridor X found the cooperation of Greek country and the Macedonian one, which used funds of European Union IPA (Instrument for Pre-Accession in EU) as well as from Hellenic plan for Economical Development of Balkans. Such important funds for assistance towards countries in transition and towards European integration would facilitate building of the country's infrastructure; however it seams that when our country will be able to fulfill the conditions to take soft loans dedicated for roads that present international corridors, such roads will no longer be part of capital expenditure. Strategically it would be better to plan projects that potentially can be financed through assistance funds for integration in EU and to be planned for implementation when Kosovo has full rights for their utilization. Since such funds are not available for the country during the current period, then as alternative options remain commercial loans which have a high cost or selling of public assets to cover obligations Kosovo has at the moment.

Despite all the difficulties and the huge burden that brings a project such as highway, besides financial sources that were thought to come from privatization of PTK and external loans and eventually internal ones, according to the statements of current government officials and former government officials they seems to have thought also about the eventual aid coming from World Bank. But the latter, as well as International Monetary Fund were skeptical regarding the economical justification of projects of Government of Kosovo. In their report "Review of public expenditures in Kosovo – June 2010" is stated:

"There are many arguments to conclude that decisions for utilization of budget for capital investment are done on subjective basis rather than objective ones. As a result, big sums of money were spent on projects that bring low economical benefits!"

Financial resources of Kosovo depend mainly on selling of assets and taking of loans. The other possibility of construction of the highway through public-private partnership or its concession is not present in government planning options. Brenck, et al. (2008) note that countries in transition in South-Eastern Europe (Chez Republic, Hungary, Poland, Croatia) highly used this possibility and number of public-private projects in these countries is impressive. Moreover, construction of roads in countries in transition of South-Eastern Europe is mainly implemented through road projects with payment through the contract Construct-Rehabilitate-Transfer[12] .

Arguments of involving the private sector in public projects deal with non-efficiency of the public sector in management of assets as well as with the huge financial burden these public projects demand. In the case of highway "Ibrahim Rugova", the huge financial burden that rests with the budget of Kosovo is the main argument for involvement in public-private projects which would release Kosovo from the big budgetary burden. However, such a possibility seems to have not found support regarding the aspect of economical justification of the project. Based on the projections on communication, construction costs and income from fees of using the road, financial simulations have shown that none of the highway segments offers economical justification[13] . Even though these simulations were based on previous evaluation of the costs and projections, new

12 Projects implemented in public-private partnership are achieved through long-term contracts between Government and Private Company (Concessionaire) for a long-term period. After the contracting period, public asset is returned on the ownership and management of the country's Government.

13 Based on the analysis of Egis BCEOM & COËI Kosovo, May 2009.

evaluations would probably give similar values [14].

Financing of the highway "Ibrahim Rugova" was based mainly on means of Kosovo budget, thus by risking the country to enter into a deep budgetary deficit. Such a situation would be prevented if the project would depend on alternative financing possibilities, such as concession of roads, or financing through loans. Highway could have been financed through soft loans from international institutions, mainly European Union, and EBRD, which member Kosovo is not. But this could have been done after the post-accession period of Kosovo in EBRD, and opening of possibilities of utilization of IPA funds. Due to the non-utilization of alternative financing opportunities for the highway, prevention of the budgetary crisis and non-liquidation situation of the country, it may be done from privatization of the profitable asset of Kosovo, PTK. However, such an obliged privatization creates economical implications for the country.

While selling of public assets in the most unfavorable case may be done fast and bad, a more positive scenario in Kosovo economic circumstances depends on the possibility of taking loans which would create a flexibility regarding privatization of PTK and would create opportunities for these assets to be sold with real market prices and through an appropriate optimal time plan. However, such a possibility is limited by the budgetary deficit of 2011 Kosovo is in. 2011 Agreement of Government of Kosovo with IMF obliges the former to complete the process of privatization of PTK within this year, while means from its selling should go into the bank account of the Government until the end of December 2011 so that Kosovo has budget reserves of 300 million Euro. In case such an act is not achieved, the first implication is that in the end of the year Kosovo will remain without budgetary reserves. The other implication regards the non-respecting of the actual agreement with IMF which would decrease the possibilities of taking loans from IMF and other international institutions (European Commission, World Bank) in following years as well.

2.4. SCENARIOS OF MANAGEMENT OF THE HIGHWAY

Financing of the highway "Ibrahim Rugova" from budget of Kosovo, is not the end of financial problems that result from the highway. Completion of its construction, planned for 2014 opens dilemmas on the manner of management following the construction period. WB 2010 report shows that Budget of Kosovo covers only around 40% of total needs for road maintenance. While, this is added the maintenance of the Highway "Ibrahim Rugova", Kosovo's abilities to manage them properly are very limited. Regarding this problem, three possible scenarios may present.

Scenario 1: Maintenance of the Highway by the Government of Kosovo – Free–Toll Road

According to this scenario, Government of Kosovo will take care of the road maintenance. Maintenance cost would be completely covered from the budget of Kosovo through taxes and fees gathered from citizens of Kosovo. Contribution for road

14 Public Expenditure Review of Kosovo, World Bank Report, 2010.

maintenance would be relatively applicable for all citizens of Kosovo, regardless if they use the highway or not. Moreover, drivers that use the highway but are not citizens of Kosovo, would use only the road benefits but would not participate in maintenance cost. Also, citizens of Kosovo who use the road more often, will bare a relatively lower maintenance cost compared to the citizens who use this road rarely.

Scenario 2: Maintenance of the Highway by Government of Kosovo – Toll Road

According to this scenario, Government of Kosovo will take care of the road maintenance. Maintenance cost would be partially covered from budget income through taxes and fees, while the other part from road fees applied for utilization of the Highway. Partial contribution for road maintenance would be relatively applicable for all citizens of Kosovo, regardless if they use the highway or not. Drivers who use the highway more often would bare a higher cost on highway maintenance proportionally to its utilization. Moreover, citizens who are not citizens of Kosovo, would also pay for the utilization of the road by contributing in the budget for its maintenance.

Scenario 3: Giving the Highway with concession

According to this scenario, Government of Kosovo would give the Highway “Ibrahim Rugova” on concession to a private company. Maintenance cost would be completely covered from the concessionaire, while income from Highway utilization fees would also be collected by the concessionaire. Eventual profit that comes from road management would belong to the concessionaire. Contribution for road maintenance would be applicable to all citizens that use the road, while its cost would be determined by the contract between the Government of Kosovo and private company. Based on this scenario, citizens of the country despite the fact that they have paid the complete cost for construction of the road, will continue to contribute for its maintenance through the fee for its use, from which concessionaire may generate profit.

3. PRIVATIZATION OF PTK

PPost and Telecom of Kosovo (PTK) is the public asset with highest profit during the last decade in Kosovo. During the period of its activity, since the post-war until 2007 PTK had a monopoly power in telecommunication sector in Kosovo. Since December 2007, this enterprise operates in competition circumstances because Government of Kosovo licensed the second mobile operator, IPKO.

Later, on 13 October 2008, according to the resolution no.02/41 Government of Kosovo decided for privatization of PTK. After almost a year from this Government decision, inter-ministry commission started its work to analyze and recommend participation of private sector in PTK, as well as developing the privatization strategy.

Privatization Strategy Report developed by the Consortium Telco AG and Wolf Theis GmbH analyzed and evaluated PTK market and privatization options. After the analysis by the inter-ministry commission was suggested selling of most qualifying shares of PTK, meaning 66% of shares. Following the received recommendations, in its meeting on 16 June 2010 Government of Republic of Kosovo reached the decision to privatize 75% of the shares of PTK, leaving only 25% of shares available for the Government. Laws of Kosovo provide that managerial control of public enterprises is reached with property over 67%. According to the Minister of Economical Development[15] , in case of selling only 51% of shares, government would be obliged to participate on eventual investments that could be made by private investor, which in case of deficit situations would not be very favorable.

After privatization of PTK, Government of Kosovo will hold in its property only the unit of Post of Kosovo, and as a result budget of Kosovo will have to subsidise this unit which operates with losses.

In order to maximize the transaction value, Government of Kosovo recommended that Regulative Authority of Telecommunication review the possibility of a five year moratorium in licenses for other possible operators (IMF, 2010). If such a thing is approved, then Kosovo will win a duopolistic market[16] for five years following privatization of PTK. Such a market is not a support to free competition, and as such damages Kosovar consummator.

By the current privatization strategy, it is provided selling of 75% of shares of PTK Sh.A., as a whole. On the other hand, Government of Kosovo aims at keeping in its property the business unit Post, legal division of which would be done in the period after privatization. From this strategy remains unclear if assets of Post will be included in privatization and will be evaluated after privatization, or will be evaluated before privatization and later will be allocated under the property of Government of Kosovo. Such a strategy creates ambiguity regarding assets which will remain property of Government of Kosovo, as well as the manner regarding the process of evaluation of these assets.

Argument of the government is that through this approach the current transaction value is maximized while in any other version transaction value would be lower.

15 Interview with Minister of Economic Development, conducted by the Project team
16 Market where only two telecommunication operators operate.

Government of Kosovo may use the blocking right in Management Board by keeping in its property the "Golden Share" so that despite keeping of only 25% of shares in its property, can block eventual decisions of the new owner of PTK, if they are in contradiction with country's strategic interests.

However, European Justice Court considers the golden share as illegal [17], which is kept from governments of various countries in order to keep the control of the company through the right of veto, in cases when private investor wants to change the strategic orientation, which could be in contradiction with country's interests. Kosovo, as a country with European perspective may create another additional problem in relation to the institutions of European Union since such an act is considered by the European Justice Court to present an obstacle for free movement of capital. If this obstacle presents a barrier in relation to EU laws, then in the moment of European integration, Kosovo would have to give up the "golden share", which then leaves it completely out of decision-making over PTK.

Moreover, approval of PTK privatization by Law on Budget, is against Law on Management of Public Enterprises 03/L-087. While adding of PTK privatization as part of the budget and determination of expectations in some financial documents is self-devaluation sine it has impact on pre-determination of the selling value, in around 300 million Euro.

3.1. DEVALUATION OF SELLING VALUE OF PTK

Privatization process of PTK is developing in non-favorable conditions for Kosovo, which have a direct impact on the value that will be given for PTK by the potential investor. Negative impact on the selling price of PTK was permeated by following circumstances:

a) PTK Sh.A., during the post-monopoly period, from 2007 showed a decreasing trend in all its performance indicators. As a result, this decrease will reflect negatively on the selling price that will be offered by the potential investor.
b) Republic of Kosovo was ranked among last ten countries in the world for protection of investors. Such a ranking does not go on favor of increase of the selling price.
c) Increase of the number of employees during last three years in this corporate despite the decrease of flow indicates non-efficiency in corporate management. Number of employees over optimal needs of the corporation creates a load on the future investor in PTK and has negative impact on its evaluation.
d) The necessity of selling PTK Sh.A., due to the budgetary deficit of the country creates pressure over Government of Kosovo for selling as soon as possible. This pressure has a direct impact on the price that will be offered by the interested companies.

17 Source: www.inhouselawer.co.uk

Moreover, due to the lack of economical analysis on the reasoning of selling PTK and value it has on the market, as well as due to the financial need to cover budgetary deficit of the country, potential investors were given an orienting signal on the expected price for PTK shares. Pre-determination of the selling value was done in several financial documents of the country. On 7 July 2010, Government of the Republic signed the first "Stand-By Agreement" with International Monetary Fund. The agreement got the highest authorization from kosovars, by signature of three most important economic decision-making posts, the Prime-minister one, the Minister of Economy and Finance and Governor of the Central Bank. In page 4 of this document, Article 5 states "…moreover we will proceed with privatization of PTK to ensure financing of the deficit". In page 7, Article 11 states "…it is important that in order to cover the deficit, privatization should happen soon…". In the same page, Article 12, it is stated that "if the income from privatization of PTK are less than 300 million euro then Government will take measures to increase the other budgetary income". In page 15 Table 1, line 13, the value of PTK is prejudiced by stating that "income from privatization are 300 million euro". Memorandum with IMF is not the only one that determines the source of income of 300 million and thus the value of PTK. There are a number of other public documents that have done the same thing. Middle-term Expenditure Framework, published in June 2010 also prejudices the same value. In page 9 of the document it states "…involvement of the highway project generates a vast gap in financing. Therefore PTK is expected to be privatized until the end of 2010". In page 19, Table 6, line 11 determines the expected value "…income from privatization: 300 million". The same determination makes the first project budget of 2010.

The new Agreement of the Government of Kosovo with IMF, "Staff Monitoring Agreement" obliges Government of Kosovo to privatize PTK and cash privatization means by 31 December 2011.

Termination of the "Stand-by-Agreement" of Government of Kosovo with IMF and signing of the "Staff-Monitoring Agreement" verifies the necessary selling of PTK during 2011. The document provides strict rules that Government of Kosovo is obliged to fulfill in order to be able to reappear as a beneficiary party in relation with IMF. Moreover, this agreement specifies that by the end of 2011 Government of Kosovo should cash the means from selling PTK in order to have budgetary reserves of at least 300 million Euro in country's treasure.

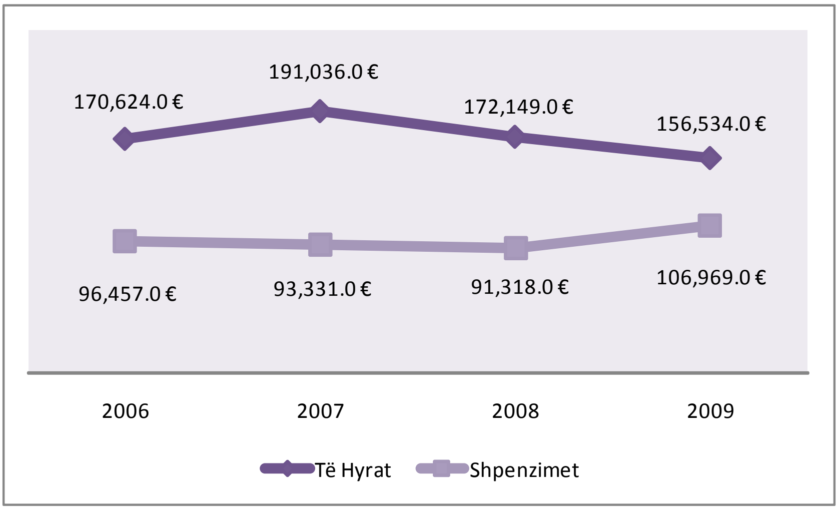
Such specification creates even more hurry on selling PTK. Moreover, ranking of Kosovo among 10 last countries regarding protection of investors, as well as heavy business environment in Kosovo, reduces the negotiating power of the country in relation to investors. The necessity to sell this public asset in a non-favorable situation for the country will have a negative impact on evaluation of PTK from the side of interested investors. As a result, optimal profit can not be reached.

3.2. . PTK PERFORMANCE

PPerformance of PTK until 2007, during the period when it had the monopoly in the market showed positive values with increased trend of success indicators. Entering of the new operator of mobile telephony, IPKO in the market resulted with loss of a part of PTK market and operator Vala, as well as caused the lowering of the prices as a result of competition.

As a result, the decrease of company's flow was inevitable, since prices of operator Vala were decreased by half in relation to the period when Vala had the monopoly in the market. However, despite the decrease of the flow on 2008, net profit of PTK in relation with previous year showed an increase due to the decrease of the corporate tax norm. During the four year period 2006-2009, PTK realized a profit of around 187 million Euro, or an average of 46 million Euro per year. Moreover, despite the lowering by half of the prices, during the period 2010-2011 PTK managed to over-pass the budgetary predictions by 7%, and with half prices managed to reach the level of income it had when the price was doubled compared to the current one[18] . Such an increase of the flow mainly fro Vala, creates a positive indication on the performance of PTK during the period 2010 – 2011.

Figure 3. Relation of income and expenditure in PTK 2006-2009: During the last four year reporting, PTK showed increase in expenditure despite the decrease of income



Source: PTK Official Page ** (in 000 €)

However, public financial reviews of PTK[19] show that it did not act in compliance with the new position in the market by stagnating in the area of new investments which would create a bigger competition space for the company, especially having in mind high financial liquidity with which PTK operates.

Decrease of investments depends on the fact that due to the strategic orientation to privatize PTK, investments might have been unnecessary during the period of pre-privatization. However, on the other hand, it could have increased the competition ability of the corporation that would have a positive impact on its market value. Activities that have happened, especially in the area of human resources show an approach which does not comply with the privatization strategic aims, since during the period 2007-2009 staff cost increased for 27%, operative cost for 25%, while income from flow decreased for 17%. This affected the net profit of the corporation as well as showed a decreasing trend. PTK operative profit[20] from 2007 until 2009 decreased for 41%.

18 Interview with PTK spokes-person, conducted by the project team.
19 During the research period, PTK Financial Reviews were published only until 2009.
20 Operative Profit – Profit prior to payment of inters and tax

All these indicating parameters of the performing trend of PTK give negative signals to the potential investors by having a direct impact on the evaluation of the value of shares of this public asset. However, decrease in the performance of PTK, initiated on 2007 when the corporation lost the monopoly power in the market seems to have reached its minimum since PTK data from 2010 which are still unpublished but confirmed by PTK officials show an increase in the flow over budgetary predictions for around 7%[21] . In the economic aspect this should have a positive impact on the PTK value indicators, but such an effect would be maximized if such a trend is verified also in the coming period. But, the decision for privatization of PTK during 2011 was reached and norms of eventual increase of flow and performance of PTK in the following years will be attributed to the private investor.

Tabela 2. Table 2. PTK Financial Review (2006-2010) ** (in 000 €)

	2006	2007	2008	2009	TOTAL
Total Revenues	170,624.0 €	191,036.0 €	172,149.0 €	156,534.0 €	690,343.0 €
Revenues	164,152.0 €	182,463.0 €	161,481.0 €	145,030.0 €	653,126.0 €
Other Revenues	63.0 €	203.0 €	17.0 €	50.0 €	333.0 €
Revenues from inter-est	6,409.0 €	8,370.0 €	10,651.0 €	11,454.0 €	36,884.0 €
Expenses	96,457.0 €	93,331.0 €	91,318.0 €	106,969.0 €	388,075.0 €
Operational Costs	19,154.0 €	20,119.0 €	23,993.0 €	25,164.0 €	88,430.0 €
Staff Costs	30,734.0 €	31,883.0 €	34,071.0 €	40,583.0 €	137,271.0 €
Depreciation	22,348.0 €	21,911.0 €	13,300.0 €	16,155.0 €	73,714.0 €
Amortization	3,522.0 €	3,172.0 €	4,192.0 €	6,579.0 €	17,465.0 €
Loss from abrogation of bank balance	400.0 €	-850.0 €	-813.0 €	-1,249.0 €	-2,512.0 €
Other Costs	20,299.0 €	17,096.0 €	16,575.0 €	19,737.0 €	73,707.0 €
Earnings before Taxes	74,167.0 €	97,705.0 €	80,831.0 €	49,565.0 €	302,268.0 €
Tax on Earnings	41,792.0 €	47,368.0 €	20,706.0 €	5,188.0 €	115,054.0 €
Net Earnings	32,375.0 €	50,337.0 €	60,125.0 €	44,377.0 €	187,214.0 €

Source: Official PTK website.

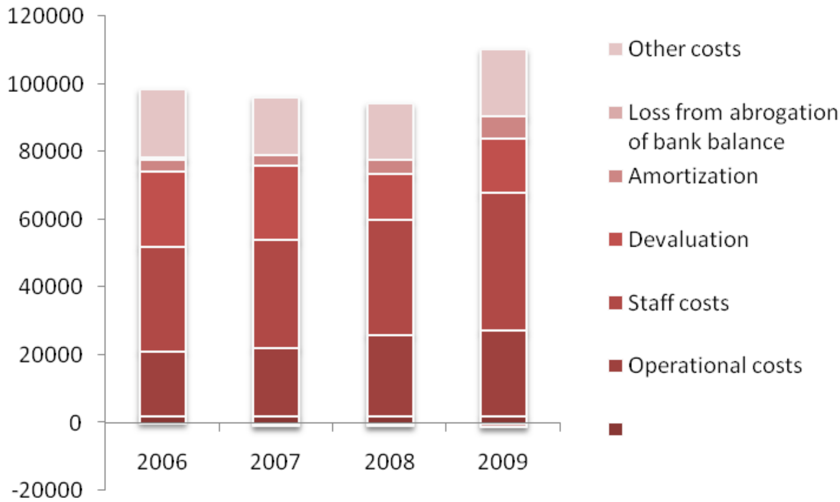
If we refer to the financial reviews of last four years (Table 2), it is evident that the value of PTK has degraded. The obvious decrease of the flow should reflect in the same direction on corporate costs, but in the case of PTK, costs have taken the opposite direction. As a result, the potential investors will pay a lower price for buying the shares of PTK.

21 Interview with PTK Spokes-person and President of PTK Professional Trade Union, conducted by the project team.

This development trend within PTK provides indications that the strategic orientation towards privatization by the Board of PTK was not harmonized with the leading policies of the executive management of PTK, which as such may have an impact that PTK is valued by a lower price in the market. Entering of the new operator IPKO in the telecommunication market in 2007 had impact on annual flow of PTK. Moreover, stagnation of investments as a means to fight competition as well as increase of the cost in most of its segments had impact for PTK to have decrease also in the main indicator of measurement of the value of a company, in the profit the company realizes and return the potential investors expect in the future. Stagnation of investments has advanced, when on 13 May 2010 Government of Kosovo reached the decision to terminate all capital investments and additional expenditure unplanned with the business plan[22] .

Increase of the number of employees in PTK during the last three years, PTK officials argument with the fact that such a policy was in harmony with the business plan of the corporation and that the current number of employees in PTK is in harmony with the business plan of the last three years. The problem is that the business plan was implemented only in this regard, but was not harmonized with planned investments. In the PTK business plan for the period 2007-2009 it is also provided that the increase of investments and creation of new selling centers of PTK throughout the territory of Kosovo, which stagnated.

Figura 4. Figure 4. PTK Expenditure structure: Staff costs show big increase in years



Source: PTK Official Page ** (in 000 €)

Employment of new employees prior to opening of their work places is reasoned by the fact that a corporation such as PTK is responsible and that new employees of this corporation should undergo a preparatory process before being ready for work.

22 Government of Kosovo, Decisions of Government No, 1/124. www.kryeministri-ks.net.

Stagnation of investments seems to be directly linked with the corporate privatization process, a stagnation which may be reasoned if PTK was privatized in 2007. Such a strategy caused a suffocation of market opportunities for positive performance of PTK, which would have an impact on increasing the market value.

One of the planned investments which were annulled is the tendering of the invoicing system that according to the PTK officials was annulled since companies that have expressed interest in buying PTK already have such a system. However, such a system was planned based on the projections and expectations that it would have a positive impact on the increase of the PTK value through the increase of the number of clients and flow, since with the current capacities of invoicing system, current products of operator vala can not be differentiated.

Moreover, another predicted investment done by PTK was participation in the fourth mobile operator in Albania, Operator Plus. Initially PTK entered as holder of 30% of shares, but in the end it resulted with PTK holding only 3% of the shares. The withdrawal was done since PTK should invest around 30 million Euro provided as holder of 30% of shares. This withdrawal from the initial plan for investments from the Board of PTK, was also linked with indications that such an investment in the pre-privatization period is unnecessary since it is not expected to have immediate effects on the value of PTK.

Non-implementation of the PTK project in cooperation with Ministry of Education of Republic of Kosovo for digitalization of all schools in Kosovo is another stagnated investment. The project provided expansion of optical fibers in all territory of Kosovo (around 1080 schools), with an investment value of 80 million Euro. Investment opportune cost unrealized by PTK was the capital ad value which would be increased an serve for a better development in the future as well as the price added-value which will also not be taken during the privatization of PTK. Therefore like PTK that implemented only one part of the business plan, the one of increasing the number of employees without reflecting it in creation of new selling points in PTK and the physical need for employees, also the board of PTK implemented partially the strategic plan regarding PTK, stopping the investments which as it seems were not harmonized with the privatization momentum.

Financial reviews of PTK offer general data on corporation as a group and not on its specific segments which are necessary to see the performance of each pillar within PTK, especially when taking into consideration the fact that privatization of PTK will include operator Vala and the unit of telecommunication as two profitable segments of PTK. And in order to evaluate the value of each unit within PTK, the aggregate value should be divided into individual values coinciding with each unit within the corporation.

3.3. PRIVATIZATION EXPERIENCES

From countries in the region which went through the process of privatization of telecom, Albania privatized 85% of shares, Bulgaria 51%, Croatia 35%, Hungary 35%, Serbia 51% and Macedonia 51%. On 2011, Serbia offered 51% of its telecom for sale with an applied minimal threshold value of 1.4 milliard euro, a cipher which was not considered as attractive for potential investor interest. When we take into consideration the market Serbia has as a neighboring country with Kosovo and the offer for a similar asset, gives indications that we are dealing with a period where PTK offer will be in competition for potential investors who have a possibility to invest also in the regional market where number of telecom consummators is more attractive, but also the transaction cost is much higher.

As it can be seen from the examples of regional countries, only Albania privatized more than 51% of shares, an example which seems will be followed also in the case of Post and Telecom of Kosovo. In the case of Kosovo, privatization strategy with which PTK was offered in the market was not supported by a cost-benefit economic analysis that would give arguments for the choice made. While, experiences of other countries that went through a similar process offer surely lessons on how the privatization strategy should be built. In the following section, a study will be analyzed conducted for the privatization of Turkish telecom.

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3.3.1 Case study – Privatization of Turk Telecom

Privatizimi i Telekomit Turk ishte një proces i rëndësishëm për shkak të vlerës së lartë Privatization of Turk Telecom was an important process due to the high financial value. In 2004 Turk Government decided to conduct the privatization of Turk Telecom by offering at least 51% of shares as block shares while the other part to be completed within three years through public sales. According to the decision of Turk Government, 55% of shares were sold as block shares, 15% through public sale after a three year period, while the other part of 30% of shares remained as state property, including the “golden share”.

The main aim of privatization by government was that the future owner of majority of shares be a partner with high world level who could increase the efficiency and quality of services.

During the pre-privatization period, from 2000 until 2004, Turk telecom had an increase in performance by increasing the number of services, number of consummators and participation in the market for around 10%, while on the other and reduced the costs for staff by reducing the number of employees for around 22%. On the other hand, only during the last three years prior to privatization the operative profit of the company increased for around 13%. Such a management of the Turk telecom company prior to the privatization period had impact to increase the market value of the company.

Moreover, in order to reach a higher value of the general transaction, Turk government decided that 20% of the privatization value be paid after signing the contract while the other part in 5 equal installments including the interest norms in following installments. Such a payment system offers the possibility for investors to offer higher values for the privatization, while government as a share holder of telecom to cash more means and to distribute them in several budget years which helps also the budget balancing and sustainability. Another alleviating aspect is that after each part of paid installments by the investor, government will release the kept assets as hypothec that are related to the financial loans of the project.

Through such a contract the consortium comprised of Saudi Telecom and Telecom Italia became the owner of 55% of Turk telecom shares (6,550 Million USD), a contract that a prestigious financial magazine called as “The selling of 2005 of the countries in development”.

Despite this agreement, in 2008 Turk government according to the provided plan offered for public sale also the 15% of the shares from which 3% would be on sale for the Turk post and telecom and small investors. Out of a total of 15% (1.911 million USD) of shares, 40% of shares were offered for sale to local investors while 60% to the foreign ones, a plan which was completed successfully. It should be mentioned that the value of the sold shares three years after privatization was increased with a norm of around 7%, which indicates an increase of performance and value of the Turk telecom by the private owner who by 55% owned the right to manage with the enterprise, and allowed for local investors and telecom employees to be part of the ownership.

Selling of 15% of shares after a three year period with a higher price than the initial price and distribution of shares also to the local investor had impact that despite the selling of 70% of te shares to distribute the vote and the right on decision-making to more than one owner in order to prevent the one-sided decisions on strategic aspect where 2/3 of the votes is needed. While keeping of 30% of the shares as part of the state treasure has a direct impact on the state budget through the dividend which increased each year during the period of ownership and management by the private company.

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3.4. PTK PRIVATIZATION SCENARIOS

Despite un-favored circumstances for selling the profitable corporation PTK Sh.A., the whole process will complete until the end of 2011 by a decision of Government of Kosovo. Moreover, the decision of the Government of Kosovo No. 01/03, date 09/03/2011 for privatization of PTK, which abrogates the previous decision No. 01/130, date 16/06/2010 crates space for ambiguity regarding privatization of 75% of PTK shares. Moreover, due to the ambiguity and complete non-transparency, privatization of 75% of PTK shares as a whole creates possibilities for several privatization scenarios

Scenario 1: Holding 25% of shares as Vala and Telecom property

	VALA	TELECOM	POST
Government of Kosovo	25%	25%	100%
Private Company	75%	75%	0%

Government of Kosovo will privatize 75% of shares of PTK Sh.A., which will not reflect on the assets of post of Kosovo, but only on the unit of mobile operator Vala, and the unit of Telecommunication. All assets belonging to Post of Kosovo will continue to own 25% of it. If the process of privatization is closed with this scenario, Government of Kosovo will hold 25% of dividend from profit of units Vala and Telecom, while will manage entirely the unit Post of Kosovo, by being its only owner. Also, in case of eventual loss as a result of non-efficiency of Post of Kosovo, Government of Kosovo will subsidize all the losses of this unit.

Scenario 2: Selling of 100% of shares of Vala and Telecom

	VALA	TELECOM	POST
Government of Kosovo	0%	0%	100%
Private Company	100%	100%	0%

Government of Kosovo will privatize 75% of shares of PTK Sh.A., as a whole. In this privatization Vala and Telecom will be sold with 100% of shares, while the unit of Post will remain ownership of Government.

Value of Post of Kosovo with its assets will be evaluated as 25% of the total value of PTK Sh.A.. Moreover, if 75% of shares are offered for selling which mean 100% of shares of Vala and Telecom units, this determines the market value of Post of Kosovo assets that is in contradiction with laws on market economy. If the process of privatization is closed with this scenario, Government of Kosovo will not be a holder of dividend units Vala and Telecom. On the other hand, if Post of Kosovo continues to operate with losses, this unit will have to subsidize from means of Kosovo budget. According to this scenario, profitable units will be sold completely, while the unit which operates with losses will have to subsidize from country's budget, will remain completely in Government ownership.

Scenario 3: The ownership over assets of Post is not clear

	VALA	TELECOM	POST ASSETS
Government of Kosovo	0%	0%	?
Private Company	100%	100%	?

Government of Kosovo will privatize 75% of shares of PTK Sh.A., as a whole. In this privatization Vala and Telecom will be sold with 100% of shares, while the unit of Post will remain in Government ownership. However, evaluation of Post assets will be conducted after privatization. With such a scenario, after privatization, Post assets may be evaluated more than 25% of PTK Sh.A. in total, left on Government property. As a result, Government of Kosovo will have to give part of assets of Post to the private investor in ownership to balance the value of 25% of the total of shares. Such a privatization of PTK would create a situation where it would not be clear what is Kosovo selling and what is it keeping.

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