

# Liberalization Agenda and the General Framework of Serbian Local Public Utility Services Regulatory Regime

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This contribution aims to cast a light on the existing local utilities regulatory framework in Serbia, and its performance and financing, including public-private partnerships and concessions. As liberalization agenda is on the horizon, the author argues that institutional capacities of local administration have to be strengthened and regulatory powers of cities and municipalities well understood and elaborated.

## Introduction

Since democratic changes in 2000, after a long and still ongoing process of transition to a market economy, the Serbian government strives to pursue fiscal, structural and regulatory reforms under an IMF program that runs through 2018. GDP Annual Growth Rate in Serbia averaged 2.81 percent from 1997 until 2016.

The Serbian road to the European Union (EU) started in November 2000, when a "Framework Agreement between the EU and the Federal Republic of Yugoslavia (FRY)" was signed, enabling the EU to provide assistance for political and economic reforms. The Stabilization and Association Agreement between the EU and Serbia was signed on April 2008<sup>96</sup>. On 22 December 2009, Serbia applied for EU membership and received candidate status for EU membership in March 2012. The Council of the European Union decided on 28 June 2013 to open accession negotiations with Serbia<sup>97</sup>. As a candidate country, Serbia has to align its system of macro-economic governance with the requirements set out by the EU. Namely, the Enlargement Strategy of the European Commission suggested for the first time to create European Semester Light, fostering the system of national economic planning in order to assist western Balkan states with tackling economic reforms, restructuring their economies and stimulating growth and employment from the early stages of accession negotiations.

For more than a decade in Serbia, the reforms were guided by neo-liberal doctrine and fostered by conditionality imposed primarily through international financial institutions such as the IMF. Privatization, liberalization

and deregulation were the main pillars of the reforms, blindly followed by politicians who have made many wrong decisions in setting transition goals. After more than two decades of transition, a political interest still dominates in assets, and the inefficiencies of the public sector of the economy have accumulated a large structural deficit, passed through to public debt. Drafted on the basis of the Guideline on National Reform Programs issued by the European Commission, Serbia's Economic Reform Program of 2016 focuses on steps ensuring the completion of the privatization and restructuring of public companies and reduction of the state's share in the economy.

Even though tremendous progress has been achieved in liberalization, privatization, and macroeconomic stabilization, the Serbian economy still faces problems generated by the public sector, including country wide network industries or local utilities. Although assets for performance of local services of general economic interest were mostly left in the ownership of local authorities, the modalities of private infrastructure financing may be expected in the future, and hence all the inherited risks.

## On the way to liberalization and restructuring local utilities providers

Restructuring of public enterprises and communal services providers (as a special legal form for provision of services of general economic interest) is one of the most important reforms on the agenda, and a big challenge for state and local administrations. Restructuring of public enterprises and liberalization in the network infrastructure sector to comply with the EU rules on competition is, on the other hand, an explicit duty assumed by signing the Stabilization

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<sup>96</sup> The Agreement entered into force on 1 September 2013.

<sup>97</sup> The First Intergovernmental Conference took place on 21 January 2014.

and Association Agreement.

From a strategic standpoint, the reform of public utilities in Serbia has been an issue on the agenda since the early 2000s. One of the most comprehensive strategic documents has been created within an EU funded project – Municipal Infrastructure Support Program, the beneficiary of which was the Ministry of Regional Development and Local Self-Government in 2010. Within this project, several toolkits were created dealing with project preparation, implementation, feasibility study etc. A (draft) Strategy of Restructuring of Public Utility Services has also been one of the outputs of this project<sup>98</sup>. However, up to now no systemic steps were taken to operationalize the idea of restructuring public utilities. The Fiscal Strategy foresaw the enactment of the Program of restructuring local public utilities, and drafting of the National Strategy for Restructuring Local Public Utilities. However, no official document has yet been published. Recently amended Law on Communal Activities has paved a way for the entry of private capital, but without any strategic approach there is a risk that the practice may diverge in more than 150 local self-government (local territorial government) units.

## The legal framework

### The main components of an enabling legal framework

As a pre-condition for liberalization of communal services, the most important legal framework set out by general legislation should refer to the issues of ownership rights, organizational forms of service delivery, the public procurement framework and tendering procedures, service financing mechanisms, price-setting mechanisms, the budgetary framework of funding capital investments, and ensuring quality control and consumer protection. Péteri classified the most important preconditions for local utility service delivery into seven categories (Péteri 2003: 11–22). First among them is legislation on organizational forms of service delivery, which ranges from rules on municipal enterprises to general company laws. Depending on the scope of decentralization, local governments are responsible for strategic development of public utility services as well as for various capital investment schemes for local projects. In addition to the legal framework on tendering and public procurement procedures (PPP), PPP rules refer to privatization and restructuring by creating the framework for alternative service provision, which should enable better resource allocation and better performance, i.e., key components in service delivery, the selection process of private partners, specifications of performance, agreements on price setting, service monitoring,

and renegotiations. One of the critical components of the regulatory process is the price-setting mechanism, if prices are approved by a central level entity or the municipality who “owns” public utility.

### Organizational forms, control and ownership

The Law on Public Enterprises and Activities of General Economic Interest<sup>99</sup> defines activities of general economic interest, which include public utilities<sup>100</sup>s. Article 3 of this law defines a public undertaking in a formalistic approach, as a specific type of a legal entity, a company established by the state, autonomous province or a local self-government unit. In addition, services of general economic interest could be provided by a limited liability or a joint stock company exclusively owned by the State, company owned by the Republic of Serbia, autonomous province, local self-government unit or a subsidiary of such companies, as well as the company or an entrepreneur to whom the public body has conferred the provision of services. This definition is not in line with the Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings<sup>101</sup>. Also, it contradicts the definition prescribed in the Law on Public Private Partnership and Concession, which is in line with the above directive. The Law on Public Enterprises and Activities of General Economic Interest regulates the setting up and the business of public enterprises. It entails general conditions for performance of activities/delivery of services, or corporate governance.

The law on Public Utility Activities<sup>102</sup> listed fifteen communal services, among which the majority represent services of general economic interest (e.g. water provision, district heating, parking service) which specific regulatory regime is more precisely defined in the Law on Consumer Protection<sup>103</sup>, however only in terms of consumer rights such as the right to access, protection against disconnection, redress etc. An option is left to cities and municipalities to define, in their decisions on public utilities (based on this law) other potential communal services, as well as details on the performance of services. Only the activities of water distribution and the city transport by trolleybus and tramway may not be provided by a private party, but solely a public enterprise owned by the local self-government unit.

### Competences and regulatory powers of Local Self-Government Units

<sup>98</sup> <http://www.misp-serbia.rs/wp-content/uploads/2010/05/Strategija-restrukturiranja-JKP-Predlog.pdf>koristi

<sup>99</sup> Official Gazette, No. 15/2016.

<sup>100</sup> This corresponds to services of general economic interest in the sense of article 106(2) of the Treaty on Functioning of the European Union.

<sup>101</sup> OJ L 318, 17.11.2006, p. 17–25.

<sup>102</sup> Official Gazette, Nos. 88/2011, 104/2016.

<sup>103</sup> Articles 83–92, Official Gazette, Nos. 62/2014, 6/2016.

The Act on Territorial Organization of the Republic of Serbia<sup>104</sup> regulates its territorial organization, formed of the following units: autonomous provinces (Vojvodina and Kosovo), 24 cities and 150 municipalities. There are 29 administrative districts, but an administrative district does not represent a territorial organization unit, but rather a regional center of state authority. Law on Local-Self Government regulates<sup>105</sup>, among other issues, competences and authorities of the City of Belgrade, and cities and municipalities as local self-government units. According to this Law, the city or municipality may establish public enterprises, or the public service could be contracted out, in line with the principle of competition, transparency and the application of the Law on Public Procurement. Namely, the Assembly of the city or municipality decides on setting up the services and public enterprises, executive and oversight boards, and gives consent on the statutes of such entities. In line with article 20 of this Law, the unit of a local self-government ensures the provision and development of communal services, and the organizational, material and other conditions for the performance of such services.

One of the consequences of the outdated definition of a public enterprise is that different rules apply to public companies, companies in majority state ownership and private companies performing activities of general interest. The Law on Activities of General Interest has not prescribed the details of the procedure for conferral of the activities of general interest. Local utilities are within municipal competence. The agreement on conferral, as an alternative to concession, is supposed to regulate mutual rights and obligations.

Article 69 of the Law on Public Enterprises and Activities of General Economic Interest, representing *lex generalis* in the matter of public sector enterprises, provides a means of “securing the protection of general interest” authorizing the Government, the competent body of the province or a city/municipality to give consent to the statute, guarantees and sureties, tariffs (safe when other law prescribed that another body grants consent), terms of supply of goods and services, disposal of assets in state ownership, capital investment, etc.

The Law on Utility Services<sup>106</sup> further explains the competence for managing local utilities. Pursuant to the Article, the local self-government unit determines, in line with this law, the conditions for performing communal services,

rights and responsibilities of utility service users, the extent and quality of communal services, and the conduct of supervision of the performance of services. The Government determines the main features such as the minimal geographical cover or number of citizens to which a services is provided, a frequency of delivery, quality parameters, technical capacity which providers should fulfill etc. This Law further specifies the legislative power of the local self-government unit to determine the manner of performance of services, general and special rights of service providers, including price controls and supervisory powers. This Law (Articles 25–29) sets the principles for price setting, basic parameters of price methodology, the procedure of the change in prices of communal services and supervisory power of the city/municipality in this regard<sup>107</sup>, as well as the subsidized price for certain categories of users.

### **Contracting-out the supply of utility services and procurement**

At the local level, infrastructure investments by private investors were initially executed on the basis of the Law on Utility Activities of 1997, which enabled conferral of performing of communal services to an entity not owned/operated by the city/municipality. Most investments were made in the sector of hygiene and waste management, areas which do not assume a large infrastructure investment. Even before the first legal act regulating public-private partnerships was adopted, some forms of institutional PPPs were concluded forming a partnership between a municipality or a group of municipalities and a private partner. (Grubišić et al, 2015).

The existing Law on Public Utility Activities (Article 9) is the basis for conferral of performance of services, on the basis of decision of the Assembly (city/municipal). The procedure of conferral of services is subject to the application of rules on public procurement and the general PPP and concessions framework. Law on public-private partnership and concessions calls for the application of the provisions of the Law on public procurement<sup>108</sup>. In this way these provisions indirectly form the constituent part of the Law on public-private partnership. Amendments to the Law on PPP and concessions specify that service concessions are classified as the group of contracts awarded based on the Law on Public Procurement.

### **Brief overview of the PPPs and concessions normative framework**

<sup>104</sup> Official Gazette, Nos.129/2007 i 18/2016.

<sup>105</sup> Official Gazette, Nos. 129/2007, 83/2014, 101/2016.

<sup>106</sup> Official Gazette, Nos. 88/2011, 104/2016.

<sup>107</sup> As prescribed in Article 28, the competent body of a local self-government unit gives consent to the proposal for price change. The proposal comprises the explanation of the rationales for price change and the detailed structure of the proposed price. The proposal has to be published at least 15 days before the competent body decides on price change. Alternatively, the Assembly of the city or municipality may determine the conditions for price change even before the consent of a competent body, if this is stipulated in the agreement on conferral of provision of services.

<sup>108</sup> Official Gazette, Nos. 124/2012, 14/2015, 68/2015.

The Law on Public Private Partnerships and Concessions of 2011 was, obviously, drafted under the influence of potential investors, and its rules enable a flexible approach to project financing. It may be claimed that the new regulatory framework is satisfactory to a larger extent (Radulovic and Nenezic, 2012). This Law contains necessary rules (for example on surety instruments, step-in rights, etc.) recommended by relevant international practice guides such as the European PPP Expertise Center (EPEC) guide on PPP of the European Investment Bank<sup>109</sup>, Public-Private Partnership in Infrastructure Resource Center of the World Bank, etc. The Law regulates the conditions and methods for defining, proposing and approving the partnerships, defines the subjects authorized to propose and execute the projects of public-private partnerships, the rights and duties of the public and private sector partners, the form and the content of the public contract (with or without the concession elements), the legal protection in the procedure of awarding the public contract, the subject matter of concession, as well as all other issues which are significant for the realization of a public-private partnership.

Public-private partnership is achieved in two ways and is organized in two legal forms: contractual and institutional. Concessions form a special part of public-private partnership. Article 20 stipulates that the public agreement shall be concluded as a public-private partnership agreement or as a concession agreement. Duration of the public-private partnership project, i.e. concession, is limited to a maximum of 50 years.

In July 2013, on the basis of the Law on PPP and Concessions, the Commission for Public Private Partnership adopted a Methodology for the Value for Money analysis in Public-Private Partnerships and Concessions<sup>110</sup>. This analysis should be obligatory when the PPP does not have elements of a concession, but the same methodology should be used in a feasibility study for a PPP with the elements of concession, prepared by a public body.

In order to enhance the transparency of the granting process and evidence of the public contracts, in June 2013 a Rulebook for the recordkeeping and content of public contracts register was adopted<sup>111</sup>. However, the general public opinion in Serbia is that the process of public tendering and public contracts is not sufficiently transparent.

Amendments to the Law on public-private partnership and concessions, effective March 2016, have been introduced to secure a better control of fiscal risks in PPP projects through the analysis of fiscal impact for project proposals exceeding 50 million EUR<sup>112</sup>.

#### **The effect of financial limits imposed on local authorities**

In terms of sources of financing, Serbian cities and municipalities may be divided into two groups (Nenezic and Radulovic, 2012:66). The first group comprises local self-government units which have reached the upper limits set out in the Law on Public Debt<sup>113</sup>. The other group is composed of those entities with low credit capacity and status, and to whom banks are not interested to lend, but could be interesting to international financial institutions and development banks. Limiting factors for financing are also related to low cash flows mainly due to limited government support, tariff policy. Therefore public utility companies are more prone to short term financing. Further, the Law on Public Property imposes restrictions related to surety. Namely, when assets are not treated as assets of an enterprise, the public company is treated as the user of the publicly owned assets (ownership by the state)<sup>114</sup>. Another limit is related to the lack of possibility of issuing a guarantee by local self-governance units, due to the Law on Public Debt. The last limitation could, to a certain extent, be mitigated through the support agreement. When credit support or financing from own resources is not a viable option for a communal service provider, the PPP is an option both for the local self-government unit, and the service provider owned by the municipality.

#### **Project proposals which have been awarded a positive opinion (green light) by the Commission for PPPs**

Since March 2012, as of the date 21 February 2017, the Commission has evaluated around fifty proposals for PPPs with or without elements of concession and has issued 44 positive opinions for PPPs with or without elements of concession<sup>115</sup>. The following table (Table 1) shows that the majority of positive opinions related to communal services, while only five were related to other infrastructure projects such as railroad concession, river port etc. Unfortunately, there is no official data about the exact amount of projected and/or performed PPPs and concessions in Serbia.

<sup>109</sup> The European PPP Expertise Centre, The EPEC PPP Guide available at: <http://www.eib.org/epec/g2g/>

<sup>110</sup> Available at: <http://www.ppp.gov.rs/dok/38/Metodologija%20za%20analizu%20dobijene%20vrednosti%20u%20odnosu%20na%20ulo%C5%BEeni%20novac%20u%20javno-privatnom%20partnerstvu%20i%20koncesijama.pdf>

<sup>111</sup> Official Gazette, No. 57/2013.

<sup>112</sup> Local projects and the other small-scale projects still remain to be developed in a decentralized manner. However, the opinion of the Ministry shall be necessary only for PPP and Concession projects where the contracting authorities / public bodies proposing the project are under the governmental authority and if their value exceeds 50 million EUR.

<sup>113</sup> Article 36, Law on Public Debt, Official Gazette Nos. 61/2005, 107/2009, 78/2011 and 68/2015.

<sup>114</sup> Articles 19-20, Law on Public Property, Official Gazette Nos. 72/2011, 88/2013, 105/2014, 104/2016 – other law and 108/2016.

<sup>115</sup> The full list of projects granted positive opinion is available at: <http://www.ppp.gov.rs/dok/37/MISLJENJA%20KOMISIJE.pdf>

Table (1) Proposals which have been granted a green light by the Commission for PPPs <sup>116</sup>	
Communal Services	City/Municipality
District Heating	Zrenjanin, Niš, Batočina, Vrbas, Pirot
Waste Management	Topola, Žagubica, Regional Center Keleš, Grocka <sup>117</sup> , Belgrade,
Public Sewage System Reconstruction	Stara Pazova
Public Transport (City or Municipal)	Loznica, Topola, Srbobran, Nis, Jagodina, Šabac, Negotin, Paraćin, Belgrade <sup>118</sup> , Belgrade <sup>119</sup> , Kanjiža, Ruma
Public Lighting	Topola, Sečanj, Vrbas, Vranje, Varvarin, Žabalj, Ada, Beočin, Plandište, Bor, Petrovac na Mlavi, Kruševac
Maintenance of residential buildings and institutions, public lighting and chimney-sweeping <sup>120</sup>	Novi Sad
Water distribution system and construction of a small power plant	Brus
Local railroad construction and maintenance	Stara Pazova
Public Parking Garage	Sabac
Other	City/Municipality
River port and Road Terminal	Apatin
Railroad Concession	E-763 Belgrade-Pozega
Building, reconstruction and maintenance of Belgrade Airport and the airport operation	Belgrade
Optical Network - Telecommunications	Novi Sad
Selected urban infrastructure property	Belgrade

Due to the lack of planning and appropriate risk management, some of the approved projects related to communal infrastructure failed in realization, such is the District Heating PPP in the City of Zrenjanin, which was entered into without a proper feasibility study. Some important infrastructure projects are in the pipeline, such as the offer for the selection of an operator for the Vinca waste landfill as part of a public-private partnership, currently one of the biggest projects of its kind in Europe. Due to the project's complexity, in line with the Law on Public Procurement, the competitive bidding process had been launched and pre-qualification process for the assessment of qualified bidders is under way. According to the City Council of Belgrade, eleven investors expressed their interest. The project involves construction, operation and maintenance of a municipal waste treatment facility and foresees the

construction of a mechanical biological treatment plant with refuse-derived fuel production<sup>121</sup>.

### The need to strengthen the institutional capacity for private infrastructure initiatives

As of the 1990s, the trend of decentralization and privatization of local communal services in Central and Eastern Europe has been continuous, with legislation enabling contracting for service delivery just one among a number of determinants of successful project implementation. However, a stable regulatory framework, institutional capacity, transparency, and the competence and accountability of public administration, including at the local level, are indispensable features in the agenda of priorities for development policies and the transformation process in post-communist economies (Laffont, 2005; Hodgson, 1998). Experiences in development aid show that strengthening administrative capacities and institution building is the key determinant in transition economies (Graham, 2002). Among different levels of influence and the development of PPP policies and projects, institutional support represents one of the main preconditions of an effective PPP policy (Verhoest et al., 2014). One of the main problems in developing PPP projects in Serbia is the lack of administrative capacity of local self-government units even in the phase of formulating the potential projects.

Although a new Serbian Law on Investments<sup>122</sup> has established a modern Serbian Development Agency, regional development agencies are not sufficiently involved in the development of instruments of financing local economic development and private infrastructure financing. The problem of „missing middle“ (Shaw and Greenhalgh, 2010) could be solved by a more active role of the association of cities and municipalities (Standing Conference of Cities and Municipalities), and the strengthening of the network of cooperation among Serbian regional development agencies. Law on Investment mandated the creation of local economic development and investment support units within the local self-government units, an entity authorised by the local self-governments, or a dedicated project team to provide support to an investor investing in the development of communal and local „economic infrastructure“. The role of the Serbian Chamber of Commerce, through its Office for Investment Support and Public-Private Partnership is worth mentioning, as well as the efforts made by the National Alliance for Local Economic Development (NALED), which represents an association of companies, municipalities and civil society

<sup>116</sup> Table has been based on the official report of the Commission for PPPs. [www.ppp.gov.rs/dok/39/2016%20-%20%D0%98%D0%97%D0%92%D0%95%D0%A8%D0%A2%D0%90%D0%88%20%D0%9E%20%D0%A0%D0%90%D0%94%D0%A3%20-%20%D0%88%D0%9F%D0%9F%20-%20%D0%A4%D0%98%D0%9D.pdf](http://www.ppp.gov.rs/dok/39/2016%20-%20%D0%98%D0%97%D0%92%D0%95%D0%A8%D0%A2%D0%90%D0%88%20%D0%9E%20%D0%A0%D0%90%D0%94%D0%A3%20-%20%D0%88%D0%9F%D0%9F%20-%20%D0%A4%D0%98%D0%9D.pdf)

<sup>117</sup> Co-generation, district heating.

<sup>118</sup> Intra-city.

<sup>119</sup> Inter-city.

<sup>120</sup> All services proposed within one project.

<sup>121</sup> <http://balkangreenenergynews.com/eleven-offers-for-belgrade-landfill-ppp/>

<sup>122</sup> Official Gazette, No. 89/2015.

organisations.

The functionality of PPP support institutions depends on several criteria, among which the following are crucial: political support, the competence of employees and well developed coordination mechanisms (Verhoest, 2014). Central PPP units may perform PPP policy formulation, technical support, the promotion of PPP and capacity building, but may also green-light projects. Pursuant to article 65 of the Law on Public Private Partnerships and Concessions, a Commission for Public Private Partnership is set up by the Government of the Republic of Serbia and is composed of nine representatives of relevant ministries, the city of Belgrade and the Province of Vojvodina. The main role of the Commission is to give its opinion on the PPP proposal, or the proposal of the concession agreement, after taking into account the opinion of the Ministry of Finance.

The normative framework for PPP implementation, which is wider than laws regulating PPP and concessions, should recognize the role of local administrations not only as stakeholders in but also facilitators of PPP implementation (Jovanic, Sredojevic, 2016). In this sense, legislation in the western Balkans should better define the responsibilities of local administrations and necessary procedures. However, determinants of the local government capacities needed for successful PPP implementation are not only set out in laws and regulations, and a number of the types of expertise are required for PPP promotion and execution.

## Conclusion

This paper aimed to provide a general overview of the normative framework of public utilities of a local character in Serbia, and to give some proposals on the reform, notably the need to strengthen the capacities of the Commission for PPPs and the institutions providing technical support, as private infrastructure investment represents one of the pillars of regional development especially where the State, cities and municipalities have reached upper debt limits. Although during the last few years the normative framework has been upgraded and is mostly in line with EU requirements, investors are still not confident, projects and risk assessments not sufficiently elaborated, and local authorities not sufficiently educated about benefits, risks and negotiating procedures. All this leads to the conclusion that the presence of international financial organizations will be crucial for a successful implementation of large infrastructure projects. Public utilities of a local character, due to underinvestment during the previous two decades, are in urgent need of restructuring. The new legal framework is an impetus for liberalization, however, the regulatory powers of local self governments are underdeveloped, especially in the domain of economic regulation. Risks in public-private partnership projects and conces-

sions may be transferred to users, and therefore proper mechanisms of consumer representation at the local level and consumer protection should be developed (Jovanic, 2012). Preferably, a public agency overseeing the regulatory powers of local self-government units should be established.

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