

# Newsletter

## PROMOTION OF SUSTAINABLE SOCIO-ECONOMIC TERRITORIAL DEVELOPMENT IN THE WESTERN BALKANS

*Public-private partnerships will gradually become an option of choice in the years to come, primarily for local governments when it comes to financing large local and regional investment projects*

# Local Public-Private Partnerships in Serbia - Critical Review

*Tatijana Pavlović-Križanić*

According to the report of the European Investment Bank for 2010, more than 1,300 public-private partnership projects, worth 250 billion euros, have been implemented in the EU between 1999 and 2009. By the end of 2007, 350 new projects, worth 70 billion euros, had been completed. In 2011, most PPP projects were implemented in France, which took primacy over Great Britain and Spain. PPP which are implemented in the EU market are of much bigger value than the anticipated value of any PPP projects in our country – “big PPP projects” which individually exceed the value of 500 million euros represent 63% of the total value of the implemented PPP projects in the EU market in 2011.

Almost a year after the adoption of the Law on public-private partnerships and concessions, only one contract according to PPP model from the new Law on public-private partnerships and concessions is being implemented in Serbia – between the public company “Informatika” from Novi Sad and Slovenian-British-Dutch consortium, which should invest between 50-60 million euros in the construction of 240.000 km of optical infrastructure in Novi Sad. Private partner is entitled to 75% of the profits from the commercialization of the optical network in the next 25 years, after which the network management is completely transferred to the public partner – public company “Informatika”. Network users will have access to broadband internet, cable and IP television, with the possibility of selecting Internet provider for each of the telecommunication services.

Except for Belgrade and several biggest cities, most local governments in Serbia are still not sure on how to interpret the new law and the criteria for “filtering” projects that could be implemented as public-private partnerships or local concessions. Ambiguity caused by the new legal terminology and principles is one of the reasons why there are no more public-private partnerships at the local level. The second main reason for hesitation are insufficiently encouraging experiences in the implementation of the public-private partnership concept in the areas of the collection and transportation of communal waste, construction and maintenance of regional land-

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fills, establishment of parking services and the like, within the projects implemented under the previously valid Law on communal activities.

Insufficient quality of the actual public-private partnership projects in Serbia is primarily caused by the fact that before the Law on concessions and PPP was adopted, local governments were not required to apply competitive procedure, that is the public procurement procedure or similar tender procedure, in the process of establishment of the public-private partnerships. In addition to that, the law did not stipulate mandatory contents of the contract and municipalities were not required to explain the decision to involve the private partner based on calculations of how much the project would cost if it was implemented in a conventional way, and funded from the budget and/or commercial credits. Lack of obligation of local governments to publish a public tender for strategic partner practically resulted in municipalities considering quite legitimate to negotiate only with one partner, which sometimes led to arbitrary increase of project costs (hence public expenditures) caused by the absence of market and competition. As a consequence, after the last local elections, in many cities and municipalities in Serbia the contracts on delegation of utility activities concluded in the last several years are now re-analyzed from the aspect of legality and economic viability. Of course, it is hard to believe that the position of investors in any of these projects would be seriously compromised, especially in regard to possible termination of contracts, but any serious doubts in relation to the quality of these contracts will undermine the contractual partner's trust, and the contracts are expected to last next two decades.

What should motivate the public sector to consider the implementation of the contracts using the model of public-private partnership or local concessions after the adoption of the law?

The first reason for that is the fact that big infrastructure projects funded in PPP form are always the best candidates for funding through relatively favorable credit lines of the European Investment Bank (EIB), World Bank and International Financial Corporation (IFC), European Bank for Reconstruction and Development (EBRD), etc. The credit lines in cooperation with commercial banks and regional funds for crediting investment projects provide very competitive financial terms, which is a big advantage for investors interested in big infrastructure investments in the areas of waste water treatment, waste management, renewable energy sources, education and sport. These favorable credit terms certainly affect the overall cost of the project.

Another argument in favor of using PPP lies in a fact that even the big cities with respectable credit rating have gradually reached the upper debt limit, which practically unables them to finance deficit services and renovate and construct the missing utility and social infrastructure from the budget or from commercial credits by local borrowing in the longer period of time. In this situation, there are two possible ways for investment in the utility infrastructure: direct borrowing by the public utility companies or resorting to public-private partnerships. Public utility companies in Serbia operate relatively inefficiently, because according to 2010 data, based on the available financial reports, 136 PUC reported a net loss in the total amount of 6,5 billion dinars. According to a recent analysis, conducted for the Government of Republic of Serbia, in the structure of costs of the public utility companies, averagely, 47% are costs of salaries, 22% are costs of energy, fuel, material and maintenance, while depreciation amounts only 12%. Other costs (for example, write-off of short-term receivables, devaluation of receivables due to inflation, expenses of litigations, costs of humanitarian and cultural purposes, etc.) make about 18% of the total costs. Such a large proportion of "other costs" in total costs can be an indicator of PUC inefficient operations, especially when considering that these costs are almost double the depreciation. It is more than obvious that, except in rare cases, utility companies are not able to independently invest in new infrastructure, and in many cases they can not even ensure the maintenance of the existing one.

Bearing all this in mind, it is more than obvious that public-private partnerships will gradually become an option of choice in the years to come, primarily for local governments when it comes to financing large local and regional investment projects. Therefore, at this point, while it is still uncertain in which direction the reform of the system of public companies, especially public utility companies, will go, the most urgent issue is the establishment of quality and transparent mechanisms for analysis of price/value of each project (value for money methodology, to be prepared by the Commission for public-private partnerships and concessions), more detailed elaboration of the legal criteria for evaluation and approval of a project (including the determination of the types of risks born by each partner), as well as establishment of the quality mechanism in local government for monitoring of project implementation. If these issues are not resolved promptly, insufficiently seriously and professionally prepared and implemented PPP could become a big long-term burden to the budgetary spending, causing an increase of public debt through generation of concealed deficit, followed by ecological and socio-economic risks. ■

# Clusters in Montenegro – Development opportunities

Clusters as an efficient tool for SME development are growing in popularity in developing countries. Having in mind the limitations faced by small and medium-sized enterprises in their business, clusters represent an opportunity to develop associations, strengthen connections and build trust, and thus created better conditions for their growth and development, primarily the development of competitiveness on the local, regional, national and international markets.

In Montenegro, clusters were first mentioned in 2004. Since then, many seminars and round tables on clusters have been organised. However, extensive development of the process started in 2010 when the Centre for Entrepreneurship and Economic development (CEED) and the Institute for Strategic Studies and Forecasting (ISSP), in cooperation with the United Nations system (UNIDO and UNDP), initiated concrete steps in the identification of clusters with the best development potentials in Montenegro. In the same year, cluster mapping was carried out in the northern region of Montenegro, and two diagnostic studies were developed for two potential clusters mapped in that area. Already in 2011, cluster development initiative was expanded throughout the entire country. The mapping process was carried out in the entire territory, and 62 potential clusters were mapped in agriculture, wood processing, food processing, construction, tourism and manufacturing industries (metal industry and stone processing).

In order to provide institutional support to cluster development, in the end of 2011 and beginning of 2012, the Ministry of Economy, in cooperation with UNIDO and UNDP, prepared the "Strategy for Sustainable Economic Growth by Introducing Clusters until 2016", adopted by the Government of Montenegro in May this year. The Strategy defined further development directions in four general objectives and three main stages.

The following goals were defined as priorities:

1. Increasing exports;
2. Import substitution;
3. Opening new business and creating new jobs;
4. Maintaining the existing employment.

The entire process is planned through:

- Incubation stage (planned for 2012);
- Capacity building stage (planned for 2013);
- Implementation stage (planned for the period 2014–2016).

An action plan was also developed within the Strategy.

The first stage of incubation is currently ongoing. Activities on 6 pilot projects are being implemented. These are pilot pro-

jects in six potential clusters that were identified as those with the highest growth potentials. They are potential clusters for:

- Mushroom collection and processing;
- Organic production of buckwheat;
- Fresh water fish farming – brown trout;
- Wood processing;
- Meat industry;
- Olive oil production.

Possibilities for cluster development in Montenegro are large. They are mostly contained in comparative advantages, but in competitive advantages as well. For example, in the potential buckwheat cluster, buckwheat was planted on 12ha of land, and three years later that area increased to almost 30ha and it is still growing. There were 14 producers of organic buckwheat in 2008, and today there are 26.

Joint business activity within a cluster can have a significant impact on the development of exports for companies that could not export independently before. In the potential cluster for mushroom collection and processing almost every company had an opportunity to export products at least once in the last two years, whereas before it was not possible for most of them.

Situation is similar with olives. Olives from the Montenegrin coast are among the best quality in the Mediterranean. There is a large number of olive trees in the area of Bar and Ulcinj more than a thousand years old, and some of them even more than two thousand years old, and still bearing fruit. Olive oil produced from such trees is extremely valuable in the world.

The goal of the process is to create opportunities for a better use of resources, better links among potential companies, creation of "collective efficiency" and raising competitiveness.

Plans for the future period include the implementation of activities from the Strategy, as well as further promotion of cluster initiative and tools for their development. The plan is to have the cluster initiative operational by 2016 and to have as many SMEs as possible involved in clusters. For that purpose, loans provided by the Investment Development Funds are given with more favourable conditions for companies that are cluster members.

Cluster development process should be seen as a new way of understanding business that offers a possibility for progress through synergy. In that sense, it is very important for SMEs to be a part of the "team" in the time of globalisation. ■

# Good practices for development projects

Marko Vujačić, EU PROGRES Deputy Programme Manager



European Partnership with Municipalities - EU PROGRES is a three-year programme by the European Union, the Government of Switzerland and the Government of Serbia aiming to support the development of 25 municipalities in the South and South West of the country. Simply said, this means new jobs, better infrastructure, transfer of knowledge to municipalities how to attract investments, equal opportunities for all people, creating better image of this area, to name but a few expected results.

The programme has entered in its third year of implementation and it is possible to make an overview of the things initiated, i.e. accomplished. Programme's Steering Committee has so far approved the implementation of over 150 projects the value of which exceeds six million euros. Of course, more important than numbers are the effects: for example, several economic projects should contribute to generation of 1250 new jobs in the years to come; around thirty infrastructural projects will improve the working conditions in schools and kindergartens, water supply, energy efficiency, in a nutshell, the quality of life; around 700 citizens received free legal aid in order to

exercise some of their rights, from obtaining personal documents to exercising the right to health protection, education etc.

In this phase, it is also possible to identify the practices applied by the Programme that also proved to be effective. Firstly, EU PROGRES most often applies the “**grant methodology**”. It implies that the beneficiary, most often the municipality, receives the grant but at the same time it takes on the accountability for the implementation of a certain project. EU PROGRES retains the role of a “mentor” and “auditor”: it monitors the implementation, provides technical support, controls whether all the contract provisions are complied with, especially the manner of spending the funds. It turned out that this methodology may reduce the efficiency but, on the other hand, it has multiple advantages. Basically, the grant beneficiaries improve the knowledge and skills necessary for successful project implementation, especially for access to and usage of donor funds.

This approach has already yielded certain results: for example, it “encouraged” a more consistent compliance with the law in the area of public procurement and construction; it improved the understanding of donor requests for obtaining financial assistance; it introduced certain international standards such as the contractual modality standards of the International Federation of Consulting Engineers (FIDIC); it helped municipalities to recognise the importance of planning and technical documentation.

Secondly, I find that the work of EU PROGRES with regards to “**good governance**” is successful, even unique. This concept is not unknown: many projects aimed to improve the compliance with the “good governance” basic principles in the government work: accountability, transparency, civic engagement, equality and efficiency. There were many more

or less successful projects, dealing, in a way, first with principles and then real life. EU PROGRES also includes activities that, for example, empower the citizens participation and only then, as a consequence, a certain improvement is expected. What makes EU PROGRES unique is the opposite approach: we deal with real life situations and consequently, we expect better governance.

How? Infrastructural projects are the best illustration. When a municipality receives a grant for the construction of a green market our good governance experts come as a "bonus". They will consider together with the municipality what is necessary to be done in order to ensure that the market operates in accordance with good governance principles. For example, they will define the manner of leasing the market stands in order to avoid any preferential treatment (this seemingly small detail is associated with the principles of transparency, equality, efficiency). Thus, finally, the project results are not only the new market structures

but also improved local rules and regulations, with clearly defined stakeholder responsibilities.

Of course, Programme implementation does not come without a challenge. Let's take the elections as an example: notwithstanding who will win or who has won, months before and after the elections will be marked by decline of interest in projects, slowing down of activities and lagging behind. That is why it is important that those who are involved in development plan for these delays. **Strong partnerships** - with ministries, municipalities, civil society organizations and other similar programmes, may help in this or similar critical situations. Partnerships? Sounds like a cliché. However, that is not how things stand - in real life there is actually room and need for stronger and more genuine partnerships. That is why partnerships are the third "good practice" of EU PROGRES that I record, and I am quite certain they should be the practice followed by similar interventions.■





## *Study of results of development assistance under the current Swedish Strategy for Development Cooperation with Serbia*



The Report is a result of the study of results of the current Swedish Strategy for Development Cooperation with Serbia. The current Strategy covers the period between January 2009 and December 2012. The Study is intended to assist Sida in its preparations for the development of a new cooperation strategy, which will cover the period after 2012.

The publication is in English language and it is available on InTER website.

[www.lokalnirazvoj.org](http://www.lokalnirazvoj.org)

## *Outcome Assessment of the Development Cooperation between Sweden and Montenegro 2001-2010*



This report is a result of the study of results of Sida's Development Cooperation with Montenegro between 2000 and 2010. The Study includes a review of the development cooperation defined by the Strategy for Development Cooperation with the Federal Republic of Yugoslavia (FRY), excluding Kosovo, which was for the period 2000-2004, the Country Strategy – Serbia and Montenegro – 2004-2007, and the Phasing-out Plan for Development Cooperation with the Republic of Montenegro, which defined the cooperation strategy from 2008 to the end of Swedish assistance to Montenegro, formally at the end of 2010. The publication is in English language and it is available on InTER website.

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On InTER blog we want to enable a constructive exchange of opinions about topics relevant for territorial development, and gather representatives of public institutions, professional organisations and private sector and all those who want give their contribution to this joint goal. Topics on InTER Blog will include: regional and local socio-economic development, decentralisation and governance, business infrastructure development, development of small and medium-sized enterprises and entrepreneurship, project development and project cycle management, etc.

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