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The World Bank

What to watch - the next month
- Launch of the WB Kosovo Poverty Assesment

Kosovo Monthly Economic Briefing

May 31, 2005

Ferronikeli deal struck

— On May 11th 2005, KTA announced the provisional bidding winner for NewCo Ferronikeli LLC, the spin-off of Ferronikeli, one of the largest and most valued Socially Owned Enterprises in Kosovo. The KTA must now decide whether to accept the bid, and confirm the Provisional Winning Bidder. Ferronikeli was privatized through a special spin-off procedure that included two bidding periods. In phase one, three highest bidding companies were supposed to continue to phase two, where they could change their bids if they needed. However, after opening the offers, only two companies passed the first bidding phase, with offers of 27 million and 22 million Euros. As part of the rules, their identity was not revealed after the first bid. On May 11th, however, the audience at the public meeting was pleasantly surprised when the winning offer was announced by KTA officials. Adi-Nikel, a US- Albanian company based in Tirana had offered the highest price of 49.5 million Euros. The second best offer came at 33 million Euros. This makes Ferronikeli by far the highest selling SOE in the privatization process that started a couple of years ago. Under the terms of the tender, bidders had to commit to investing Euro 20 million and guaranteeing the employment of 1,000 workers. The plant was built in 1983, and at that time it had a design capacity of 12,000 tons per year but actual production peaked at 7,000 – 8,000 tons per year. At its operational height in 1989, the company employed approximaely 2000 people, and produced 7,800 metric tons of contained nickel. However, under-utilization, degradation and damage forced the closure of the mine in 1998. Further damage was inflicted during the 1999 NATO bombing. Demand for ferronickel is currently strong and the plant is competitively located close to the European market

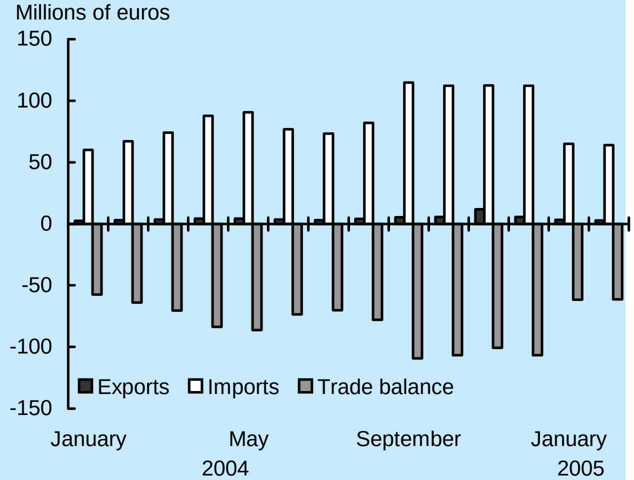
— In celebrating their 10th year anniversary, Riinvest brought attention to the key economic and spatial challenges facing Kosovo. In their report “Kosova – socioeconomic profile and development challenges” the key economic and spatial challenges for Kosovo were stated as—development of infrastructure and public services (particularly in sub-urban, urban-rural and pan-European transportation); increasing investment in education; and ensuring a quality standard of living for the population. The report predicts that by 2015 there will be another 250,000 to 300,000 inhabitants in Kosovo. This will require the economy to generate 25,000 to 30,000 new jobs each year just to keep the existing employment rate constant. The report also reviewed small and medium enterprise development and the key economic sectors of energy, mining and agriculture.

Key Statistics - at a glance

					2004	2005	
	2001	2002	2003	2004	Dec	Jan	Feb
GDP (% change)	..	1.2	3.1	3.2	..	..	..
Reg. unemployment	238.0	282.3	282.3	302.0	302.0	303.8	299.0
CPI (SOK)	..	..	1.6	-2.5	-3.4	-3.5	-3.8
Fiscal balance (€mn)	96.6	106.4	62.6	-134.3	-100.1	..	..
Exports (€mn)	10.6	27.6	35.6	56.5	5.6	3.3	2.7
Imports (€mn)	684.5	854.8	973.1	1,063.2	112.3	64.8	63.9

Note: Monthly fiscal balance, export and import figures are non-cumulative.
CPI is % change year-on-year (e.g. Oct 2004 is change from Oct 2003 to Oct 2004). Registered unemployment in thousands.
Source: BPK, SoK, MFE, Kosovo Employment Office and IMF staff estimates

Monthly Exports, Imports and the Trade Balance



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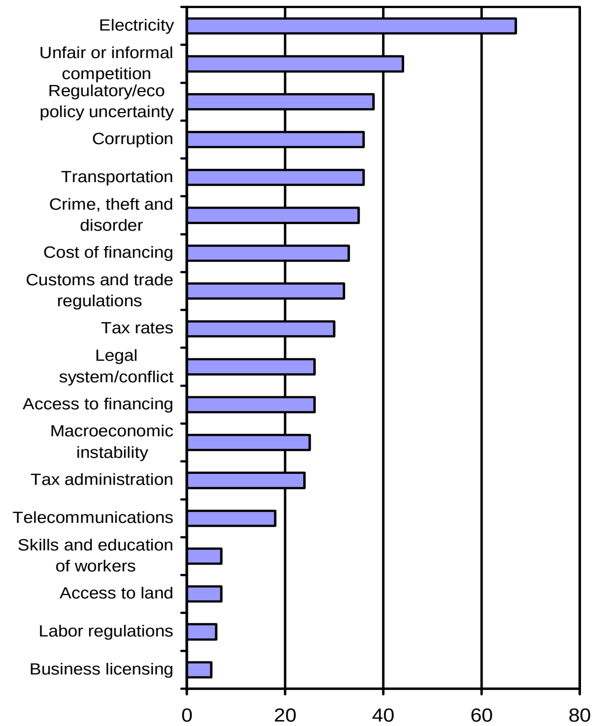
Enterprise development in Kosovo is constrained, with the sizeable informal economy being partly responsible

Following the re-registration process of businesses, we now have a better sense of the size of formal business activities in Kosovo. The new Kosovo Business Registry started operating in 2003 and currently shows the enterprise sector is comprised of around 45,000 formal businesses, around 90 percent of which have the legal status of personal businesses and by far the vast majority is represented by micro-, small- and medium-sized enterprises (MSMEs). More than 60 percent of all firms typically engage in trade and service activities – just retail trade constitutes one third of the total. Only 1.5% of registered enterprises operate in the primary sector and 9% in the manufacturing sector. Very few firms are involved in significant value-adding activities. These MSMEs face a range of constraints.

According to firms themselves, the key constraints in the Kosovo environment are frequent power outages, unfair or informal competition, regulatory policy uncertainty, corruption and crime, the cost of transportation and customs and trade regulations (see chart). It is estimated that the inadequate power supply translates to around 9 percent of total sales, which reduces profit margins and/or is passed onto consumers through higher prices.

General constraints to operations - pecentage of firms ranking constraint as “major” or “very severe”



Source: World Bank (2004)

Estimating the size of the informal sector in Kosovo is frought with difficulty. However, it is clear that it is sizeable. This “grey economy” represents a significant competitive barrier for those firms that do operate legally, as informal firms often have a competitive advantage through tax avoidance and lower compliance costs with the authorities. Part of the explanation for informality is related to the development of alternative channels in the pre-1999 era. However other factors keep the current level of informality high. Enforcement of regulations—such as licensing, construction permits and health and trade inspections—has been erratic, particularly at the municipal level. A great deal of confusion amongst firms as to administrative and regulatory requirements creates high compliance costs, uncertainty and lack of transparency.

A sizeable informal economy also is problematic for the compilation of National Accounts. Drawing on examples in other economies, the size of the informal sector in Kosovo could be reduced by strengthening enforcement of regulations within municipalities and harmonization among themselves; encouraging data sharing and better coordination between municipal and central level. More specifically, new, uniform regulatory framework should aim to keep low the number of licenses required to operate a business; place standards and limits on the number of tax, trade, health and other inspections; define time periods for approval of applications by local officials; standardize and keep under control the fees imposed for meeting administrative and regulatory requirements; clarify and strengthen procedures for appeal of decisions; strengthen penalties imposed on enterprises for illegal operations; and consider changes in tax policy that would reduce the tax advantages of illegal operations (such as a strengthening of VAT administration). A number of measures to strengthen trade and production related institutions are needed: (a) an effective instrument of assistance to exporters in penetrating foreign markets is needed; (b) export credit mechanisms should be solidly established, as has been done in neighbouring countries; (c) an investment promotion agency facilitating both local and foreign direct investment should be established soon; and (d) consideration should be given to establishing export processing zones and similar tax free environments for exports.