

The Monetisation of Assets through Concession and Applicability in the Sector of Energy in Bosnia and Herzegovina

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Abstract: *Financial effects of monetisation through concession in the sector of energy in Bosnia and Herzegovina (B&H) may well increase the level of domestic investments, production, exports, employment and general economic growth, without additional higher borrowings and loss of ownership in these strategically important industries. These new financial opportunities are necessary for faster economic development of the country, especially in the transitional period, as this development process is a great challenge in modern world economy. It requires significant commitment and coordinated efforts of the public and private sector.*

The case study of Terminal Kakanj Power Plant (KPP) presented in this paper show that it is possible to implement monetization of assets through concession in the energy sector in B&H.

The empirical results provide evidence of positive correlations between monetisation through concession process and economic development in B&H or other transition and development countries.

Keywords *Monetization, Concession, Development, Financial Effects, Energy Sector*

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Introduction

Due to the lack of investment funds the economies of many countries are often in unfavorable and seemingly hopeless situations, where incomes are insufficient for necessary new investment, which slows the growth of capital and production and finally results in slowing of the income growth. Such economic situation is very difficult and depressing, and the way out of this situation is not easy and requires adequate knowledge and hard work.

One of the possible way-outs is through new investments, which can change and direct a vicious circle of this situation towards the revival and development of the economy and overall society. The question is how to acquire new investments, i.e. how to ensure the necessary funds for this purpose?

In this regard, the governments have an important task, especially in providing funds, which is not easy.

Public infrastructure in many countries, because of their high value, may be the basis for new investments, because this potential can be exploited so that the existing resources and assets available in the network industries can provide fresh money. This can be achieved by monetization of assets through concessions. The government's funding source of increased importance is the "monetization" or insuring the cash flow from existing public assets. Revenues made by the monetization may be used for: new infrastructure funds directly, or for other purposes. On the other hand, this process is a good opportunity for the government to gain the capacity of new technologies, increase production and exports, achieve stability in the energy system, and to avoid possible risks of worn out and technologically obsolete capacities or losses, etc. A new concession management structures, in partnership with the public sector, with an agreed concession fee, receive infrastructure to manage, which in long-term involves: investment, exploitation, maintenance, sale of services and all other that is related to the specific activity and agreement.

The process of monetization has to take in account large interests of stakeholders, this is especially true for the public sector, concessionaires, financial institutions and service users. Their interests are different, but they are strongly connected to each other. The implemented project which presented in this paper (page 4.) and experiences of countries show different interests of stakeholders and main reason for

monetization through concessions in network industries. These practical examples of projects and results of research presented in book “Achievement in Finance of Infrastructure, PFI/PPP”, Izet Bajrambasic, 2004, (chapter: “Participants and the interest of the participants in the PPP Projects”) give very clear explanation of stakeholders different interests.

The interests of the public sector are: new financial resources, continuous provision of public services, faster development of infrastructure and economy, allocation of risks, safety in the delivery of public services, quality of services, market competition and others.

Interests of concessionaires are: long-term investments, an increase in the volume of business, applying experience and knowledge in the field of work, protection of property and copyright, freedom of financial transfers and alike.

The interests of financial institutions are: long-term borrowings, safety in money return (guarantees for the return of money) and to ensure the priorities of payments compared to other costs in the operational work of the concessionaire.

The interests of service users are: to have developed network industry (infrastructure) and services, to have adequate service quality and price, to have the option of investing in these industries and alike.

Interests of all stakeholders must be met, achieved and to be sustainable for a longer period of time, because it is the greatest guarantee for the success of the project.

This is often politically more acceptable option than the full privatization, since the government can exercise control of public property operators, and at the end of a long-term concession contract assets are returned to public ownership. This shows that there are political, economic and financial reasons for the monetization of assets through concessions, and therefore it is important to research and study this financial instrument in B&H.

According to result of the case study presented in this paper, it is clear that there are great opportunities for the application of this model in the energy sector in B&H. The study was conducted on the most complex production facility of KPP, Public Enterprise Elektroprivreda (PEEP). It is possible to apply monetization of public assets through concessions, where the government would remain the owner and the

concessionaire would operatively manage an independent enterprise KPP. Such an approach will greatly enhance and accelerate investment in the energy sector, while at the same time create new opportunities for the implementation of other planned investments, such as revitalization of the relevant coal mines.

Literature review and experience of other countries

One of the important segments of economic development is investing in infrastructure. Infrastructure of a country is understood as the fundamental service foundation of the economy, society and overall development. It is well known that, for the development of the economy, the adequate services are necessary, including transport, electric power, telecommunications, water and waste water etc.

Larger investment in this sector produces higher market demand, and it implies that there is an increase in production, which enhances employment and gross domestic product. These economic relations and results are particularly significant for developing and transition countries, which in this process see a good opportunity for economic and social progress.

Large number of authors in economic literature confirms the need to invest for faster economic growth, and great contribution to that is provided by international trade and free movement of capital.

The capital investments depend on many factors including the accumulation and savings. The amount of capital determines the volume of domestic product and domestic product determines the amount of savings and investment. On this way domestic product determines the amount of accumulated capital (Blanchard, 2005). This cycle is very important for each economy and expected capital increase. Public infrastructure investments in network industries have large investment share and capital increase. It was pointed out that the investments are planned according to the assessment of expected cost and benefit, and that relationship, including amortization which significantly affects the level of investment.

Assessing of investment, interest and risks are important factors that are taken into account, because refund depends on that. It is especially important to examine this in public investment, due to the mostly high investment volume and long-term financial burden, which is not easy for public sector. Public investments are specific and require special analysis and calculation of costs and benefits, but not for an

individual or a small group, but for all potential users and entire society. The realization of these efforts is not simple because financial resources for these investments determine plans and possibilities. For this analysis, the state employs large teams in order to prove the need and cost effectiveness of investment (Mankiw, 2004). Government support is mostly expected in terms of new investments and ensuring the funding. The main problems arise when the accumulation is not sufficient, and credit debts are not possible or are at risk. This can be partially avoided, because it is possible to obtain funding in other ways, beside from own accumulation and no debt.

One of these ways is partnership to private sector with different possibilities to invest. Financing and development of infrastructure on the basis of the Private Finance Initiative (PFI) and the Public Private Partnership (PPP) means introducing the private sector into financing and management of public services and physical infrastructure aimed to increase financial possibilities, improve the quality of public sector, develop infrastructure and introduce the business principle into the public sector. The partnership of the public and private sector in the PFI/PPP systems is, with the common interest, directed towards long-term contracts for sustainability of the relationship and the infrastructure system (Bajrambasic, 2004).

Monetization of assets through concession is one of the PPP models, which is very relevant in recent years. "An increasingly important source of government financing is from the monetization, or securitization of cash from existing public assets. This is often a more politically acceptable option than outright privatization, since the government can exercise a degree of control over the asset operator, and at the end of the long-term contract the assets will revert back into public ownership. The proceeds from such transaction can be used to fund new infrastructure directly, or for other purposes" (Colchester, 2005).

This is why the public sector increasingly desires private investment in public assets. A finance market is open and private investments have no restrictions and all investment forms are available: bonds, option, futures, derivatives, real estate and even fine artwork ... (Armstrong III, 2004). Relate to this large possibilities of private investment, the public sector may have to prepare an attractive project if they would like to have private investment in public infrastructure.

It is not easy, but practice has shown that many countries need partnerships to private sectors and monetization of assets through concession. There are many cases of this monetization model around the world.

The experiences of other countries in terms of monetization through concessions in network industries are positive, and reasons and interests for these processes are various.

Examples of projects in the USA and South East Europe region are listed below.

- The first concession in the USA for already constructed infrastructure facility was awarded in 2005 for the Chicago Skyway Bridge, which was built in 1958. The bridge is 12 km long, and the annual number of vehicles is around 19 mils. The annual income from the collection is approximately \$ 45 mils. The bridge was operated (operations and maintenance) by the City of Chicago Department of Streets and Sanitation for more than 50 years. The concession was awarded to the Sky Concession Company, LLC for 99 years, and the company paid \$ 1.83 mil. In this case the government justified concession by the fact that they need funding for new infrastructure projects in Chicago, and that this was the easiest way to get fresh money. (<http://www.chicagoskyway.org/>)
- Indiana is the first US state, which monetized the road Indiana Toll Road by collection through concession for a period of 75 years, with the offered value of \$ 3.85 bn. The concession was awarded to Spanish investor Macquarie Infrastructure Group and Cintra. Analyst Richard Beales (Financial Times, 2006) claims that this example could open the door for other financial constrained countries to invite private investors to roads and bridges for resources/assets that are traditionally owned and operated by state and local governments.

This is monetization through concessions of previously constructed motorways. The state of Indiana has constructed this motorway much earlier with its own funds and loans and it has already been used for a fee. The reason for such move by the government was financial problems and high maintenance costs, as a result of the infrastructure management by the state. (<http://www.governing.com/topics/mgmt/indiana-toll-road-model-privatization.html>)

- Road Alligator Alley was constructed in 1964 with two lanes, and enhanced with two more lanes, which financed from the bonds issued. The owner and operator was a state-owned company Florida DOT. Due to the high costs and financial needs, it was decided that the road will be given under concession.

In this concession, revenue collection did not follow the growth of operating costs (management and maintenance) of the road, and transformation was done through the concessions, as in the case of Indiana Pay Toll. (<http://inthepublicinterest.org/case/proposed-privatization-alligator-alley>)

- The Government of Macedonia in 2008 awarded concession to the Turkish company TepeAkfen Ventures (TAV) for two airports in Macedonia: Alexander the Great - Skopje and St. Paul -Ohrid. The concession period is over 20 years, and mandatory total investment is Euro 200 mil and the annual concession fee to the Government of Macedonia is Euro 30 to 40 mil.

The government made this decision due to the need of large investments and large debts for airports. All these investments and debts were transferred to the concessionaire by the transformation. (<http://www.mtc.gov.mk>)

- The Government of Montenegro in 2008 decided that the Port of Bar is not to be privatized but to carry out the restructuring, and that the port should be given under concession. After restructuring, concession agreements to 30 years were signed, at an annual fixed concession fee in the amount of Euro 27,500 and a variable fee of 1.5% of the annual income of the concessionaire. The essential decision of the Government is that the infrastructure remains in state ownership as a national interest, and that it can be given under concession. The Government's stake of the operating companies can be sold as well, because it is not of the national interest. Therefore, the Government of Montenegro sold majority stake in operating companies related to the port of Bar. This project combines the privatization in the part of the operational work and monetization via concessions in the part of infrastructure. (<http://www.minsaob.gov.me>)
- The Republic of Croatia Government in 2011 awarded concession for Zagreb Airport to the French consortium Zagreb Airport International Company (AIC) for 30 years to construct new passenger terminal and for management of existing and newly constructed terminal and associated infrastructure. Within three years' period the ZAIC should construct a terminal for the capacity of five

million passengers per year, the total capital investment in the first phase amount to Euro 236 mil., with an additional Euro 88 mil for regular maintenance. (<http://www.mmpi.hr>)

The ratio of ownership is not changed: 55% of the state, 35% of the city of Zagreb, 5% of Velika Gorica and 5% of Zagreb County.

The topic of this paper is very specific and it request research methodology which covers comprehensive area and specific research parts. Research methodology of this paper is descriptive in next article.

Methodology

The overall aim of this study was to research applicability for the monetization of assets through concession in the energy sector in Bosnia and Herzegovina. In particular, the focus of this study is to solve the problem of finance and risk in investing in public infrastructure, and exploring the possibility to establish a new financial resource based on the existing public assets.

Research methodology of this paper covers the process of the whole research activity and essentially is the core component of the research paper itself. It includes the following parts: descriptive microeconomic and investment status of the countries, generally; investment and concession approach in theory and practice; the primary and secondary data capture methods; case study of the monetization of KPP including mathematic operation (BCR, NPV, IRR, Payback method) and graphic presentation; discussion and results and conclusion with recommendations. The contents of this research process were used in order to determine the basis and assumptions for this paper and achieve the overall aim of the study.

In order to provide the appropriate data, case study and analysis to evidence an acceptable solution for the current finance problem, the most appropriate methods for this paper is the data collection method and analysis including case study method.

There are four main action areas recommended to cover all activities: data capture, case study, data analysis and result.

Data captured from different resources: internal and external. Internal data used for this paper are from: books, laws, studies, magazines, etc. (specified on the end of this

paper). External data used are from: business plan, annual business report, technical and finance studies, investment plan and the internet, etc. (specified on the end of this paper).

Case study prepared base on technical and finance studies, published information, experience of other countries and author's knowledge and experience. Data analysis is done as narrative description and through result of the case study. The case study presented main results to achieve the overall aim of the study.

Macroeconomic aspects and assumptions of the study have been described only partially to the extent necessary, and which is linked to the developing countries and transition economies. This aspect is not presented comprehensively, because it is a specific topic of the paper.

The information captured on needs and financial status of these countries clearly indicates the urgency for investing, but also a great debt and significant difficulties in repaying debts. Additionally, these countries need new investment and fresh money for economic development. An analytical approach was used for the main part of the study, and an example of possible way to address these issues in B&H and other countries in the region was presented.

Strategic plans for the development of the energy sector in B&H have not been agreed or operationally synchronized. However, it is known that for planned investment the accumulation of enterprises is nowhere near enough, and other forms of investing and plan implementation are considered. A key unresolved question is: which investment models should be applied and which funding sources should be used to develop production capacity.

Investment programs and technical study, which are still valid, were used as the basis for new investment model, and they were prepared for the traditional method of implementation based on finance borrowing. Predicted method of implementation was faced with serious financial difficulties, and the project stalled. Besides traditional modes of investment, it is necessary to consider other known forms as well. Technical and financial data from the mentioned documents have been used to model the monetization through concessions as a basis for investment, business plans and calculation in the concession period of 30 years.

The presented case study is related to monetization through concession of KPP, which is belonging to the Public Enterprise Elektroprivreda B&H (PEEP).

Previous business analysis and planned investments of KPP are the basis for assessing the operations in the concession period, which is analytically, with investment dynamics, presented in the following four separately business periods: 2015-2019; 2020-2026; 2027-2032 and 2033-2045. These analytical business periods are operating in continuity, varying according to the level and type of investment, and different business results. This analytical approach enables to calculate the profit and net profit, with included cost of concession fees, as well as net present value, which is essential for the analysis of concession relations between government and the concessionaire, and the evaluation of overall management transformation of KPP.

Case study: Monetization of KPP

KPP capacities developed in stages, based on the large deposits of coal in this area, from the initial 32 MW in 1947 to 578 MW of total installed capacity, concluding with block 7 from 1988. In addition to production and selling of electricity KPP produces and sells thermal energy, slag and ash.

Financial operations of KPP is not individually stated and publicly disclosed, but it is a part of overall PEEP business, which is a certain limitation for analysis. However, there is more data on the operations, such as: production volume, costs and resources of business, so it is possible to calculate the basic business elements and indicators.

New investments in KPP are given in a separate document Investment Program 2010 (Technical Study). Current operations and planned investments provide the necessary data for evaluation of possibilities of KPP monetization through concession, and therefore in the continuation of the text separate analysis of these two important segments are listed.

Business data of KPP

Known elements of KPP business for 2010 are: total costs (207.878 mil KMⁱ), total assets (964.630 mil KM), number of employees (663), total production (1,831 GWh) and investments (56.041 mil KM). Other elements of business are not known, but elements of PEEP business operations are known.

Detailed and systemized PEEP business results from 2009 and 2010 are suitable for calculation of the missing elements of KPP business for 2010. KPP participation in electricity production in total production of PEEP can serve as a key to calculate the total revenue of KPP. The volume of PEEP production in 2009 is 6926.50 GWh, out of which KPP produced 1907.97 GWh. In 2010 PEEP production volume was 7181.40 GWh, out of which KPP produced 1831.00 GWh. Participation of KPP in total production of PEEP in 2009 is 27.55 %, and in 2010 amounts 25.50 %. Basic calculated elements of KPP business statement, as "independent company" for 2010 would be as shown in the following Table 1.

Table 1: *Basic calculated elements of KPP business statement*

| Description | Amount (mil KM) |
|---------------------|-----------------|
| Total revenue | 235.000 |
| Total costs | 210.590 |
| Profit before tax | 24.409 |
| Tax 10% | 2.440 |
| Netprofit | 21.968 |
| Number of employees | 663 |

Source: *Authors' own work and Annual Business Statement of the KPP 2009*

Analysis of recent investments in KPP

Significant investments in existing capacity in PEEP are completed in the previous period. PEEP has invested 1.056 million KM in the development by 2010, and planned investment for the period 2011 to 2015 is 970 million KM, and for the period 2016 to 2020.811 million KM.

The first investments according to the overall KPP plan are related to the construction of Block 8, for which the preliminary Design and Environmental Study have been completed. Block 8 (300 MW) is the first block in the gradual transition to the new technology. Continuity of replacing the existing installation is planned for a longer period, so that full energy stability is achieved in 2030, with the planned installation of Block 9 (300 MW).

The completion of construction and commissioning of the regular operation of new block 8 in power plant Kakanj is planned (the traditional construction approach) for 2018 (Investment Program).

The study envisages total investment and required work resources as well as operating costs.

The total investment in fixed assets (Block 8) at constant prices amounts to 945.267 mil KM.

Table 2: *Business and Investment Forecast in Concession Period*

| Description | Business period (mil. KM) | | | | Total |
|----------------------------|---------------------------|-------------|-------------|-------------|-----------|
| | 2015.-2019. | 2020.-2026. | 2027.-2032. | 2033.-2045. | |
| Contracted concession fee | - | 140.000 | 130.000 | 390.000 | 660.000 |
| Total Profit | 136.445 | 163.688 | 176.666 | 645.671 | 1.122.470 |
| Tax 10% | 13.645 | 16.366 | 17.666 | 64.571 | 112.248 |
| Total Netprofit | 122.800 | 147.322 | 159.000 | 581.100 | 1,010.222 |
| Total discounted value | 97.645 | 74.573 | 49.149 | 88.405 | 309.772 |
| Operative capacity(MW) | 450 | 340+300 | 600 | 600 | - |
| Operative capacity (block) | 5,6 and 7 | 6 ,7 and 8 | 8 and 9 | 8 and 9 | - |

Source: Authors' own work

In the first year of work required current assets amounts 20.830 mil KM. The cost of financing the investment amounts 59.948 mil KM, and total investment at constant prices is 1,035.046 mil KM. Total investment at current prices amounts to 1,106.338 mil KM. Block 9 has same price amounts (investment calculation).

It is important to note the need for rehabilitation and modernization of three aforementioned mines that production and future of KPP depends on. These mines are the basis of development and operation of KPP, and it is therefore necessary to

simultaneously invest in the mines. Investment indicators are satisfactory and the Technical Study is the basic document for making a decision on the future status and operation of KPP. Also, this document is a solid source of data for analysis of monetization possibilities through concessions.

Given the large number of tables and calculations of separately periods of business and investments, below is the table presenting in the aggregate profit and net profit, with concession fees according to the calculation and capacity of KPP, for aforementioned periods of business.

Discussion and Results

The table shows that the aggregate net profit is 1,010.222 mil KM, and the discounted value of the net profit is 309.772 mil KM, and that the aggregate contracted installment fee is 660 mil KM, while the immediate fee of 200 mil KM is not shown in the table. In the part of compulsory investment for the concessionaire it is important to note that the last two periods of operation is shown with capacities of new technologies and that it is possible to achieve the goal of replacing old plants according to the planned schedule.

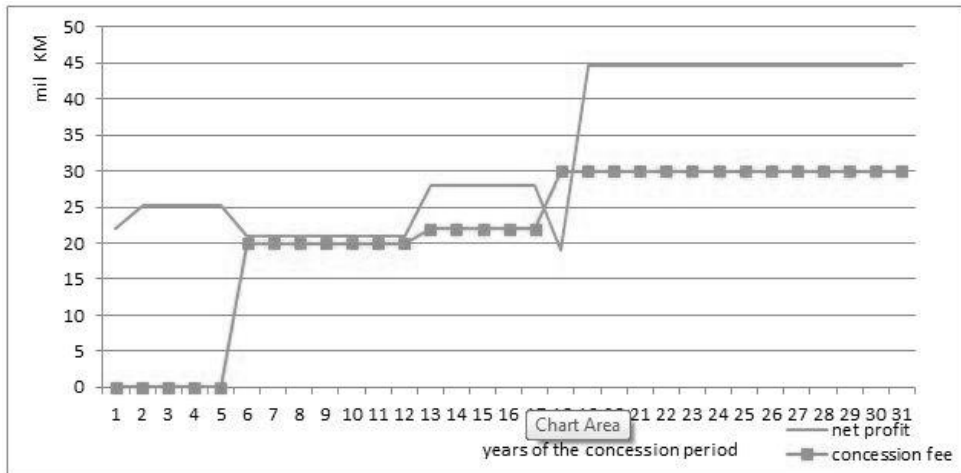
Net present value according to calculation and immediate concession fee, is positive and amounts 109.772 mil KM (309.772-200.000), which is an indicator of the success and feasibility of monetization of assets through concession in KPP. The calculation of discounted value is per discount rate of 8 %. It is important to note that the costs include: operating, maintenance, costs for environmental protection measures, financing costs, a 10% tax (profit/net profit), and costs of concession fees.

We have taken into consideration the conditions of IFI's,ⁱⁱ where the grace period is five years, the loan repayment period is 20 years and the interest rate up to 4.5 %, and it would be a financial support to the concessionaire.

Operating of KPP, according to the Technical Study, shows a high amortization, which exceeds the amount of the (credit) annuity, which is important for the financial cash flow in the company. Further, the aggregate business results according to the previous table show significant net profit, as well as the discounted value. It is good financial framework for the concessionaire, which provides good possibilities for company reform, investing and making profit. The ratio of net profit and

contracted installment concession fees from Table 2 is important, so it is presented in the following Figure 1.

Figure 1: *The Ratio of Net Profit and Concession Fees*



Source: Authors' own work

Developments in these two values in concession period (30 years) show that the fees are stable at certain periods, and that the net profit is stabilized in the last decade.

Presented monetization of KPP shows that there are good assumptions for this process and that the application is possible and acceptable. The analysis shows financial and other benefits for the government and the concessionaire and achievement of a common goal, and that would be the production of electricity.

Besides the benefits, each partner in this process would have to accept important responsibilities in order to make the project successful. For example, the government must take on the responsibility of modernization of mines, which are relevant for KPP and the obligation to secure supplies of coal. In this regard, the government would use contracted immediate concession fee to modernize the primary mines Kakanj, Breza and Zenica. On the other hand, the concessionaire would accept an obligation to deliver electrical energy e.g. priority for B&H. Of course, partners in this process agree on all details and sign the concession contract on monetization of KPP.

Conclusion

All defined activities of the research methodology used for this paper have been done and a final result is very clear and visible. The research results and experience of other countries shows that it is possible to monetize an existing, constructed infrastructure asset, i.e. certain capacities as an example of KPP. The research results with emphasis on KPP indicate that the energy infrastructure in B&H has great value and is mainly owned by the state and that the monetization of assets through concessions is possible. The presented case study showed that interests of all stakeholders had been met and had been achieved. It also showed that was sustainable for concession period of 30 years, because it was guaranteed by the financial success of the project.

Resources and needs of B&H are great in all segments of network industries, which definitely should be used, bearing in mind that, generally, these are complex strategic industries that require special attention and sustainability of the system. It is the reason why the monetization process is much better option than privatization, because it is based on changing the management structure, but not changing of ownership as well, which remains with state (public).

Monetization of assets through concessions in the strategic industries sector is possible in the economies of countries, if there are clear benefits and if such model of monetization is acceptable, with regard to the legal and business environment. In these national economies that requires significant commitment and coordinated efforts of public and private sector.

Generally, exploring new financial opportunities is necessary for faster economic development of the country, especially in the transitional period, as this development process is a great challenge in the modern world economy.

This monetization process is common job for the public and private sector to have a mutual interest and risks in realization of long-term contract. There are many different risks for both partners. The basic risks in this process are: political, legal, commercial, operational and maintenance risks, then income and financial risks. All the risks have to be included in the risk analysis. The risks are disadvantage of this monetization process, because each of them can make implementation problem. High quality risk management and contracting are requested for successful monetization process.

Recommendation: Taking into account results of this study and risks in this process it is necessary to continue exploring, preparation and implementation projects of the monetization of public assets through concessions in B&H.

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ⁱ1,9558 Convertible Mark (KM, ISO CODE: BAM)= 1 EUR (Currency Exchange of the Central Bank of B&H, No.092)

ⁱⁱ International Finance Institution (WB, EIB, EBRD)