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EFFICIENCY OF PPP IMPLEMENTATION IN BOSNIA AND HERZEGOVINA

ЕФИКАСНОСТ ПРИМЈЕНЕ ЈАВНО-ПРИВАТНОГ ПАРТНЕРСТВА У БОСНИ И ХЕРЦЕГОВИНИ

Summary: *Bosnia and Herzegovina is among the countries whose social and economic development needs greatly exceed financial capacities of the public sector. Implementation and financing of capital projects of public importance such as: highways and road infrastructure (bridges, tunnels), railway lines, ports, airports, gas pipelines, refineries, power generation plants, social and municipal infrastructure (hospitals, schools, prisons, water supply network, waste disposal) often lead to significant fiscal constraints. Financing investments in the context of limited budget capacities requires a new approach and strategy. In a situation where public sector in Bosnia and Herzegovina does not have enough resources necessary for the efficient implementation of capital projects, there is a need for engaging private capital. Public-private partnership, although a relatively new form of financing, opens significantly more opportunities for financing development, providing public services and meeting citizen's needs, which will be the subject of this paper.*

Keywords: *public-private partnership, public sector, financing, infrastructure.*

JEL classification: *L32, P48*

Резиме: *Босна и Херцеговина спада у ред земаља чије социјалне и економске потребе велико премашују финансијске капацитете јавног сектора. Реализација и финансирање капиталних пројеката од јавног значаја као што су: ауто-путеви и путна инфраструктура (мостови, тунели), жељезничке пруге, луке, аеродроми, гасоводи, рафинерије, постројења за производњу електричне енергије, друштвена и комунална инфраструктура (болнице, школе, затвори, водоводна мрежа, одлагање отпада), неријетко доводе до значајних фискалних ограничења. Финансирање инвестиција у контексту лимитираних буџетских капацитета захтијева нови приступ и стратегију. У ситуацији када јавни сектор у Босни и Херцеговини не располаже у довољној мјери средствима неопходним за ефикасну реализацију капиталних пројеката, тада се јавља потреба за ангажовањем приватног капитала. Јавно-приватно партнерство, иако релативно нов облик финансирања, отвара значајно веће могућности за финансирање развоја, обављање јавних услуга и задовољење потреба грађана, што ће бити предмет разматрања овога рада.*

Кључне ријечи: *јавно приватно партнерство, јавни сектор, финансирање, инфраструктура.*

JEL класификација: *L32, P48*

1. INTRODUCTION

In the past several years, Bosnia and Herzegovina, with the support of the international community, has accumulated significant resources and energy in the preparation of development strategies and economic development planning. Nevertheless, the country burdened with transition, unsuccessful privatizations, the change in ownership structure, the transition from one to the other social order with an inevitably turbulent political environment, did not fully create the conditions for the effective implementation of development plans and meeting the growing citizens' needs. Reforms in almost all areas of social life have slowed down the economic and economic development of Bosnia and Herzegovina. All the aforementioned aspects have been reflected in the fact that Bosnia and Herzegovina today has the worst transport infrastructure in the region, the obsolete and dysfunctional railway network, fragile municipal infrastructure, inadequate capacities in education, health care, justice and other public activities. In order to overcome all these problems, significant financial resources are needed, which Bosnia and Herzegovina currently does not have at its disposal. The fact is that even the majority of much richer countries do not possess the funds necessary for the effective realization of the aforementioned, especially those less developed and the countries in the process of transition, so they need to engage private capital. Public-private partnership is one of the particularly suitable forms of investing private capital for the purpose of financing investments in the field of

providing public services, development of infrastructure and other public goods, or meeting public needs through PPP projects. “Due to the limitation of budgetary resources, PPP appears as a model that creates faster assumptions for the quality provision of public services and the satisfaction of public needs” (Savanović 2009, 38).

2. THE CONCEPT AND MODELS OF PUBLIC-PRIVATE PARTNERSHIP

“All public-private partnership definitions have certain common characteristics, such as: (1) public-private partnership always refers to the cooperation of two or more entities (of which at least one is a public entity), (2) each entity is a principal, (3) the relationship is long-term, stable and based on mutual or complementary benefits, (4) entities transfer material or non-material resources to partnership, and (5) risk and responsibility are distributed to all participants in the partnership” (Benković 2011, 1). The partnership between the public and the private sector can be organized in many ways and established in various economic and non-commercial activities.

According to the Green Paper on public-private partnerships from April 2004, we distinguish two basic forms, i.e. modalities of public-private partnership:

- a contractual PPP, where partnership between the public and the private sector is based exclusively on a contractual relationship,
- institutional PPP, which involves cooperation between the public and the private sector within a specific legal entity.

The concept of contractual form of PPP defines partnership based exclusively on a contractual relationship between different entities. This term includes a multitude of models in which one or more projects, larger or smaller, are awarded to a private partner, which can include the structuring, design, financing, performance, renewal, use of goods and/or the provision of services. The common features of the PPP contract model are long-term contractual cooperation (e.g. 25 to 30 years) between public sector representatives and a private enterprise (or a consortium of several private investors) where the funding mainly relies on private funds, but where the state resources are also included. The contract defines the integration of all stages of the project throughout the duration of the contract (design, financing, construction, maintenance, use and eventual demolition and removal), the division of investments and responsibilities.

When it comes to institutional PPP, the main characteristic of this form of PPP is the establishment of a common public and private sector institution for the purpose of implementation of a particular public project or for providing public services. Shares, responsibilities, mutual obligations, risk allocation and management of such an institution are subject to the contract of a private and public partner. The institutional form of PPP can be structured by establishing a new institution or by taking over the share and control in an existing public institution by a private partner. Institutional forms of PPP are mainly applied in the provision of public services that are of great importance to the public sector, which requires that this sector maintains a part of the control and supervision of the provision of services (e.g. traffic, water supply, etc.).

When establishing partnerships between the public and private sectors, planning and risk assessment is one of the key elements of project analysis and the justification for entering into PPP arrangements. These risks most often include construction risk, availability risk, demand risk, operational and maintenance risk, residual value risk, financial risk, etc. Risk allocation is specific to each individual case of public-private partnership. One of the main principles of each PPP model is the risk allocation to the contractual party which has best abilities to manage the risk. Adequate risk allocation is a condition for a successful implementation of PPP project.

Depending on the degree of involvement of the public and private sector in the design, construction, maintenance, financing, management, operationalization, as well as the risk allocation in the provision of public services and/or the construction of public infrastructure, it is possible to distinguish several basic models of public-private partnership:

- *Design & Build-DB*; The public sector concludes a contract with a private partner that designs and constructs an infrastructure or a specific facility in accordance with public sector specifications, most often for a fixed price, so the cost risk is mainly transferred to a private partner. In this case, it should be noted that there are different opinions that DB projects are not part of the PPP spectrum.

- *Maintenance & Operation Contract (O & M)*; In accordance with the signed contract and under certain conditions, a private company manages public property, which still remains state-owned.
- *Design & Build & Finance & Operate - DBFO*; The most commonly used PPP model that allows the private sector to design, finance and build the public good, to take the public good into the long-term lease and manages it (to earn income in contracted period), and after the lease is expired to transfer the public good to the public sector.
- *Build & Own and Operate (BOO)*; The private sector finances, builds and manages the public good of which it is the owner. There are also certain limitations for the private sector arising from a precisely defined contract and they are implemented through permanent regulation by the appropriate structures of public authority.
- *Build & Own & Operate & Transfer - BOOT*; The public sector grants a franchise to a private company to finance, design, build and manage public good, as well as the right to charge for its use over a period of time, after which the ownership over the public good is hand over to the public sector. The private sector also fully takes over operational management of a particular infrastructure object throughout the duration of the contract.
- *Buy & Build & Operate - BBO*; The public sector transfers public property to a private (or mixed) entity that improves and manages public property for a certain period of time.
- *Operation License*; Is often used in IT projects when a private company obtains a license or the right to provide public service over a specific period of time.
- *Finance Only*; The private sector, usually a financial institution, directly finances the project or uses various mechanisms, such as issuing bonds, etc.

The advantages of cooperation between the public and private sector are multiple, and by choosing the appropriate financing model, it is possible to achieve faster infrastructure development, lower overall costs, better risk allocation, better service delivery, efficient management and getting the best value for money spent.

3. PUBLIC-PRIVATE PARTNERSHIP IN BOSNIA AND HERZEGOVINA

Although there is interest of the wider community, and above all the real need of the public sector for the affirmation of PPP projects, Bosnia and Herzegovina has not made any significant results in this field. There are several reasons for this, and the complicated legal regulations further slowdown the realization of these projects. There are 12 laws on public-private partnership in Bosnia and Herzegovina, as well as 14 laws on concessions. The first steps for the establishment of the legal framework for concessions and public-private partnership, were taken in 2002 by adopting the Law on Concessions at both BiH and Entity levels, the Law on Public Procurement of BiH and the establishment of the Commission for Concessions and the Public Procurement Agency of BiH. In 2009, the National Assembly of the Republic of Srpska adopted the Law on Public-Private Partnership, and in 2010 the Brčko District Assembly done the same by adopting the Law on Public-Private Partnership in Brčko District of Bosnia and Herzegovina. Situation is slightly different in the Federation of BiH. Although all ten Cantons of the Federation of BiH have adopted the laws on PPP, the Law on public-private partnership has not been adopted at the Federation level, although the draft law has been in the parliamentary procedure of this Entity since 2010. This problem is further complicated by the fact that there is no umbrella law regulating this area at the state level.

By adopting and institutionalizing the PPP concept, the public sector in Bosnia and Herzegovina gets a completely new role in the process of revitalization, construction of infrastructure and the provision of public services. New role of the public sector also requires new strategies, new organizational structure and administrative processes, as well as new capacities within the public sector administration. The capacity of the public sector to plan, prioritize, initiate, evaluate, structure and, ultimately, implement the PPP project represents the biggest challenge and has a great importance for the implementation of the PPP concept at entity and local community levels. Currently, the public sector in Bosnia and Herzegovina lacks the resources and capacities necessary for the successful development of PPP projects, especially in the areas related to the identification of needs and preparation of pre-feasibility and feasibility studies, which very often leads to poorly structured, financially unjustifiable PPP projects. Although local communities from the Republic of Srpska submitted more than 20 different PPP-funded projects, most of them did not get the approval of the

Ministry of Finance because the projects were unjustified and because of the wrong choice of the PPP model. Perhaps the key problem in the underdeveloped PPP concept in Bosnia and Herzegovina is the complete lack of capacity of the public administration to provide technical assistance from one administrative center to potential public partners that are legally authorized to launch PPP projects. This issue can be solved through the establishment of a special PPP unit for coordination and provision of technical assistance within the competent entity institutions, in the same way that countries in the region such as Serbia or Croatia have solved it. Nevertheless, despite all these problems, the public sector in Bosnia and Herzegovina is very intrigued by the potentials of the PPP concept, which enable further development and improvement in the field of financing public services. This interest is primarily fueled by the great gap between real needs for improvement and further development, and financial reality and insufficient public sector revenues.

The PPP concept increasingly appears in the areas of public service provision, which, up till now, have been regarded as sole responsibility of the public sector. For example, the lack of financial resources and limited opportunities in financing security projects conditioned the implementation of the PPP concept at the Ministry of Internal Affairs of the Republic of Srpska which implemented the project "Improving traffic safety using radar devices and modern technologies for recording offenses, transmission and processing data on violations". This project involves procurement of 180 modern radars and their integration into the system which will enable efficient recording and automatic processing of violations and the whole project will be implemented in 7 towns and 48 municipalities in the Republic of Srpska. The financing of the project will be secured through investments of the private partner, and by using the contractual form of public-private partnership in accordance with the provisions of Article 8 paragraph 1 a) of the Law on Public-Private Partnership in the Republic of Srpska. The contractual form will be implemented as a private financial initiative in which the private partner finances the procurement of the equipment, assembles, installs and approves it, and guarantees the maintenance of full functionality during the duration of the contract. Private partner will charge fees for his services from the public partner by allocating the revenues generated by using the equipment in question, in a manner defined by contract. The estimated value of the private partner's investment is BAM 9.3 million, and the duration of the contract is 120 months from the date of conclusion of the contract. The implementation of this project is carried out in accordance with the Conclusion of the Government of the Republic of Srpska No. 04/1-012-2-731/17 from March 23, 2017.

4. LOCAL COMMUNITIES IN BOSNIA AND HERZEGOVINA IN THE CONTEXT OF THE APPLICATION OF PUBLIC-PRIVATE PARTNERSHIP

Between the growing needs of citizens and the demand for the delivery of quality public services, on one, and financial reality and insufficient public sector revenues, on the other hand, financing local development in Bosnia and Herzegovina can be a very complicated task for local governments. The inflow of the budget at all levels in Bosnia and Herzegovina, including municipalities and cities, is mostly coming from indirect tax revenues. In 2016, the Indirect Taxation Authority of BiH (ITA) collected a record amount of revenues from indirect taxes, a total of BAM 6 billion and 638 million or 4.48% more than in the previous year (ITA 2017). After VAT refunds to taxpayers, which amounted to BAM 1 billion and 108 million in 2016, the net revenue recovered which were distributed between the state, the Entities and Brčko District amounted to 5 billion and 530 million BAM. The amount of BAM 750 million was allocated to the state institutions of Bosnia and Herzegovina in 2016, where the Federation of BiH received a total of BAM 3 billion and 31 million, the Republic of Srpska BAM 1 billion and 560 million, and Brčko District BAM 168 million (ITA 2017). Despite the growth in revenues from indirect taxes, part of the funds belonging to municipalities and cities have not increased. The reason for this is the fact that with the growth of revenues from indirect taxes, the external debt of Bosnia and Herzegovina and Entities also grew, and that growing liabilities from the financing of external debt, in accordance with the established system and distribution method, have reduced the proportion of funds distributed to Entities and local communities.

Faced with limited budget revenues, local communities in Bosnia and Herzegovina are in most cases forced to adapt their budget spending within the expenses allocated for investment, maintenance, subsidies, grants and remits, which leads to the low- quality public services and insufficiently

developed infrastructure. The inability to significantly influence creation of the budget, along with a large number of unresolved issues (communal infrastructure, social spending, unemployment, restructuring of business entities, unsuitable premises of health and educational institutions), stirred up the need of creating new strategies and ways of financing local development. Public-private partnership, as one of the possible forms of financing public services, is gaining importance in recent years in the context of the development of local communities. More and more local communities recognize the potential of engaging private resources in the construction and delivery of public services. In addition to the numerous local government initiatives for the implementation of PPP which are in different stages of implementation, the municipality of Sokolac is among the first local community in Bosnia and Herzegovina that have taken active steps in the implementation of PPP project, which will be further discussed in case study.

A) CASE STUDY – APPLICATION OF THE PPP MODEL IN THE IMPLEMENTATION OF THE DISTRICT HEATING PROJECT IN THE MUNICIPALITY OF SOKOLAC

Municipality of Sokolac is one of the first municipalities in the Republic of Srpska that has received all the necessary approvals from the relevant ministries to start and implement the public-private partnership project “District heating system for biomass with cogeneration – Sokolac” (European Bank for Reconstruction and Development 2015). Within the “Feasibility study for district heating systems for biomass with cogeneration – Sokolac” it was proposed to install a cogeneration plant on biomass with a capacity of 1 MW of electricity and a thermal capacity of 4.1 MW. The project envisages the installation of 28 thermal substations distributed over the urban part of the municipality with a total power of 15 690 kW. The produced electricity will be supplied to the electricity network by the so-called feed in tariff of 241,30 BAM/MWh. The total heating area after the reconstruction of the existing district heating network will be 131.592 m². In the financial analysis, it is planned that the contract period will be divided into two sub-periods. The first is the implementation period, which includes the signing of a contract and the verification of activity records, and it lasts for a maximum of two years. The second is the period of heat supply, which begins after the activity records are verified, and it is planned to initially last for 15 years with the possibility of extension. Six months before the expiration of the contract, a final review, final verification and transfer of ownership to a public partner will be carried out. For the implementation of this project proposal, the institutional form of the PPP model was selected. The total amount of capital investments amounts to EUR 7.6 million, or BAM 15.2 million. During the heat supply period, in an organizational sense, the private partner manages the entire system (boiler rooms and district heating network) through the duration of the contract. Private partner performs system maintenance and direct collection of revenues from the sale of electricity during this period. Through the heat supply period, public partner is administering the heating payment from all users. From the collected funds, public partner pays the contracted annual amount to the private partner. The difference between the collected funds and the contracted annual amount payable to the private partner, public partner retains for himself to cover the recovery costs and for possible profit. The most important aspect of this public-private partnership model is the risk sharing between public and private partners.

Table 1: Risks that public and private partner may potentially face

RISKS	
PUBLIC PARTNER	PRIVATE PARTNER
delay in obtaining licenses	delay in obtaining licenses
consume less than the minimum heating consume	unforeseen works
reduced recovery rate	fuel price increase up to 5%
	increased maintenance costs
	lower electricity revenues
	heating consume did not reach the design consume

Upon completing contract period, the whole system, including all equipment in the boiler room and the district heating network, becomes the property of public partner.

5. CONCLUSION

Based on the performed research and analysis of all collected data, this paper presents a case study - the application of the PPP model in the implementation of the district heating project in the Municipality of Sokolac. The previously implemented feasibility study, the selection of the appropriate PPP model, the optimal risk sharing between the public and private partner, with the support of the competent institutions in this process, leads to well-structured and financially justified PPP projects. The district heating project in the Municipality of Sokolac shows the way in which municipalities, which have relatively small budgets, can implement the most extensive infrastructure projects and improve the lives of citizens of their local communities. By installing a biomass cogeneration plant, the Municipality of Sokolac will expand and renew the existing district heating network, which will provide a sustainable district heating system based on local biomass.

Bosnia and Herzegovina is a country with a very underdeveloped transport infrastructure, unused energy capacities and other natural resources. Public sector in Bosnia and Herzegovina is faced with the need to improve the quality of public services in almost all areas of social life. Sources of revenue in public sector are insufficient and represent a limit for public sector to meet growing needs for faster development and improvement of service quality. Positive examples of developed countries indicate that the implementation of projects under the PPP model can be a mechanism that will provide a new framework for actions between the public and private sector, that will provide benefits and enable the strengthening of these two sectors of society through synergetic effect (Vladušić 2012).

However, the situation in Bosnia and Herzegovina, on this as on other issues, is very complicated due to the fact that Bosnia and Herzegovina is a decentralized state consisting of two Entities, the Federation of Bosnia and Herzegovina and the Republic of Srpska, which have a fairly broad political, administrative, legislative and tax autonomy. The Federation of Bosnia and Herzegovina, furthermore, consists of ten Cantons that also have the characteristics of small federal units with their own government, ministries, prime ministers, etc. Apart from the two Entities, Bosnia and Herzegovina also includes the Brčko District, which also has its own government, laws and other elements of a relatively independent local government unit. To that, one should add the complex and very often dynamic political situation, which greatly slows down progress in any area of economic and social life in Bosnia and Herzegovina. However, a great need for financial resources and their lack in the public sector, as well as completely new opportunities in the construction of infrastructure and the provision of public services, made possible for the concept of public-private partnership to slowly gain ground in Bosnia and Herzegovina, granted much faster in the Republic of Srpska than in the Federation of BiH. An understandable and easily accessible institutional presentation of the PPP concept to the stakeholders would greatly accelerate implementation of projects based on public-private partnership principles, and the public administration in Bosnia and Herzegovina would certainly play a new role in the process of providing public services.

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