Dealing with the infrastructure deficit

Chico Santos

THE NECESSARY FISCAL TIGHTENING imposed by Finance Minister Joaquim Levy has made it clear that the public sector lacks the resources to carry out essential public works. Planning Minister Nelson Barbosa has been put in charge of the urgent revitalization of the federal program of infrastructure concessions, whose continuation is vital to restoring public confidence. He is calling on the private sector to invest and accelerate public works that the government has been unable to carry out expeditiously.

The government is moving to improve the environment for success of the program, which requires large investments. On April 2nd, the president issued Decree No. 8428, which regulates the use of Expression of Interest Procedures (PMIs) for companies or individuals interested in helping the public sector to structure concessions or public-private partnerships (PPPs). Article 18 of the decree allows the government to bar participation of those responsible for structuring a project from bidding to carry out that project. By separating project structuring from the interest of the concessionary, the decree seeks to plan infrastructure projects without a bias in favor of possible concessionaires.

The government wants to unlock investments in sanitation, railways,

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ports, airports, highways, and other sectors that are essential to the economy, but have not materialized for lack of funds or government capacity. Examples abound. On March 25 the Court of Audits (TCU) reported that of 491 contracts for sanitation projects signed since 2007 by the Ministry of Cities, totaling investments of R$8 billion, by the end of 2012 work on 57.6% had been suspended, delayed, or never begun—only 11.8% of the projects had been completed.

Initiated in 2007 and seen as vital to mitigate the perennial problem of water insecurity in the Northeast, the project to divert part of São Francisco River water to supply the states of Ceará, Pernambuco, Paraíba and Rio Grande do Norte, where 12 million people live, was expected to be completed in 2010 at a cost of R$4.5 billion. Early in 2015 the Ministry of National Integration admitted that only 70% of the work was done and promised completion in the first half of 2016, at an additional cost of nearly R$4.5 billion.

The beginning of 2015 was also marked by suspension of road works contracted by the National Department of Transportation Infrastructure (DNIT), which in mid-March admitted to having accumulated R$1.3 billion in debt. Among the major public works suspended or slowed down was work on the section of Highway BR-381 between Belo Horizonte and

Of the 76 public-private partnerships, only one is federal

PPPs contracted by sector.

Sanitation	16
Solid waste	14
Health services	9
Urban passenger trains	7
Stadiums	6
Citizen assistance	6
Prison system	3
Roads	3
Housing	2
Urban transport	2
Multi business	2
Information technology	1
Urbanization	1
Culture	1
Airports	1
Education	1
Public buildings	1
Total	**76**

Source: Radar PPP.

Governador Valadares cities in Minas Gerais state, part of the Growth Acceleration Program (PAC).

Economist Armando Castelar Pinheiro, researcher at the Brazilian Institute of Economics (IBRE), thinks the government's decision to try to accelerate infrastructure concessions makes sense: "There is in Brazil a huge demand for infrastructure services, which constitutes a huge investment opportunity," and "huge market interest in investing in such projects." Pinheiro also welcomed the assignment of managing the concessions program to Planning Minister Barbosa: "It shows that the issue is being treated with appropriate seriousness." Pinheiro also thinks that concession contracts for such long-term projects (25–30 years) may to some extent help revitalize the economy.

Pinheiro believes, however, that in Brazil infrastructure concessions still depend on the political convictions of the executive branch, causing uncertainty about both the success of bids and the ultimate operation of concessions. Concessions started during the Itamar Franco administration (1992–94), beginning with the concession for operating the Rio-Niteroi Bridge (1994). They were intensified during the Fernando Henrique Cardoso administration (1995–2002) with concessions for roads, railways, electricity, and oil exploration, but then diminished during the Luiz Inácio Lula da Silva administration (2003–10). "Lula was conservative in macroeconomic policy, retaining the policy of his predecessor, Cardoso, but in the area of concessions for construction and operation of infrastructure he very quickly changed the legal framework, introducing uncertainty," he says.

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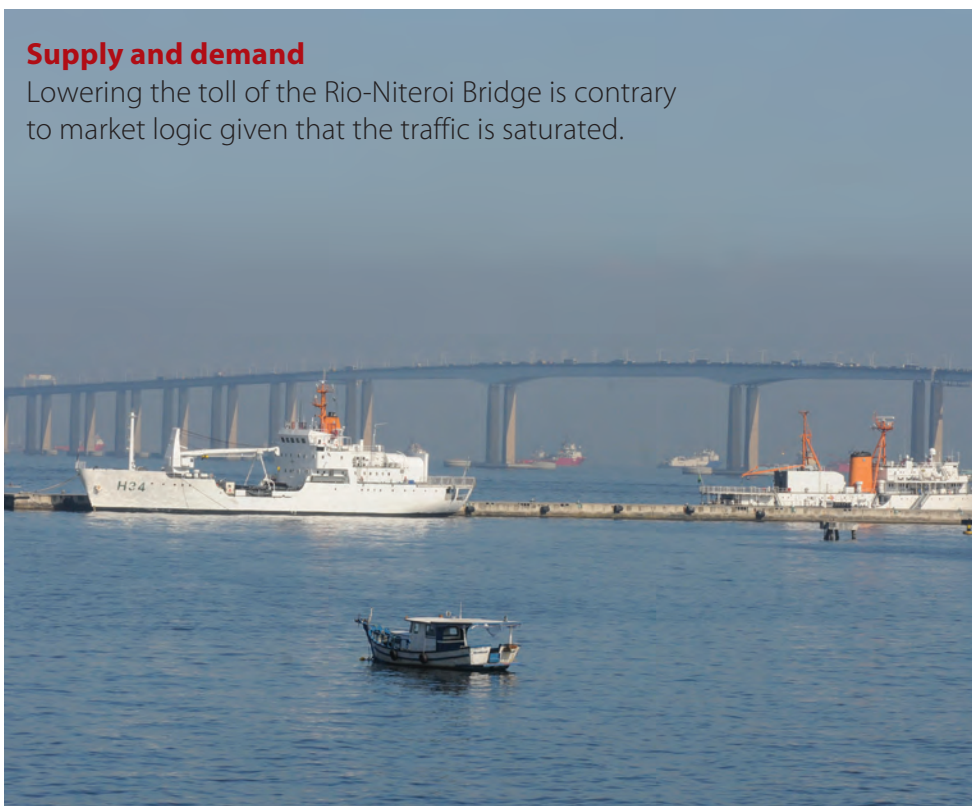

Supply and demand
Lowering the toll of the Rio-Niteroi Bridge is contrary to market logic given that the traffic is saturated.

The independence of regulatory agencies from the government is precisely what allows them to protect the rights of consumers and investors.

The most problematic of these changes, in Pinheiro's opinion, was interference in the regulatory agencies created by Cardoso. "In practice, regulatory agencies lost their independence and became controlled by the ministries," he says, explaining that the independence of regulatory agencies from the government is precisely what allows them to protect the rights of consumers and investors, creating for both safeguards against short-term political cycles.

With the regulatory agencies weakened, the concessions that followed were less successful. Several highway concessions set road tolls too low, discouraging concessionaires from investing the amounts the contracts required. Pinheiro also criticized the policy of the National Treasury injecting money into the National Development Bank (BNDES) to lend cheaply to concessionaires at the cost of raising the public debt.

"The BNDES alternative is closed. It has no more room [to lend cheaply]," Pinheiro says, stressing that despite all the Treasury and BNDES efforts to encourage infrastructure investments, the results were far from encouraging. Nor did the money BNDES lend increase investment in infrastructure, which held steady at 2–2.5% of GDP. Pinheiro notes that some recent successful concessions, such as the main Brazilian airports, were granted under pressure from the 2014 football World Cup.

According to a McKinsey Global Institute study, among the world's largest economies Brazil has the lowest stock of infrastructure capital as a proportion of GDP: only 53%, compared with a global average of 70%, which does not even include Japan, where the ratio is 179%. The study estimates that to raise its infrastructure capital to 70% of GDP, Brazil would need to invest an annual

Guarulhos airport, São Paulo state
Photo: Filipe Frazao/Shutterstock.com



Plan ahead
Guarulhos airport is one of the projects for which bidding was structured by Brazilian Project Structuring (EBP).

average of 5.5% of GDP over the next 20 years. For the last two decades actual investments in infrastructure have been only 2.3% a year.

Claudio Frischtak, president of the Inter B International Consulting, is not optimistic about the future: "There is no silver bullet to make concessions take off. There is an overlap of macro and micro factors."

At the macro level, in addition to adjustment of prices and the exchange rate, he considers a minimum level of stability and visibility to be fundamental. "The exchange rate is depreciating, but its volatility is driving investors away," he says. At the micro level, he sees the situation as varying from sector to sector. For example, he believes that "planning for the transport and logistics sectors is not reliable." For him, the state-run Planning and Logistics (EPL) company, originally created to administer the high-speed train, was not sufficiently empowered to do so.

Frischtak rates the work of the Energy Planning Company (EPE) to be adequate. "Despite some mistakes, it is the only serious planning," he says. He believes that in the energy sector problems have resulted mainly from the government's forced reduction in electricity tariffs, which ended up disrupting the whole sector.

As for railways, Frischtak does not see how concessions for their construction will work, since according to the "open access" framework, state-run Valec will buy and sell all railway cargo capacity, ensuring the railway builder remuneration whether or not there is traffic. This "has a huge potential fiscal cost." So far open access has generated more suspicion than interest. The government is now seeking another way to get railways built.

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In the case of airports, Frischtak criticizes the model that made state-run Infraero, the former monopolist in the sector, a mandatory partner of concessionaires. Infraero will have to contribute 49% of the capital of the concessionaire. As Infraero is basically undercapitalized, he believes the government will have to contribute money that the private sector should have brought to the concession.

Santiago Chile



Unsolicited proposals
Of 400 projects submitted by the private sector in Chile, only 18 were auctioned.

To raise its infrastructure capital to 70% of GDP, Brazil would need to invest an annual average of 5.5% of GDP over the next 20 years.

The government must make many corrections in order to improve the concession program, Frischtak says. It should also make sure that investments are properly governed, with appropriate regulation and planning and attractive conditions for financing through the capital market and insurance, without burdening the public sector: "As long as the BNDES continues to lend liberally at low interest rates, the domestic capital market will not develop. BNDES loans should be as scarce as possible."

The role of PMIs

The Expression of Interest Procedures (PMI) instrument was created by the government to help identify and structure projects that will benefit society, especially infrastructure projects. The federal level created PMI in 2006 and states and municipalities then copied it in their own laws.

According to the Radar PPP (https://www.radarppp.com/), since the first quarter of 2013, 125 PMIs have been published. "The PMI is a way of advising the public sector, which in turn has access to more projects," says Pinheiro. "The government needs services. The PMI makes the need more specific," he explains, noting that the PMI should not be confused with the engineering project that should be done by the concessionaire. "The PMI studies and structures the concession that will be granted by the government."

In developed countries, the concession is structured by the government, which has capacity and qualified staff to do these studies, Pinheiro explains: "In these countries, the public sector performs all the steps until the bidding process is completed."

In emerging economies, where governments often lack the staff, financial resources, and the institutional capacity to select appropriate projects of public interest, the unsolicited proposal is common. In that case, a private company generally takes the initiative to identify projects of benefit to society and submit them to the government. If encouraged, it makes the technical studies necessary to structure the bidding of the concession project and will be one of the bidders. Although controversial, unsolicited proposals are advocated for emerging countries because they allow the private sector to bring new infrastructure ideas to the government when the public sector lacks the capacity and financial resources to do its own studies.

Another option is to call on other interested parties to submit proposals after the original author has done so. In such cases, the original author has the right to match the winning bid and get the concession. This, Pinheiro says, is the system practiced in the Philippines, South Africa, Taiwan, and parts of India and Italy and in the U.S. territory of Guam.

Based on data collected by BNDES staff Fernando Tavares Camacho and Bruno da Costa Rodrigues, Pinheiro says that the results of unsolicited proposals with regard to competition are "disappointing." In Chile, a country that has created a solid framework to benefit from these proposals, of 400 projects proposed by the private sector, only 18 were auctioned, and

structuring of the auctions took two years longer than the four years expected. Also, competition has been very low: In South Korea the original project applicant won 90% of the time, and in the Philippines 92%. In Taiwan, only one in 29 bids had more than one bidder.

In Brazil, the PMI, the alternative adopted at the federal government, differs fundamentally from the unsolicited proposal because the government takes the initiative to bring the idea to the private sector and formally requests projects, surveys, investigations, or studies that may lead to an auction or a PPP. But a different legal mechanism, the Expression of Interest of Private Enterprise (MIP), used by some states resembles an unsolicited proposal.

Pinheiro thinks the federal framework adopted by Brazil suffers from shortcomings similar to those of countries that adopt unsolicited proposals: few projects go to auction and when they do, there is virtually no competition. Among the factors contributing to this unsatisfactory performance are the need for the public sector to establish a large structure to evaluate PMIs, making processing costly and time-consuming, and the fact that the original project applicant can participate in the bidding, which creates a bias in that applicant's favor.

Pinheiro sees the possibility that the government will bar bidding by those responsible for structuring the project, directly or indirectly, as the main improvement of the PMI brought by Decree No. 8,428. He believes this measure will encourage some development companies to specialize exclusively in project structuring.

So far the most successful experience is Brazilian Project Structuring (EBP), a PPP founded in 2008 by BNDES, Banco do Brasil, and seven private banks. The company has concluded structuring of 17 bidding projects, including the PPP of Mineirão stadium, Minas Gerais state, and concessions for the airports of Guarulhos, Brasília, Viracopos, Galeão and Confins.

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EBP general director Maria Eduarda Gouvêa Berto says that the company was born from the understanding that the structuring phase of a project is one of the most sensitive for development and expansion of infrastructure services in Brazil; it is a complex process, usually involving expensive projects of long maturation. She points out that the partnership between the nine public and private banks is itself an interesting PPP. The EBP supports governments in structuring projects of public interest and is barred from running infrastructure services.

In analyzing Decree 8428, Frischtak estimates that it will expedite the structuring of infrastructure concessions, although he believes there are many more complex problems to be solved to move infrastructure projects forward. Rodrigo Reis, founding partner of Radar PPP, thinks the decree encourages a maturing of the legal and institutional framework in municipalities, establishing best practices in terms of transparency in the preparation of PPP projects through the PMIs.