

KOSOVO'S SOVEREIGN FUND: WISE INVESTMENT MANAGEMENT OR PIPE DREAM?

July 2022



The creation of the Sovereign Fund should include clear policies for the management of state-owned assets and a public database of state assets.



In addition to the creation of the Sovereign Fund, the government must remain committed to structural changes in the economy, the rule of law, as well as interventions in education, labor market and fiscal policy.



Creating a Sovereign Fund could prove an important milestone for the domestic economic environment. Through supporting mechanisms, economic reform policies could support the private sector, increasing productivity and employment, at the same time ensuring sustainable investment opportunities in state-owned assets.

**KOSOVO'S SOVEREIGN FUND:
WISE INVESTMENT
MANAGEMENT OR
PIPE DREAM?**



Publisher: Friedrich-Ebert-Stiftung Kosovo, Rr. Pashko Vasa 23, 10000 Prishtina, Republic of Kosovo

Responsible: Renè Schlee

Author: Rudina Nallbani Hoxha

Date: 2022

Design: Milky Way Creative

Printed by: Studio Forma



KEY RECOMMENDATIONS

- Align Sovereign Fund's goals with the country's' development ambitions to create opportunities for long term sustainable development
- Smart investment in local, regional development projects and strategically important industries will strengthen opportunities for regional development and sectoral diversification of industries
- Limit opportunities to bail-out indebted POEs to prevent the Sovereign Fund from becoming a financial aid institution
- Create fiscal rules for access to Fund, to ensure a buffer for the investment-saving cycle, depending on Fund's objectives
- Establish early on transparency and accountability standards, subject to external oversight which increases the confidence of investors and the public in the efficient management of state-owned assets
- Responsible investing in assets and projects with environmental and climate impact assessment in supporting Kosovo's challenges towards decarbonization and international commitments

INTRODUCTION

International Sovereign Wealth Funds (SWF) have grown substantially in the past two decades, although they are not considered a new strategy for governments acting as investors. The emergence of SWF occurred as a result of the growth in the demand for natural energy resources. During the 1950s, the global increase in demand for fossil fuels generated valuable capital for oil- and other natural resource-rich countries. To accommodate budget or exchange rate surpluses, Governments began rechanneling additional funds into sustained saving and investment funds. Witnessing the success of the Sovereign Funds in international markets, countries with a lack of natural resources initiated domestic funds for investment purposes. The objective of the latter is to invest abroad or domestically to support the performance of public assets and expansion of the domestic economy.

The idea of setting up a Sovereign Fund has been prevalent since the Kurti II Government announced it among its priorities of the four-year Program. To date, not much was spoken regarding the creation a specialized fund responsible for managing Kosovo's financial and non-financial assets. Since the early 2000s, privatization has been the central concept in leading market-oriented reforms. While today we can assess the privatization process had few success stories, the greatest part was followed by controversies and court proceedings. **Establishing a Sovereign Fund could be a make-or-break reform policy in Kosovo. In the long term, POEs could be leading the way to much-needed public policy reforms in successfully managing state assets.**

The focus of this analysis is to distill key recommendations on the establishment of an SWE from analyzed practices. Recommendations are based on background information on Sovereign Funds, their classification and purpose, followed by SWF performances. Further, the analysis will discuss a number of risks in managing Publicly Owned Enterprises (POEs) and the need for a new management model of state-owned assets. To date, Kosovo is yet to fully implement an economic growth strategy focused on supporting the domestic economy and the private sector. The introduction of a supporting mechanism, in the medium- and long-term, can bring productivity gains, employment, and technology transfer.

Conclusions and recommendations are in accordance with proven practices which ensure efficient management and investment of public funds. Legislative provisions should secure: (1) investment management policy with clear objectives; (2) planning and coordination with other national long-term programs and strategies; (3) a transparent model of investments to ensure investor confidence; (4) adoption of non-compliance measures, followed by management transparency and accountability. **Application of Sovereign Wealth Fund practices would also ensure that citizens are well informed on the direction and administration of public funds and state assets.**

1

SOVEREIGN FUND RELEVANCE, OBJECTIVES AND CLASSIFICATION

The top-down approach in reforming POEs in Kosovo has not proven successful in the past. In the absence of a clear political will for transforming state-owned assets operating in a market-based economy, responsibilities for poor management have been carried over from one government to another. Currently, poor management of state-owned assets is associated with insolvency and the inability to perform without state assistance in several POEs. Much-needed reforms in managing POEs have been delayed by previous governments while the privatization cycle continued with little progress. Domestic productivity decreased each year, bringing Kosovo's international trade balance to an excessively negative trend.

Sovereign Funds have been a policy instrument for countries with large foreign surpluses coming from resource revenues. Since the past decade, many countries are introducing development funds for investments in the domestic economy, foreign assets, or a combination of both. This represents an opportunity for Kosovo to start a new period in strengthening financial and non-financial asset management, which would benefit the country's wider economy.

Capital accumulation and budget surpluses (usually from commodities' export) has been the main motivation for countries around the world to set up government-owned or controlled Sovereign Wealth Funds (SWF). Although there is no commonly endorsed definition of SWFs, according to the Organization for Economic Cooperation and Development, SWFs are "pools of assets owned and managed directly or indirectly by governments to achieve national objectives"¹. International Monetary Fund complements this definition, adding a timeframe of investments for "long-term purposes".

The first Sovereign Funds have been established in the 1950s and are considered the brainchild of the British colonial government and were initially set up by commodity-rich countries which had accumulated substantial foreign exchange reserves from commodity exports².

Governments use the proceeds of their excess funds as investment instruments to generate long-term profits. Sovereign Wealth Funds are state-owned investment fund or entity that is commonly set up from several categories of capital excess:

- The surplus in the balance of payments
- Privatization revenues
- Foreign currency and/or resource export
- Fiscal surpluses; and other

Pension funds are also categorized as sovereign wealth funds as long as the Government has a role in choosing the management or Board and, to a larger extent, the incomes into pension funds are stable in the long term. However, SWF and Pension Funds (PF) differ in their investment goals and purpose, as PFs are individual contributions dedicated to financing retirement schemes. Such is the Kosovo Pension Savings Trust (KPST) the purpose of which is to manage and administer citizens' pension contributions.

Although SWFs are, in the majority of cases, foreign or domestic market investment instruments, for stabilization purposes they can be used to invest in state corporations or make exceptional transfers to the national budget. Intervention to macroeconomic policies is often questionable, as it could make the Fund a bail-out resource for indebted state-owned enterprises. This has been the case in the 2008 global financial crisis when countries used SWFs to save large, indebted corporations. Rather than offering a short-term financial injection, Kosovo should restructure its enterprises with increasing operational efficiency. Experience with companies operating in competitive sectors, such as the Telecom, shows it only keeps companies vulnerable until the next crisis.

1 OECD (2008). Sovereign Wealth and Pension Fund Issues, OECD Working Paper on Insurance and Private Pensions available at: <https://doi.org/10.1787/243287223503>

2 Kin-Yip Ho, Zhaoyong Zhang (2014). Handbook of Asian Finance: Financial Markets and Sovereign Wealth Funds. Sovereign Wealth Funds in East Asia: An Update of their Recent Developments

Globally, most SWFs were created from 2000 to 2009 and between 2010-2020. An increase in oil prices due to higher demand for the auto industry in the past century, followed by a significant increase of commodity capital steered Governments into separating excess incomes. In order not to have the excess capital flowing directly to the national budget, causing macroeconomic imbalances, Governments created separate investment and savings Funds.

Assuming a regular economic cycle, short-term capital flows will continue to be linear in Kosovo. Instead, SF goals are pinpointed towards smart investments in domestic and foreign assets; quality governance; efficiency in management, financial stability in fostering investments, and implementation of corporate governance principles in POEs.

SWFs have different goals when it comes to their funding sources or aspiration purposes. Typically, SWFs differ in two significant categories: commodity originating from natural resource exploitation and export such as oil, gas, diamonds, copper, etc., or non-commodity generated from financial revenues due to privatization cycles, foreign exchange reserves, or surplus in tax revenues. Intuitively, the commodity SWFs are larger in percentage

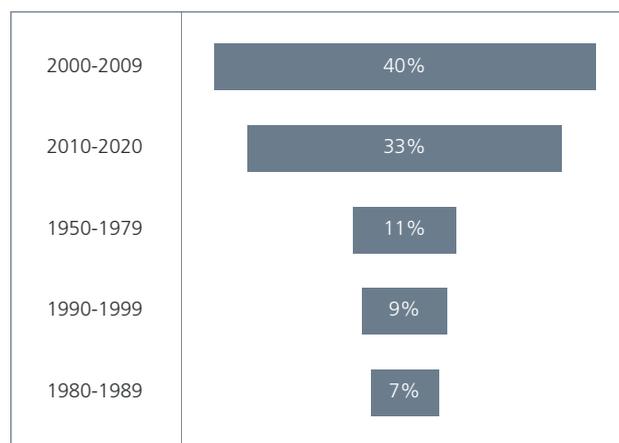


Figure 1. Percentage of SWF created by a decade

Source: SWFI, 2020 data

compared to their non-commodity counterparts. On that account, the five biggest SWFs in assets come from countries with abundant natural resources, except for China and Hong Kong. Norway Government Pension Fund leads the way with assets in over 9000 companies around the world and controls approximately 1.4% of international market capitalization.

1	Norway Government Pension Fund Global (Commodity, Europe), set up in 1990 - with assets of over US\$1,34 billion
2	China Investment Corporation China (Non-Commodity, Asia), e. 2007, with 1,2 billion assets
3	Kuwait Investment Authority (Commodity), e. 1953, with 6,93 million assets
4	Abu Dhabi Investment Authority UAE (Commodity), e.1976, with 6,49 million assets
5	Hong Kong Monetary Authority Investment Portfolio Hong Kong (Non-Commodity), e. 1993, with 5,85 million assets ³

³ Sovereign Wealth Fund Institute (2021, November 22). Data available at: <https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund>

2

SWF PRINCIPLES OF TRANSPARENCY AND ACCOUNTABILITY

Differentiations in SWFs investment objectives, size, corporate governance structures, etc. make it complex to give a unique definition to SWFs. However, an important managing aspect of the SWFs is transparency in operations. Managing state-owned assets has proven challenging in developing countries, mainly due to corruption and uncertainty concerns. In this context, transparency in financial proceedings increases the credibility of operating state funds.

To advance transparency in asset and reserve management, the International Monetary Fund (IMF) gathered 25 countries in creating a voluntary organization of the International Forum of Sovereign Wealth Funds (IFSWF) in 2008. Countries delivered a set

of twenty-four (24) *Generally Accepted Principles and Practices, known as the Santiago Principles, for sovereign wealth funds' institutional governance and risk-management frameworks*⁴. While the adopted Principles are not mandatory, Governments have agreed to submit a self-assessment on the implementation of Santiago Principles every three years. The main objective of the principles is to keep a stable global financial system, while SWFs should follow necessary regulatory and disclosure requirements in investment countries based on an economic and financial risk investment.

According to the Santiago Principles⁵, such endorsed practices for SWF include, inter alia:

1	Create a legal framework in support of effective operation and achievement of objectives
2	Close coordination with domestic fiscal and monetary institutions when SWFs activities have direct domestic macroeconomic implications
3	Transparent and publicly disclosed policies, rules, and procedures in funding, withdrawal, and spending operations,
4	Effective division of roles and responsibilities to ensure independence in operation and management,
5	Compliance with national and international financial reporting standards, as well as independent auditing, etc.

Another significant transparency indicator is the Truman Scoreboard (TS)⁶ which consists of 33 principals developed in 2012. Similar to Santiago Principles, TS focuses on making publicly accessible the government ownership structure, investment policy, market values, returns and risk management policy, timely and audited financial reports, etc.

The importance of transparency in investment and operations in SWFs is sometimes used as a counterargument for revealing every potential investment the Fund will make. It is costly and time-consuming to prepare and publish possible investments and could potentially damage profit opportunities.

At the same time, observers notice that it is unnecessary to put in place scoreboard standards for which market participants are able to evaluate themselves. However, with the increased role of the government as an investor in the international market, the competition in setting higher standards grows, particularly when it is matched against corruption index, index of economic freedom, etc.

Kosovo should set a new course in implementing transparency and accountability standards. When setting up the Fund, a governance structure with a clear division of responsibilities should be set.

⁵ More on Generally Accepted Principles and Practices "Santiago Principle" at www.ifswf.org

⁶ Bagnall, E. A., Truman E.T (2013). Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard, Peterson Institute for International Economics

⁴ International Forum of Sovereign Wealth Funds (2021), History of IFSWF available at <https://www.ifswf.org/>

The experience in state management of POEs-s so far shows management, enactment, and monitoring responsibilities within Government structures have not been efficient.

This opportunity should also be materialized by addressing key obstacles in the judiciary, such as corruption, organized crime, contract enforcement, contested property, etc.

3

SOVEREIGN FUND IMPLICATIONS IN KOSOVO

In September 2021, the Executive Commission (consisting of Ministers) tasked with proposing and drafting the basic principles of the Sovereign Fund proposed the establishment of a Working Group (WG), including economic and legal experts. The WG was responsible for drafting the concept-note with specific proposals regarding the basic principles, legal and institutional implications, methodology, and challenges in establishing the Sovereign Fund.⁷

The Kosovo Government has prioritized this approach as "...one of the biggest economic reforms of our country since independence". It was emphasized in the Executive Commission meeting that the "primary purpose of this Sovereign Fund should be ensuring the management of the financial performance of strategic assets. This means an enhanced performance, increased value, and higher return on investment"⁸.

Many strategic and development policies have been adopted in Kosovo from the post-war period and there has been no lack of strategic documents promising a bright economic future. However, dedication towards long-term policy planning has been short-sighted due to political interests. Unstable majority governments with frequent electoral cycles have been an added burden in achieving a stable political and economic environment for progress in Kosovo. Thereby, the current political environment with a stable parliamentary majority favors an opportunity for a long-standing economic reform.

The current Government has prioritized creating a special fund dedicated to managing Publicly Owned Enterprises (POEs) and other state-owned financial and non-financial assets. The Unit for Monitoring the Publicly Owned Enterprises, running under the Ministry of Economy, is responsible for supporting the Minister and the Government in exercising its duties and responsibilities as a shareholder. However, in practice there are many challenges for the Unit to perform its tasks, and on many occasions their decisions were politically challenged⁹. Over the years, numerous attempts to change the current legislation to avoid political interference in monitoring POEs have failed.

Regardless of the current structure of POEs, there are still numerous assets of various classification for which privatization is not completed.

The privatization process was led by Kosovo Privatization Agency since 2003, which had the exclusive rights in selling and privatizing national, public, and social property in Kosovo territory. The total funds accumulated during 17 years of privatization amount to around €752 million¹⁰, both from selling privatized assets or liquidation. The privatization process was followed by many controversies in the process and has been evaluated as largely unsuccessful in supporting economic transformation from state to private ownership¹¹. As there are still many claims to assets (property, land, etc.) from the privatization process, privatization funds are currently deposited at the Central Bank of Kosovo.

Total funds from privatization consisting of €752 million might seem like a moderate amount for investment in Kosovo (considering the size of the economy) however much of the volume has already been shared with employees (20%) or as claimants to the owners' assets. Considering the sizable and valuable assets privatized during this prolonged process in Kosovo, one might question the value at which national, public, and social assets were sold and under what conditions. Capital raised during the privatization process is considered to be one of the components of the SF in Kosovo. A general perception is that the Government intends to create an umbrella state- managed structure for managing POEs, privatization funds, socially owned enterprises and other state assets.

At the same time, Publicly Owned Enterprises have primarily been in the spotlight due to poor management, insolvency, inability to pay workers' wages, politically based employments, etc. Family members and friends of politicians, including party members, have regularly been appointed as Board members or have been employed in state-run companies.¹²

9 More on POE corporate governance and monitoring at Riinvest Institute for Development Research (2012). *Qeverisja korporative në Ndërmarrjet Publike në Kosovë*

10 Privatization Agency of Kosovo (2021, November 16). *Annual Reports 2020*. Available at <https://www.pak-ks.org/page.aspx?id=1,40>

11 More on the privatization process at OSCE Privatization in Kosovo: *Judicial Review of Kosovo Trust Agency Matters by the Special Chamber of the Supreme Court of Kosovo* (May 2008) or *Kosovo 2.0 The Ghosts of Privatization* (June 2021).

12 Balkan Investigative Reporting Network (2020). *Parties of Employment, Recruitment Monitoring Report* (December 2019 - December 2020), Prishtina, 2020. Available at https://birn.eu.com/wp-content/uploads/2021/01/Recruitment-Monitoring-Report_Parties-of-Employment_ENG-1.pdf

7 Kosovo Government (2021, September 22). Decision No. 06/36. <https://kryeministri.rks-gov.net/wp-content/uploads/2021/09/Vendimet-e-Mbledhjes-se-36-te-te-Qeverise-se-Republikes-se-Kosoves.pdf>

8 Office of the Prime Minister (2021, September 22). *The Working Group for the establishment of the Sovereign Fund of the Republic of Kosovo is formed, chaired by prof. dr. Besnik Pula*. Available at <https://kryeministri.rks-gov.net/formohet-grupi-punues-per-themelimin-e-fondit-sovran-te-republikes-se-kosoves-me-kryetar-prof-dr-besnik-pula/>,

POEs' financial reports remain undisclosed or delayed, although according to current legislative norms, they should be made publicly available. In its latest report, the National Audit Office has reported short-term and long-term liabilities for the largest part of the companies, raising concerns regarding their sustainability in performing activities¹³. Long gone are the days when the most successful public company, Kosovo Telecom, paid millions of euros of dividends on annual basis (45 million in 2012¹⁴). Today, Kosovo Telecom pressingly requires € 47.8 million in form of debts or investments¹⁵ from its shareholder/Government, to meet "all liabilities that Telecom of Kosovo has to creditors, without avoiding the risk that these obligations seriously threaten the principle of continuity. ¹⁶" The same request has been made by the company in its financial statements to be able to run sustainably and profitably.

Currently, there are 16 Publicly Owned Enterprises (POEs) where the Kosovo Government is the sole shareholder (100%) and one (Trepça, operating in the mining sector) where the Government is 80% shareholder while 20% belongs to company employees. Exceptionally, Trepça operates under Law on Trepça, whereas other companies are governed by the Law on Publicly Owned Enterprises. Prishtina Airport is currently under concession for 20 years to Limak and Aeroports de Lyon from y2010. The contract with this consortium prohibits the Government of Kosovo from developing a commercial flight business within country borders for the period of the validity of the consortium contract with Limak and Aeroports de Lyon.

Most POEs operate in the water supply (6), water irrigation (2), telecommunication (1), postal services (1), airport (in Gjakova, besides Prishtina), railway (1), electrical energy generation (1), etc. There are still numerous "socially-owned" enterprises, privatized during the early 1990-s where the workers are shareholders. However, most of them are inoperable, or they simply rent their premises or land for other purposes/businesses. KPA has the legal power to administer socially owned enterprises "regardless of whether they have transformed or not"¹⁷.

Many of the POEs are in dire need of financial infusion, restructuring, partial privatization, PPP, and/or a new model of management. Currently, few of them cannot afford to pay workers' wages (carrying financial implications for the national budget), are overstaffed, or work on max. 20% of production capacity. Naturally, as in the case of water supply companies, these would remain in majority central/local ownership as they supply primary services to the population. Their focus should continue to be on providing quality services at affordable prices.

¹³ More on POEs financial report available at Kosovo National Audit Office, https://www.zka-rks.org/wp-content/uploads/2021/09/RaportiVjetoriAuditimit_2020_Eng.pdf

¹⁴ Ministry of Economic Development (2012). Raporti Vjetor i Performancës së Ndërmarrjeve Publike 2012, pg. 16. Available at https://me.rks-gov.net/npmpn/repository/docs/Raporti_Vjetor_i_Performances_se_Ndermarrjeve_Publike_2012.pdf

¹⁵ Ministry of Finance (2021, November 16). Financial Statements of Publicly Owned Enterprises. Telekom i Kosovës Sh.A. Available at <https://mf.rks-gov.net/desk/inc/media/809BDD61-CD29-45A6-85C6-E09D7F3B281A.pdf>

¹⁶ Ibid., pg. 14

¹⁷ See Law Nr. 04/L-0341 on Kosovo Privatization Agency, Article 5

4

SF COUNTRY CASE ANALYSIS AND PERFORMANCE

The aim of showcasing the selected countries is not to present best case practices, rather to display the complexity and divisiveness of Sovereign Funds. The selection of the Sovereign Funds is based upon a thorough analysis of government-based funds. When considering Kosovo's potential Sovereign Funds size, structure and objective, there is no "match for all" complementary examples. By analyzing SWF, we discover differences in management portfolio, investment aims, or goals with respect to state-owned assets. Examples presented in this report combine what could be considered the backbone potential of Kosovo's Sovereign Fund: effective management of POEs, natural resource management, socially owned enterprises (with defined legal framework), commitment as an investor, and potential excess revenues.

Most SWFs globally have been developed in the period between 2000 and 2009, when countries accumulated foreign currency reserves due to the globalization of the world economy. Increased demand for oil and its subsequent effect on the revenues from commodities was another reason for countries to develop special purpose or investment funds. Regrettably, SWFs in some countries are an extended political hand of the Government and family members of the political elite, creating a buffer for mismanagement of the country's resources. Venezuela once called a Petrostate due to its heavy reliance on the export of oil, weak government, and political structures, fell into the resource trap in 2016 due to plummeting oil prices in the global market. Pretty quickly the country ran into economic chaos caused by hyperinflation, food shortages, humanitarian crises where currently, according to the National Survey of Living Conditions (ENCOVI)¹⁸, 95% of the population is living in poverty.

Wise management of natural resources with a clear separation from government spending by setting a low and smoothed spending rate contributes to building a strong public finance policy orientation towards future generations. It also safeguards against price fluctuations and volatility in revenues in the long run. Mandating the establishment of a separate fund with financial reserves and transparency in operation also contributes to the development of countries with low living standards and increased poverty rates. Such is for example Timor Leste Petroleum Fund which has been created as a requirement deriving from countries constitution (following independence from Indonesia in 1999), mandating fair and impartial use of its natural resources, to the benefit of national interest.

In addition to their primary difference from commodity to non-commodity, SWFs also distinguish in their main purpose. In 1967, Norway initially set up a small pension fund which grew in assets and size due to good management and investment policy, becoming today the largest worldwide state-owned SF. The largest international commodity fund by assets, the Global Government Pension Fund (GPF) was established in 1990, following the discovery of oil reserves in the North Sea.

¹⁸ For a detailed report and data visit <https://www.proyectoencovi.com/encovi-2021>

Currently, it owns assets in more than 9000 companies worldwide and invests only in international markets. Fund's primary goal is to bring wealth to future generations, by making long-term sustainable investments in well-functioning markets. The extent of the influence on international markets has not diminished citizens' "active" role through Parliament, in Funds portfolio investment. The Fund's future investment policies often become politicized during election campaigns.

Slovenian Sovereign Holding holds a similar asset structure to Kosovo's potential structure. Main revenues invested in the Holding are generated from privatization proceedings to efficiently manage state-owned assets. However, asset concentration is high, given that the top 10 companies in the portfolio represent almost 80% of the overall assets. Most of the Fund's portfolio is invested in the domestic economy.

Regardless of the standards outlined in legislative acts, the implementation of corporate governance principles has been criticized by OECD. A country report highlights the need to "continue privatization efforts and further strengthen corporate governance in State-Owned Enterprises".¹⁹ Slovenia risks operating uncompetitive and inefficient companies, particularly in rapidly developing sectors. Due to the large degree of state involvement in the economy (11% of employment and 51% of SOE assets to GDP²⁰), running in a competitive market without being able to quickly adjust to latest trends, puts efficiency and profitability of state management at risk.

Just as important, although very recently created, Ireland Strategic Investment Fund's aim is investing and strengthening the domestic economy through innovation and employment. ISIF is a mixture of domestic and global investors. What makes ISIF distinct is its orientation towards supporting government programs such as Project Ireland 2040. Strategic national documents were combined to set the vision and implement an investment framework for Ireland 2040. The Project targets investments in five Priority Areas: Regional Development, Housing, Indigenous Businesses, Climate Change and Brexit. In September 2021, the Fund announced that its investment strategy over the next five years will be in climate action projects. Such projects will include renewable energy generation, and storage, energy efficiency and sustainability in performance like reducing countries' carbon emissions. Similar to Norway Government Pension Fund Global, ISIF is following trends in meeting global challenges towards climate change.

Equity (share)	Fixed income (bonds or securities)	Real assets	
Up to 70%	Up to 30%	Up to 7% in real estate	Up to 2% in renewable energy infrastructure

Figure 2. GPF Investment portfolio

Source: Norwegian Bank Investment Management

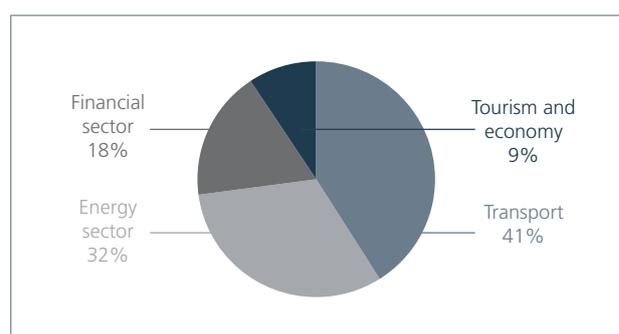


Figure 3. SSH Investment Portfolio

Source: SSH

Overall, European states manage a part of their wealth mainly oriented towards state corporations. Slovenia owns more than 50% of SOE assets to GDP, compared to Estonia which owns about 40% or Turkey with less than 10%. Although not the latest, same EBRD²¹ data show that Kosovo owns about 20% of POE assets compared to BPV, while about 6.5% of all employees work in Public Enterprises. Among the Western Balkans countries, Kosovo will be the first Sovereign Fund initiating country.

Although the Concept documents dismisses Kosovo's commodity potential, future utilization should not be eliminated at this point. In addition to lignite (which supports 95% of the domestic electricity demand), Kosovo is rich in mineral and metal deposits, rare metals, and rare earth elements²². Regardless of the government's position on natural resource exploitation, underground potentials cannot be ruled out. Whether governments will utilize resource earning potential, and to which extreme, it will depend on Sovereign Fund objectives and opportunities. Sovereign Fund's ability in channeling sectorial investments and attracting investors experienced investors could create opportunities for Kosovo's insufficiently explored underground (through rents, taxes, fees).

¹⁹ OECD Economic Surveys (2020). Slovenia Executive Summary, June 2020.

²⁰ EBRD. (2020). Economic performance of state-owned enterprises in emerging economies. A cross-country study, available at: <https://www.ebrd.com/what-we-do/economic-research-and-data/cse-ec-onomists/economic-performance-soes-in-emerging-economies.html>

²¹ Ibid

²² Further information on Kosovo's underground resources can be found at Kosovo Mining Strategy 2021-2025 available at http://old.kuvendikosoves.org/common/docs/Strategjia_Minerares_e_R_Kosoves_2012_-_225__Ang.pdf

RECOMMENDATIONS AND CONCLUSIONS

Creating a Sovereign Fund could prove an important milestone for the domestic economic environment. Through supporting mechanisms, economic reform policies could support the private sector, increasing productivity and employment, at the same time ensuring sustainable investment opportunities in state-owned assets. Over the years Kosovo has achieved its economic progress mostly through public investments and consumption. Decreasing the dependence on foreign goods and services is essential in achieving economic growth and stabilizing the external trade balance.

Governments should be careful not to put all eggs in one basket when it comes to investment opportunities (Slovenia's asset concentration is an example). In addition to applying a proper management policy, investment policies should diverge into several economic sectors creating conditions for long-term sustainability. Although investing in one sector in the short-term might have a big impact in increasing economic activity and related productivity gains, in times of crises or unexpected economic downturns, this formula might prove to be financially harmful. The approach with which the investment patterns are channeled will have a considerable effect on the country's economy, particularly in small countries like Kosovo, and must be measured against those that add value in the economy (employment, productivity, innovativeness).

A level of caution must be kept in keeping the expectations from SF realistic. The creation of an SF will not solve Kosovo's socio-economic challenges. Along with the creation of the SF, the government should remain committed to structural changes in the economy, including rule of law, contract enforcement, dispute resolution, as well as interventions in education, labor market and fiscal policies. These elements are essential to develop a solid ground in which the SF thrives and becomes a support mechanism for the economy. Setting up a Sovereign Fund needs clear policy objectives for the management of state-owned assets. An added prerequisite for SF viability is state-asset holdings inventory and information transparency on the latter. To date, Kosovo does not have publicly available (digital) asset database for in-country and foreign-owned assets. The fundamentals in institutionalizing the Fund should consist in making information and data on state assets available to the public, including their continuous purpose and progress in the future.

Establishing a SF will require allocation of significant financial resources. Considering the current economic circumstances in Kosovo (and beyond), risks from budgetary and political pressures are likely to increase. Financing models presented in the Government concept document should leverage the opportunities offered through private and commercial investment. As the process of establishing the Fund might exceed medium-term perspective, the financial structure needs to be foreseen in the budget planning framework. Simultaneously, Government bodies should ensure legal adaption where necessary during the creation of Sovereign Fund. Alleviating legal risks ensures expectations are met when the Fund is fully operational and ready for financial investment cycle.

Implementation of new policies with potentially significant economic effect must be guarded against opportunities for misuse. Current and future governments should ensure harmonization of Funds' objectives with national long-term plans, investments in strategic and industries with a comparative advantage, while respecting transparency and accountability standards. Recommendations and conclusions are in line with these elements.

1. Sovereign Fund's objectives aligned with the country's development ambitions

Creating a Sovereign Fund is a structural development policy and should be set up and developed with a sound legal framework. As this is one of the most important long-term development policies, it should be aligned with other national development objectives and strategies. Besides domestic development strategies (National Development Strategy 2030, Digital Agenda 2030, Energy Strategy, etc.), Kosovo also has international obligations with regards to Stabilization and Association Agreement with EU or Green Agenda for Western Balkans. Ambitions set out in these documents could be used to promote and advance, i.e., the green economy agenda. Norway and Ireland specifically address climate challenges through their Sovereign Fund investment policies in renewable energy and carbon-free emission. Fund's aims should be in line with development potentials (specific industrial sectors or projects) and/or in which a country has a comparative advantage. This does not imply that the fund's objectives should not change over the years. For example, in countries with large commodity export revenues, objectives changed from budget stabilization purposes to creating separate funds for different investment objectives.

23 Informacione të mëtejshme mbi burimet nëntokësore të Kosovës mund të gjenden në Strategjinë e Minerarave të Kosovës 2021-2025 në dispozicion në http://old.kuvendikosoves.org/common/docs/Strategjia_Minerare_e_R._Kosoves_2012_-_225__Ang.pdf

2. Smart investment in local, regional development projects and strategically important industries

Investing in industries with development potential and comparative advantage industries will foster growth within the country. At the same time, it can offset the negative trade balance which is consistently growing since the 2000s. The Big Picture: A Progressive Economic Agenda for Kosovo alongside labor market, social and fiscal policies, examines industrial productivity and export. Data analysis shows the overall productivity trend has been decreasing throughout the years, suggesting the need for an industrial reform in Kosovo²³.

Investments in agriculture, as one of the most subsidized sectors in Kosovo, are yet to see an increased level of agricultural productivity or export of agricultural products. On the contrary, Kosovo citizens have seen an increased demand for imported primary products (wheat, oil, fruits, and vegetables). SF could support targeted domestic economic activity and employment, especially where employment rates are high, such as among the young population and women.

Regional economic imbalances in Kosovo have centralized main economic activities in the capital city. Based on regional potentials, Funds' investments should target developing local economies through commercial investments and integration of circular economy frameworks. Considering the COVID-19 pandemic has altered the global production and supply chains, Kosovo should use this opportunity to attract foreign investors by creating and promoting favorable economic conditions. International (manufacturing) companies are rethinking their production strategies to reduce their dependency on South-East Asian low-cost production. The opportunity for Kosovo is in regard to its geostrategic position, supported by further investments in infrastructure, labor upskilling, and education.

3. Limit access to bail-out indebted POEs

Since the post-war and independence period, the Government has not reviewed its ownership policy in POEs, holding a centralized, 100% ownership structure (except in Trepça, as mentioned in Chapter 3). Most POEs have been operating with financial difficulties in the past years, rendering them fragile to perform their functions. In addition to putting their operations at risk, financially unsustainable companies also risk the public interest. The majority of the POEs have short-term and/or long-term liabilities, with an uncertain outlook on liability return. The Fund should avoid the role of a bail-out resource, except in extremely specific cases of national interest. Sovereign Funds should abstain from financing insolvent or illiquid companies, as this makes the Fund a financial aid institution. It will also make POEs reliant on a "government haven" every time a company runs into financial difficulties.

To improve their financial and operational performance and adapt to the needs of current economic developments, POEs require internal restructuring, development based on key performance indicator (KPIs), investment, and innovation-led growth managed by professionally appointed individuals within company structures.

4. Fiscal rules for access to the Fund

Most countries have set up fiscal rules for access or withdrawals from the Fund, preventing a long-term depletion of funds. Governments may be tempted to access principals or reserve fund in cases of budget deficits or debt accumulation. In extraordinary cases of economic decline, a pre-established saving rate helps mitigate shocks to budget revenues in the short term. Therefore, the implementation of fiscal rules sets the limit on the highest annual percentage available for transfer, with saving rates that support potential withdrawals.

COVID-19 pandemic created an extraordinary economic shock in the global economy. Some countries used the funds available to support the domestic economy through escape clauses. Others, like Ireland, created special recovery or stabilization funds which enabled quick support to vital areas of the economy and private businesses to smooth the sharp decline in economic activity. Although spending cuts were necessary to avoid budget pressures, vital areas such as healthcare during the pandemic needed financial and non-financial support measures. The fiscal space could be used to support these measures when budget revenues are unexpectedly low during crises, or when access to credit is expensive.

5. Ensure that transparency and accountability standards are defined early

Transparency in operation and management should be applied in the same manner as when running private funds in international markets, or possibly higher, having in mind the political risks. The importance of transparency is two-fold: it provides assurances to potential investors and the citizens that public funds are managed in line with the widely adopted standards. Public disclosure requirements have increased in the past two decades, not only limited to SF but also private equity companies. The same standards should apply regardless of whether the fund is running positive returns or when losses are incurred. Enforcement of transparency and accountability standards, or scoreboard measures, is low as there is no implementation mechanism. However, a country should see its interest and positive benefits of accepting non-compliance standards in managing Funds objectives. Channeling foreign investments through SF implies that the government is responsible towards investors and their country of origin. This bears potential legal implications, as Kosovo has, regrettably, experienced frequent arbitration proceedings.

²⁴ Jakurti et al. (2021). Situata e përgjithshme: Agjenda Ekonomike Progressive për Kosovën, Friedrich Ebbert Stiftung, dhjetor 2021, në dispozicion në <http://library.fes.de/pdf-files/bueros/kosovo/18983-20220301.pdf>

6. Mitigate legal risks which might impede SF operationalization

The legal process of establishing the Kosovo Sovereign Fund should include timely schedule to avoid lengthy implementation. Legal implications arising from the concept document are several and include (1) changing the state ownership policy, (2) adapting the current Law on Publicly Owned Enterprises, (3) drafting new law on national champions and (4) asset expropriation. Some of the listed socially owned companies which could be included in the SF have an unclear legal status. Their status should be initially defined before any action regarding their future involvement in the SF is undertaken. At the same time, proposals deriving from KSF include creating new companies/institutions such the Stock market or new company responsible for SOE-s. All these aspects require stock of competencies within public administration at the central and local level. Capacity building support mechanism with clearly identified stakeholders involved in the process are fundamental to reduce the pressure in moving forward.

Considering the challenges in managing state-owned assets in the past two decades, Sovereign Fund is a good policy proposal, as it streamlines current assets (regardless of their source) into an investment, thereby creating future assets. Sovereign Fund is the right tool for managing macro-economic imbalances (saving and bust cycles); it can also help address future obligations with declining birth rates and an aging population in Kosovo. However, one must keep in mind that Sovereign Funds: (1) are a long-term investment policy, and will not have an immediate economic effect; (2) should not limit the expansion of other sectors, not supported by SF. Given that other long-term investments include education and infrastructure, priority choices should not be detrimental to them. Since the privatization process has not been proven as a successful model for post-war economic transformation, Sovereign Funds around the world showcases examples where the state and prudent public management can organize more efficiently to the benefit

ADDITIONAL READING

Kin-Yip Ho, Zhaoyong Zhang, in Handbook of Asian Finance: Financial Markets and Sovereign Wealth Funds, 2014. Sovereign Wealth Funds in East Asia: An Update of their Recent Developments

Kosovo National Audit Office (2021). Auditor General's report on the Government's annual financial report on the budget of the Republic of Kosovo, available at: https://www.zka-rks.org/wp-content/uploads/2021/09/RaportiVjetoriAuditimit_2020_Eng.pdf

Sovereign Wealth Fund Institute, available at: <https://www.swfinstitute.org/fund-rankings/sovereign-wealth-fund>

International Forum of Sovereign Wealth Funds, available at <https://www.ifswf.org/>

More on Generally Accepted Principles and Practices "Santiago Principle" at www.ifswf.org

Kosovo Government (2021, September 22). Decision No. 06/36. <https://kryeministri.rks-gov.net/wp-content/uploads/2021/09/Vendimet-e-Mbledhjes-se-36-te-te-Qeverise-se-Republikes-se-Kosoves.pdf>

Office of the Prime Minister (2021, September 22). The Working Group for the establishment of the Sovereign Fund of the Republic of Kosovo is formed, chaired by prof. dr. Besnik Pula. Available at <https://kryeministri.rks-gov.net/formohet-grupi-punues-per-themelimin-e-fondit-sovran-te-republikes-se-kosoves-me-kryetar-prof-dr-besnik-pula/>,

Riinvest Institute for Development Research (2012)., "Qeverisja korporative në Ndërmarrjet Publike në Kosovë" Riinvest Institute

Privatization Agency of Kosovo. Annual Reports 2020, available at <https://www.pak-ks.org/page.aspx?id=1,40>

OSCE Privatization in Kosovo: Judicial Review of Kosovo Trust Agency Matters by the Special Chamber of the Supreme Court of Kosovo (May 2008) or Kosovo 2.0 The Ghosts of Privatization (June 2021).

Ministry of Finance. Financial Statements of Publicly Owned Enterprises. Telekom i Kosovës Sh.A. Available at <https://mf.rks-gov.net/desk/inc/media/809BDD61-CD29-45A6-85C6-E09D7F3B281A.pdf>

Law Nr. 04/L-0341 on Kosovo Privatization Agency, available at: <https://www.kuvendikosoves.org>

A detailed report on Venezuela's National Survey of Living Conditions and data available at: <https://www.proyectoencovi.com/encovi-2021>

Press release from the Expert Group that has assessed climate risk and the GPF: The Government Pension Fund Global's work on climate risk should be strengthened. Available at <https://www.regjeringen.no/contentassets/54cfd391677a405a8666071f8d865e32/pressrelease.pdf>

OECD Economic Surveys (2020). Slovenia Executive Summary, June 2020.

EBRD. (2020). Economic performance of state-owned enterprises in emerging economies. A cross-country study, available at: <https://www.ebrd.com/what-we-do/economic-research-and-data/cse-economists/economic-performance-soes-in-emerging-economies.html>

Bagnall, E. A, Truman E.T (2013). Progress on Sovereign Wealth Fund Transparency and Accountability: An Updated SWF Scoreboard, Petterson Institute for International Economics

Kosovo Mining Strategy 2021-2025 available at: http://old.kuvendikosoves.org/common/docs/Strategjia_Minerare_e_R_Kosoves_2012_-_225__Ang.pdf

Balkan Investigative Reporting Network (2020). Parties of Employment, Recruitment Monitoring Report

(December 2019 - December 2020), Prishtina, 2020. Available at https://birn.eu.com/wp-content/uploads/2021/01/Recruitment-Monitoring-Report-Parties-of-Employment_ENG-1.pdf



**KOSOVO'S SOVEREIGN FUND:
WISE INVESTMENT
MANAGEMENT OR
PIPE DREAM?**

Kosovo's Sovereign Fund: Wise investment management or pipe dream?



In addition to applying a proper management policy, investment policies should diverge into several economic sectors creating conditions for long-term sustainability. Although investing in one sector in the short-term might have a big impact in increasing economic activity and related productivity gains, in times of crises or unexpected economic



downturns, this formula might prove to be financially harmful. The approach with which the investment patterns are channeled will have a considerable effect on the country's economy, particularly in small countries like Kosovo, and must be measured against those that add value in the economy (employment, productivity, innovativeness).