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Project:

*Privatization in West Balkan with special emphasis
on Montenegro*

Privatization in Montenegro

Podgorica, May 2001.

Preface

This paper is done as part of Project "Privatization in West Balkan with special emphasis on Montenegro"

Objective of the paper is presentation of privatization process in Montenegro in terms of basic results, problems and experience from privatization in Montenegro.

Paper consists of seven parts.

It begins with legislative framework for privatization and chronology of privatization process in that area. Then, strategies and approach to privatization is presented and some technical procedures in operation of privatization strategies. Two different periods will be analyzed:

1. Until 1999
2. After 1999

In fifth part some opinions and remarks regarding privatization process are presented, in sixth part experience from Montenegro but under lights of experiences from other countries and finally, at the last part, questions how we should proceed further.

My associates, Dragana Ostojic, M.sci and Maja Bacovic, have done collection of research materials; both of them are assistant lecturers at the Faculty of Economics in Podgorica.

1. Legislative framework

Privatization process in Montenegro has been conducted in several phases, which are connected with changes made in legislative framework regarding privatization.

Beginning of privatization in Montenegro (first phase of privatization), as in all other former Yugoslavia states, had been connected with Federal Legal Act on Social Capital (1989), which is based on model of internal privatization. But, ideological campaign against privatization had disabled enforcement of this Law in Montenegro (except in few companies)¹.

Montenegrin legislation in this area had been established in 1992. Before this, we had strong expert and political discussion. Legal Act on Property and Management Transformation passed the Parliament. According to this Law, all companies had obligation to become corporate (become public companies - share company), to make estimation of value of capital and to make, until depersonalized, capital with personalized ownership structure. Capital was distributed on:

1. Workers (10% free + 30% under specific privilege conditions)
2. Three state funds (Development Fund, Pension Fund and Employment Fund)

So, with this Law social ownership in Montenegro was eliminated and capital had been shared between workers and state. (Ratio was 60% and more in favor of Funds and 40% or less for workers).²

Privatization Law passed the Parliament in June 1996 represents beginning of new, third phase of privatization process in Montenegro.³ This Law has been focused on privatization of state capital in public companies and state capital in funds. Also, in this Law mass voucher

¹At first multy praliament elections in Montenegro the Comunist Union won and that was the only Republic where comunists nominaly stayed at power.

² The amount of shares per worker was limited at 18.000 DEM.

³ This Law is brought after adoption of the Federal Law on basis of change of ownership

privatization was introduced - distribution of shares to all-mature citizens for free.⁴

Also, faster privatization was tried to be influenced by obligation of funds to offer their shares on market. Law insists on increase of effective demand: shares can be bought by old foreign currency saving and Government bonds.

Above this Law, Government adopted two decrees: Decree on Shareholder's registry (December 1996) and Decree on privatization coupons (December 1996)⁵.

At the end of 1996. Government establishes relationship with Know How Fund and precedes expertise of current legislation. At the beginning of 1998. cooperation with USAID (Barents group) has been established⁶. During 1998. Together with foreign advisers we had strong discussion related with privatization Law and its changes. Speediness, transparency and publicity were issues had been insisted on.

Parliament adopted: Amendments on Privatization Law (February 1999.)⁷. According to this Law, privatization regulative and legislation was insisted on. Followed with Law, were adopted Decree on Dematerialization of securities and vouchers, Decree on privatization vouchers, Decree on Privatization funds and special management companies, Decree on share selling by publicly announced tender, Decree on Central register of shares, Decree on buying shares with old foreign currency saving. By this Law new authority was established, Privatization Council of Government of Montenegro. With this Law power of Government in privatization policy decision-making becomes stronger with obligation to adopt privatization plans for each year. Understandable and clear procedures were entered, model for privatization of state capital in public companies, introduction of mass voucher privatization (free distribution of voucher to all citizens older than 18), position of funds has been changed. Some models from previous period were canceled; specially sell of control package of shares

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⁵ The work on Decree on foundation and functioning of privatization funds (December 1996), but in that concept it was never finished.

⁶ Before all, Ph.d Robert Stone from Know How Fund and Ph.D Erwin P. Geiger, who with their expertness, experience and efforts gave large contributions to preparation of privatization legislation in Montenegro.

⁷ It is about completely new Law, but politicians have insisted on "continuancy", what resulted that it is named Changes and Amendments of Privatization Law.

to management of companies, which is resulted with serious problems. Privatization legislation from 1999. Insist especially on transparency and publicity of all procedures and conditions regarding privatization and making better conditions for foreign investors. This has resulted with avoiding privatization affairs and lower corruption, which was present in previous period.

During 2000. and 2001. Several decrees changed especially in area of regulation and control of privatization funds.

Privatization legislation passed in 1999 is still valid in Montenegro.

For privatization process in Montenegro, above privatization legislation, are very important other systems legal acts, passed also by Parliament of Montenegro, especially:

1. Law on Securities.
2. Law on Banks.
3. Law on Central bank.
4. Foreign Investment Law.

And several Laws related with fiscal reform.

Enterprise Law, Bankruptcy Law and Public Procurement Law are under procedure.

Foreign experts and advisers have very positive attitude forward our privatization legislation and it's enforcement.

The most important, still non-solved issues regarding privatization legislation are:

1. Restitution
2. Protection of minority owners
3. Competition Law

These Laws are under preparation.

2. Strategy and principles of privatization

Montenegro is in favor of privatization policy in all areas, if private capital is interested to be invested in them.⁸ Rights of domestic and foreign investors are equal⁹. Montenegro is the first country in region with no-visa regime for foreigners. Montenegro as small state develops model of open economy and crucial philosophy of its privatization process is: "We don't sell our companies, we buy good owners".

But, realization of the strategy, as mentioned before, has been passed several phases. Or, conditions for strategy realization have been created evolutionary.

Perhaps, based on analyses, Montenegro is state with least prejudices about private property and open economy and integrations with region, Balkan.

It is probably influenced with tradition of clear establishment of ownership in Montenegro (First Law was enforced in 1888.)¹⁰, also Montenegro is small state and liberal economy and open society are approved by it's elite, specially by economists.¹¹. Of course, further development of economic reforms process will test real straight of willingness for market economy and internationalization.

In Montenegro we insist on entrepreneurial approach to privatization¹². Entrepreneurship is energy for creation and development. Privatization has to create environment for entrepreneur and on the other side, all privatization revenues are predicted for development of new companies

⁸ However, there are in the practice resistances from certain political parties concerning "privatization" of strategic enterprises (Elektroprivreda, Jugopetrol, Luka Bar, ...).

⁹ Some political parties are stressing the need to "protect" the land from foreigners!

¹⁰ Valtazar Bogišić: *General assets law for kingdom of Montenegro, Cetinje 1888*. So, for example in article 5, it is written that "this law is in power as for Montenegrin as for foreigners"; and in article 15. "anybody's property is saint and untouchable".

¹¹ That was a reason to speak about "Montenegrin economic school" stressing at that way very liberal approach to economy and insisting at development of entrepreneurial economy, that is not by many economist possible at Balkans. The dominant participation of the state and state control is required.

¹² For example Development Fund had invited up to now 14 million DEM in new privatization projects;

and improving of infrastructure. 20% of privatization revenues are invested in social policy and social consequences of privatization.

Property democracy is one of strategic goals. It means all citizens of Montenegro will become owners of shares. This is good way to make wider democratic base of politics and entrepreneurial base of economy¹³.

Even Montenegro is small state, connection of privatization and capital market development is strongly emphasized. Privatization should influence trade with property rights and related with it development of capital market compatible with regional, especially these from Former Yugoslavia countries.

Protection of property rights is important principle of privatization. Even this is more declarative than practically shown by now; willingness to improve this is obvious. Strikes of employees and protection of social peace influenced brake up of many contracts; even new owners filed all conditions. In case of foreign investors, they have right, before contract is signed, to select arbitrage from domestic or international court.

Key principles of privatization are:

- a) **Publicity**, availability of all information to citizens.
- b) **Equitableness**, all citizens are involved in process.
- c) **Transparency**, clear and understandable procedures.
- d) **Protection of property rights**, Government (state) guaranties, trough it's bodies and agencies, protection of property rights.
- e) **Transferability of property rights**, providing conditions for trading with shares at capital market.
- f) **Control**, precise mechanism for control of privatization process by Government and Parliament (special committee established).

¹³ 43% of total capital in Montenegro will be privatized trough: 28% trough vouchers distributed to 450.000 citizens and 15% to workers and pensioner (250.000 persons).

3. Technical procedures and conduction of privatization strategy

Until 1989, in Montenegro two types of property were dominant: state and social ownership.

There are some differences in terms of privatization techniques and authorities of some institutions regarding state and social ownership. But they are not so important and won't be presented here. Both types of ownership (state and social) pass similar methodological procedures. They will be explained under part explains general methodologies.

If we exclude influence of Law on Social capital (Federal Law from Former Yugoslavia legislation), process of change of ownership in Montenegro has been started with Law on property and management transformation (1992)¹⁴.

There are two phases in process of change of ownership in terms of legislation:

1. Transformation.
2. Privatization.

Transformation included several steps:

I step. Estimation of value of capital in company, which will be transformed by combination of methods:¹⁵

1. Net asset method.
2. Discounted cash - flow method (income based method).

II step. Company creates program of transformation based on one of the eight methods:

1. Sell of state capital for full prize and/or under special conditions.¹⁶

¹⁴ Yet, according to the Consittution of SR Jugoslavije (founded 27.04.1992) property transformation and privatization are in exclusine authority ot republics members - Serbia and Montenegro. That is the reason for existing completely different laws in Serbia and Montenegro in area of privatization.

¹⁵ In practice, method of net assets is usualy dominant having in mind many instabilities in Montenegrin economy in last decade.

¹⁶ In case of method (1) incomes from sales goes to state funds in proportion: 60% Development Fund, 30% Pension Fund and 10% Employment Fund.

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2. Increase of capital and selling of shares for full price and/or under special conditions¹⁷.
 3. Selling of enterprises.
 4. Buying up of companies by management or by foreign experts groups.
 5. Capital investment of foreign or domestic investors.
 6. Conversion of debt into shares.
 7. Transfer of shares on Development fund, Pension fund and Employment fund¹⁸.
 8. Identification of state capital in enterprises¹⁹.

Above this, possible model was leasing contract, management contract or franchising.

III step. Government Agency for reconstruction and foreign investments approves program of transformation.

IV step. Operating the program of transformation.

Special conditions for transformation are:

- a) All companies had to distribute 10% of their capital to employees or ex-employees without charge with high limit of 3000 ECU per employee.
- b) Companies can sell shares under limit of 30% of total value of capital to employees with discount of 30% and additional discount of 1% for each year of work. Limited value of shares, which employees can buy according to this method, is 10.000 ECU per employee. Shares have to be paid for ten years.

According to the Law from 1996. Employees who don't buy discounted shares have right to get some additional percentage of these shares for free (to convert them).

Also, shares, which are not bought or converted by employees, can be sold to citizens with discount of 30% and have to be paid for 10 years also. For cash payments citizens can get additional discount of 10%.

¹⁷ In case of method (2) sales income goes to company.

¹⁸ In proportion 60% Development fund, 30% Pension fund and 10% Employment fund.

¹⁹ This is related to fix assets or part of capital of companies that from certain reasons couldn't be privatized.

Other shares were transferred on three state funds and funds have had obligation to sell shares for four years. This obligation was delayed because of sanctions from UN.

Second step is privatization. Privatization is related with shares transferred on funds (Development fund, Pension fund and Employment fund). Privatization includes state capital in public companies, which are under management of Agency for reconstruction and foreign investment.

Phases of transformation and privatization in Montenegro had been conducted during the same time. Actually, during transformation employees registered their shares, either those, which are free, and those, which can be bought under special conditions (discount). Internal privatization was conducted at the same time as transformation.

Empirical results of transformation

In period from 1992-2000 347 social companies were transformed under model of transfer of social capital on funds. Estimated value of capital of enterprises was 5.152.830.495 DEM.

Transformation of these 347 enterprises by years was conducted as presented in following table:

Year	Percentage of transformed companies	Estimated value of transformed companies (DEM)
1994. and earlier	5,19	584.031.439,91
1995.	35,45	1.836.497.011,45
1996.	18,86	1.426.441.187,00
1997.	14,70	1.067.217.151,19
1998.	11,82	390.275,49
1999.	14,98	34.253.530,00
TOTAL	100,00	5.152.830.495,47

Ownership structure of transformed capital by model of transfer of shares on funds is presented in following table:

	Capital value in DEM	%
<i>Total social capital</i>	<i>5.152.830.495,47</i>	<i>100,00</i>
<i>Owners</i>		
Development fund of RoM	1.818.695.436,03	35,3
Employment fund of RoM	313.333.913,42	6,08
Pension fund of RoM	941.300.245,02	18,27
Employees	1.154252.796,10	22,40
State	456.747.840,34	8,86
Banks	98.140.876,04	1,90
Other	370.359.388,52	7,19

This table presents results of first phase of transformation and privatization.

Privatization capital was from funds and state.

Above state capital, Montenegro has had state capital. Total state capital was estimated as;*****

Next table shows structure of capital (social and state) after first phase or phase of transformation (corporatization).

Total capital; State Social	
Capital of funds State capital Banks Employees	

4. Privatization

4.1. Privatization until 1999.

4.1.1. Internal privatization

As already mentioned, employees had rights on free shares with value of 3.000 ECU, and shares sold under special conditions (with discount of 30% plus 1% for each year of work) with payment obligation for ten years and limited value of purchase of 10.000 ECU per employee.

This right had all employees and pensioners. With this method 22,40% of state capital had been privatized. Employees elected their representatives in management boards.

Selling of control package of shares

4.1.3. Selling of ideal package of shares

4.1.4. Auction sale

4.1.5. Tender sale

During 1997. and 1998. Announced international tenders for six companies. Two companies were sold.

"Trebjesa", Nikšić

Institute "dr Simo Milošević"

4.2. Privatization from 1999.

4.2.1. Key problems in privatization until 1999 and their consequences later

Several problems followed model and concept of privatization until 1999, which influenced enforcement of new Privatization Law, passed by Parliament in February 1999.

1. Privatization from this period was focused on employee (internal privatization) and domestic buyers, before all management. Privatization was characterized with selling with high discounts and delayed payments. All this didn't result with quality improvement of management. Contrary, new management boards were unable to solve basic problems in companies in terms of organization, reconstruction, etc. By the rule Management board was controlled by management, not opposite, as it should be. Management elected members of management board usually. Managers got significant power and they were free of any control. They behaved as owners without any risk. With real limitations under which Montenegrin companies operated (political instability, macroeconomic instability, inflation, unemployment). This fact influenced negative results of companies, included those, which were privatized.
2. Privatization process, especially according to model of control package of shares, wasn't transparent enough. Transparency is issue, which is specially insisted on from foreign advisers. Transparency lack results in unclear procedures and rules, closeness of process and advantagable position for management: lack of information about companies and hidden problems in companies, lack of clear payments procedures, direct deals and negotiations with partners.
3. Insufficient protection of property rights. In several cases employees asked from new owners additional requests, out of those contracted by selling contract and collective contract (wages, employment protection, other benefits)²⁰. Some buyers were enabled to come to company they bought, because

²⁰ For example Zanatsko Lovćen. Even though owner has fulfilled his obligations, the contract has been broken under pressure.

employees didn't want them there.²¹ Under these circumstances state authorities usually decided to break up contracts, usually not in favor of the buyer. Those situations encouraged employees to be against privatization or other techniques related with new management of the company.²²

4. Low quality of information mechanism²³, unclear and non-understandable contracts²⁴, Non-transparent procedures²⁵, and restitution problems²⁶ have opened many discussions related with privatization, which influenced the image of privatization
5. Insufficient demand for shares. Actually, the privatization model until 1999 favored the domestic buyer. But, domestic saving was very low, extracted by political and economic crisis. Also, some

²¹ Special case of Autoservisa from Podgorice.

²² The specific is the case of HTP "Budvanska rivijera". After one year negotiations with the French firm ACCOR, the management contract has been signed that should last for 15 years for six hotels at the Montenegrin coast: Sveti Stefan, Miločer, Maestral, Kraljičina Plaža (hotels from Budva), Fjord from Kotora and Plaža, HTP Boka Herceg Novi. The members of the negotiating team that was led by the Minister of Tourism, were our international legal advisors: Denton Hall Lupicinio, Madrida and Mark Harrison, lawyer from London.

According to the management contract, ACCOR would take management of the hotel for a certain fee, that is basically connected with business results. ACCOR didn't have financial obligations concerning investments in hotels. That was the obligation of the Government of Montenegro. The board of directors and workers of Budvanska rivijera were against that contract, under the motive that it is inconvenient for "Budvansku rivijeru" (that made losses for years and without investments into hotels and each year received subventions from the Government), and that ACCOR is investing nothing! Investments through the image of ACCOR, including Montenegrin hotels into their network of 3.600 hotels all around the world, transfer of management technologies, training of workers from Budvanska rivijera and set of other favorabilities, were not enough for making a decision! Even they didn't have an economic alternative to answer the question: how to improve the business of the company, all were against the contract. Discussions in public quickly received a political character! Skillful politicians from opposition (and position) have presented in public that: "our best hotels are sold to foreigners for free". What were the motives for resistance can be assumed. Before all, if we know that this company has favored the model of sale of part of assets of the company (total amount was about 8 million DEM) and receiving subventions from the Government (about 11 million in last few years).

This was one of the hardest attacks at privatization and reforms in Montenegro!

²³ "Crnogoracoop", Danilovgrad

²⁴ "Trebjesa", Nikšić

²⁵ Institute "dr Simo Milošević".

²⁶ Public discussions and presentation of association of citizens for returning the property to former owners.

individuals and banks took out capital from the country²⁷. Quality of domestic banking sector was low²⁸.

6. Potential foreign investors, having in mind political situation, were cautious. Also, to their cautions contributed unclear legal procedures, low level of property rights protections and contracts protection and speediness of economic reforms in Montenegro. Also, orientation on open economy and equal treatment of foreign and domestic investors has started at the end of 1999.²⁹.
7. Institutional and legal framework for privatization was insufficient to provide radical privatization. Management was dispersed (Agency for reconstruction and foreign investment, Development fund, Pension fund, very shortly - 3 months - Minister for Privatization). Foreign consultants pointed necessity of centralization and stronger control of privatization process.

Even many of mentioned problems appeared in 1999. And 2000. Their base is in models, which were actual before 1999. But we cannot be unjustified with previous period because some positive results were achieved. Before all, concept of social state was destroyed and political attitude in favor of privatization was built. Also, attitude that private property can be only base for market economy and democratic society. In this period we believed Washington consensus is efficient and it is great therapy for all problems.³⁰. We learnt about importance of institutions and institutional framework. This is approved by Montenegrin experience.

This entire problem initiated question: how to transit to new privatization models, which is approved by international standards and understandable for foreigners, challengeable for investors and more transparent.

Or, how to transit from closed and distributive model of privatization to open and more marketable model?

It was key question, which was tried to be answered on with Privatization Law from 1999.

²⁷ ***** Monetarni savjet za podatke *****

²⁸ Banking sector comprehends: eight domestic and one foreign bank.

²⁹ Npr. Platform for rgulation the relation between Montenegro and Serbia.

³⁰ Believing that macroeconomic stabilisation, deregulation and privatization are enough for quick tranzition.

4.2.2. Basic characteristics of new concept of privatization from 1999.

By decision of Government of Montenegro from September 1998 Privatization Council was established. It is body established to manage, control and operate privatization process in Montenegro. This was way to create privatization power ("single authority") or better: unified chain of command with privatization in Montenegro³¹. Reason for establishment was dispersed management with privatization process in Montenegro, difficulties in contacts and communication with other authorities, unclear responsibility, etc.³².

In cooperation with experts from Barents group and Know How fund, Privatization Law was prepared, or Amendments on Privatization Law. Base for this was "Saint Stefan agreement" from July 1998.³³. After establishment of Privatization Council, procedure related with preparation of new Privatization Law has been started and Law passed by Parliament in February 1999.

New concept has promoted a concept of "centralized decentralization". That means that Privatization Council has been given executive and supervisory function, and for the rest of institutions (Agency, Funds, as well as the companies themselves) authority, responsibility and rights has been clearly defined. However, previously started process of "spontaneous privatization", in which management boards, commissions and

³¹ A. Lojpur, M. Dragašević, D. Janković: Understanding privatization, Official Gazzete of Montenegro, Podgorica, 1999., str 286.

³² About motives se: Ph.D Veselin Vukotić: Initiative for speeding and improving privatisation process in Montenegro, Development Fund of Montenegro, 1998. (internal publication).

³³ Difficultis in comunication with foreign advicers and big misagreement between participants in privatization process coused organization of meeting in Saint Stefan where participated representatives from Government, Agency, Funds, independent experts, political parties and USAID, Barents group and Know How Fund. It was meeting where we discused should foreign agenciel continue to provide technical suport in privatization in Montenegro, or, is Governemnt of Montenegro ready to change concept and procedures in privatization. Meeting was very dificult. We were several times in diferent position. Many domestic participansr didn't realised they were tested, they and Government in terms of wilignes for privatization process. They insisted on small details, interfearnece of politics into privatization. Foreign advicers were against this aproach. They asked for implementation of international standards in privatization process.

funds had been selling physical assets of the companies, has been stopped.

The Law did not provide for some of the techniques of "spontaneous privatization" like selling ideal part of companies or controlling packet of shares to management (which have been dominant method of privatization in Montenegro prior to 1999). Model of internal privatization has been finished, and model of so called "crosswise ownership" has been abandoned³⁴. Privatization model of debt - equity swap was made almost impossible. That model could be implemented only if shares are not sold through other models (tender, auction, etc). Model of selling company by direct negotiation has been made viable only in cases and procedures provided by the Law. The Law brought in obligation of making annual Privatization Plan, which include methods of privatization for each company and timetable for certain activities. Privatization Plan has to be made public. The Law provided for the following methods of privatization:

1. Sale of shares,
2. Sale of assets,
3. Exchange of shares for privatization vouchers,
4. Recapitalization through new issue of shares,
5. Joint venture,

On the end the agreement about main issues has been made. Mr. Robert Stone PhD (on behalf of foreign experts) and Mr. Veselin Vukotic PhD (on behalf of domestic experts) made a report "St Stefan agreement on privatisation in Montenegro", which has been accepted by all the participants of the meeting. That document covered all problematic issues about privatisation in Montenegro, putting accent on the control and transparency of the process, organization of the process, institutional support to the process, mass voucher privatisation, etc.

Foreign experts think that adoption of that agreement represent a clear will of Montenegro to enter the new phase of privatisation, which will be technically supported by international institutions, especially US AID and DFID (Know How Fund at that time). Mr. Kit Sharper, at that time representative of USAID for Yugoslavia, in his letter to Mr. Milo Djukanovic, President of Montenegro, states his content with the St Stefan agreement and expressed will to continue with technical support, putting an accent on the need for setting up an executive body which will conduct the process of privatisation.

Two months latter, The Privatisation Council was set up.

³⁴ That was model in which one state owned company buy shares of or exchange shares with another state owned company. Model was not transparent and raised questions both of evaluation of those companies and managing them. One of cases is exchange of shares between Tobacco factory Podgorica and Mill "Zitopromet".

6. Debt-equity swap.

All of those methods have to be conducted in open and competitive procedures. The Law brings in a concept of dematerialization of shares and stipulates for establishing Central Registry, as well as provides possibility for establishing management companies and privatization funds. The Law provides possibility of establishing Parliamentary commission to follow openness and transparency of the process.

The Law covered privatization of state owned companies, as well as usage of privatization proceeds. Proceeds from sale of state owned companies will be used for financing development programs which are of interest for Montenegro. The idea is that the proceeds are not used for budget and expenditures. This Law mentioned, but didn't cover in full, restitution, especially agriculture land. That means that Law from 1999 has gave principles of privatization in Montenegro, make switch from concept of "closed privatization" to "open privatization", from workers (insider privatization) to citizens (voucher privatization), from unclear to clear procedures. The Law provide conditions for making new institutional framework and control of privatization, and for making privatization understandable to domestic and foreign investors.