MIF Retrospectives

Infrastructure and Public-Private Partnerships in Latin America and the Caribbean

2

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By David R. Bloomgarden and Asako Maruyama

Introduction

Infrastructure provides services in energy, water, telecommunications, and transport that are fundamental to the activities of all households and businesses. Moreover, infrastructure is a major factor in economic growth, poverty alleviation and environmental sustainability in any country. In order for Latin America and the Caribbean (LAC) to achieve the same growth as East Asia, new infrastructure investment, in addition to the cost of maintaining existing infrastructure, would be estimated to be at least 3% of regional GDP, or between US$50 and US$70 billion per year. Empirical studies have shown that improving infrastructure can contribute significantly to economic growth in the region. For example, the estimated marginal productivity of telecommunications, transport and power projects exceeds that of non-infrastructure capital.[1]

Since the 1980s, the region's relatively slow infrastructure development vis-à-vis East Asia explains a significant portion of the growing gap in growth rates between the two regions (The World Bank, 2005, p.4). The access and affordability of basic infrastructure services deeply affect those living below the poverty line, and are key considerations in the drive to reduce poverty. Recent studies indicate a strong correlation between infrastructure expenditures and the share of the population living on less than US$1 a day, infant mortality and primary school enrollment (IDB, 2003, p.1).

Overall, the region has done spectacularly well in attracting private investment in infrastructure. Between 1990 and 2003, LAC attracted fully half of the US$786 billion in private infrastructure projects in the developing world. Even so, in 1998 -- the peak year for private investment in the LAC infrastructure sector -- investment in new and existing capacity was less then 2% of annual GDP. Public funding dropped from 3.1% of annual GDP in the period 1980 –1985, to 0.8% for the period 1996-2001 in the seven major economies in LAC. However, private investment only increased from 0.6% to 1.4% per annum, on average, for the same group. This increase was clearly insufficient to offset the decrease in public flows (The World Bank, 2005, p.13).

[1] Empirical studies here are cited in World Bank 2005. For example, it cites an empirical analysis of Calderón and Servén using panel data of Latin American countries to show positive and significant output contribution of telecommunications, transport and power. (Calderón, C. and L. Servén. 2003. "The Output Cost of Latin America's Infrastructure Gap." In W. Easterly and Servén, Eds., *The Limits of Stabilization: Infrastructure, Public Deficits and Growth in Latin America.* pp. 95-118. Palo Alto: Stanford University Press. Washington, D.C.: The World Bank.)

Moreover, private investment in the region has been concentrated in just a few sectors. For the region as a whole, telecommunications has attracted 46.9% of total investment, while energy (mostly electricity) accounts for 30.7%, transport for 17.2% and water and sanitation for only 5.2% of investment totals (IDB, 2003, p.7). LAC would need to invest 4% to 6% of GDP every year for 20 years to reach Korea's level of productive infrastructure. (The World Bank, 2005, p.5) It is estimated that US$22 billion per year in new infrastructure investments are required in the electricity sector, US$17.8 billion per year in roads, US$6.6 billion in water and sanitation, US$6.1 billion in telecommunications (IDB, 2003, p.2).

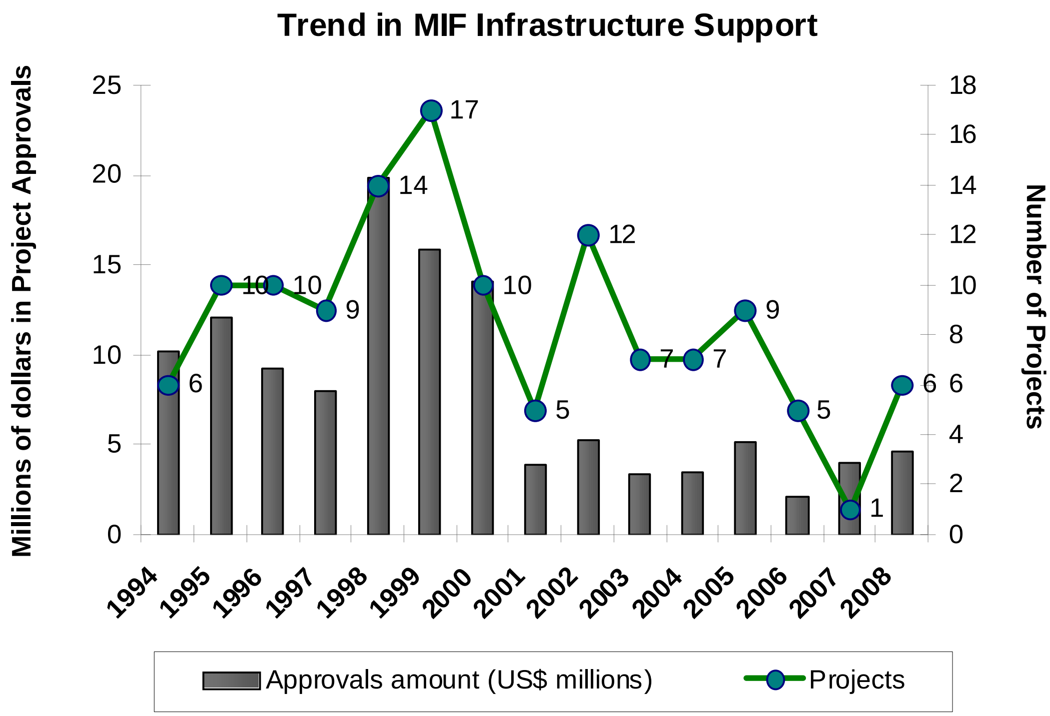
While several airlines in the region have been privatized, legal, constitutional and political impediments have prevented most other transport operators, as well as telecommunications companies and electricity generators from being sold. Government concerns about the performance of infrastructure industries also encourage them to retain ownership. Overall, concessions have been more common than divestitures in the region, particularly for roads, airports, ports and water and sanitation. (The World Bank, 2005, p.17) However, a large number of concessions have been renegotiated, sowing widespread concern over the fairness and transparency of deals. Consequently, private participation in concessions has fallen across the region. Improved concession design, risk management and frameworks that better balance public and private interests in infrastructure concessions will be needed to lure the private sector back into this segment.

Evolution of IDB and MIF Support for Infrastructure

The Inter-American Development Bank (IDB) and Multilateral Investment Fund (MIF) see infrastructure as fundamental to economic and social development. Since its creation in 1961, the IDB has invested more than 40 billion dollars in energy, telecommunication, transportation, water and sanitation. Since 1994 MIF has financed 128 operations for a total of approximately US$121 million[2]. MIF has supported infrastructure reform in almost all countries of the region. In fact, most regulatory agencies in the region have received MIF support, and over half of all IDB technical assistance grants for improving infrastructure development have originated in MIF.

The main MIF infrastructure strategy has been to use grants to support regulatory, legal and institutional reforms that increase private sector participation in infrastructure, including public-private partnerships. These efforts aim to increase access to basic infrastructure services, while leveraging those resources of the IDB Group that are allocated for sustainable infrastructure projects.

[2] As of September 2008



Source: Authors, based on MIF project data

As seen above, the overall number of MIF infrastructure projects approved in 2006 was about half the amount approved in 2000. When MIF began to fund infrastructure projects in the mid-1990s a wave of economic reforms was sweeping the region. These targeted reductions in fiscal deficits and macroeconomic stability, and thereby reduced public investment in infrastructure. In turn, participation in infrastructure was opened to the private sector, and in almost all countries legislation and regulation was enacted to accommodate private participation in this sector (IDB, 2003, p.7).

Investment in infrastructure projects with private sector participation grew in the region from US$14.6 billion in 1990 to a peak of US$75.6 billion in 1998. However, in the wake of the global financial crisis in the late 1990s, private infrastructure investment declined dramatically, from US$38.7 billion in 1999 to US$23.3 billion in 2001 (IDB, 2003, p.7).

At the same time, public disapproval with reforms was growing across the region. While the quality and quantity of services had improved, growing discontent with higher tariffs, layoffs, excessive profits of private utilities and corruption eroded public support for reforms (IDB, 2003, p.14). Public confidence in the transparency and fairness of the private bidding process ebbed further in the wake of frequent renegotiations of concession contracts. By 2001, fully 64% of the region was solidly opposed to further reforms, impeding the approval of MIF projects aimed at promoting private participation in infrastructure.

MIF Infrastructure Support

Despite these challenges, MIF continues to respond to demand for infrastructure services and is applying lessons learned to adapt to changing circumstances in the region. As part of a broader decentralization process, MIF has helped local governments to strengthen regulation at the level of localities and small operators. Further, MIF is promoting alternative means of private sector participation, including the use of management contracts, leasing contracts, Buy Operate and Transfer (BOT) contracts, and local level concessions. In addition, MIF projects are applying concession methodologies in newer areas, such as health care.

Joining forces: public and private investment in the urban bus sector

In Panama City, MIF helped restructure the urban bus sector with an innovative approach that uses joint public and private investment and the cooperation of all unions in the sector. This project was adopted from a successful program used in Colombia, known as Tasnmilenio, which uses dedicated center lanes on major arteries, feeder networks and a smart station system. The system in Panama City has the capacity to move up to 45,000 passengers an hour in each direction, and includes express services at a much faster average speed than under the previous system. Bus fatalities have been cut sharply and particle emissions are down more than 30%. The program helped consolidate the regulatory framework and facilitated private investment, thereby achieving significant improvements in service. Panama City attracted private investment in bus transport estimated at US$100 million for replacement of existing fleets as a result of this program. The State invested US$40 million for investment in road works and road markings and US$30 million in credit facilities made available through Banco de Panama. (IDB, 2003, p.38-39)

Proper timing of the political window is critical to ensure government support for reforms that facilitate private participation in infrastructure. MIF has created three "lines of activity", or dedicated funds that deliver quick and timely support for private and public entities in concessions, infrastructure and airport security. The first line for concessions was approved in 1997 during the upsurge in government infrastructure reform efforts across the region. Airport security was launched in the wake of September 11, 2001 to help international airports and commercial airlines in conforming to International Civil Aviation Organization (ICAO) standards for airport security. The line of activity for infrastructure was approved in October 2001 to help consolidate sector reform and to strengthen the regulatory framework and institutions in smaller economies of the region.

The relatively small size of funding for projects under the line of activity for infrastructure (US$300,000 per project for concessions) made it less attractive for use beyond the municipal level. Moreover, expedited procedures did not yield the anticipated savings in time because of delays in execution, and the diversity of approaches funded under the line of activity limited the efficiencies in project preparation and the chance to replicate successful projects. In 2006, as a result of an evaluation on infrastructure projects, MIF simplified procurement procedures and provided greater delegation of authority to country offices. These measures significantly reduced delays in project execution and improved execution efficiency. The lines of activity for airports, on the other hand, were efficiently executed due to more focused purposes and objectives and greater efficiencies resulting from shared designed and preparation work.

Overall, MIF has supported infrastructure reform in most sectors in a majority of countries in the region. MIF projects have opened up opportunities for the broader IDB Group in several areas. These include the strengthening of local regulatory frameworks for infrastructure (to facilitate municipal and sub-regional projects), the coordination of regional regulatory regimes related to infrastructure among countries involved in integration programs, the application of concession methodologies to health care, the use of management contracts for local concessions, and support for new areas related to infrastructure, including consumer protection, training of regulators, urban transport, solid waste management, among others (IDB, 2003, p.55).

The divestment in the tourism sector

In Ecuador, MIF supported the divestment of idle state-owned tourism assets. Using a transparent and efficient process, MIF was able to facilitate the reinvestment of the proceeds of divestment into the promotion of tourism with full public and private cooperation. Using a trust mechanism administered by an independent trustee, the project proved the viability of this alternative over earlier "fire-sales" of state assets. Moreover, sale proceeds are placed in a fund in which earnings are reinvested in tourism, rather than being diverted to current spending, thereby promoting sustainability. (IDB, 2003, p.34-35)

Based on an evaluation by the IDB's independent evaluation office, MIF has been effective, relevant and innovative in promoting infrastructure. More work, however, needs to be done to address tariff adjustments and affordability for the poor. Indeed, only a few MIF projects were aimed at protecting consumers or promoting the participation of small and medium sized enterprises in infrastructure related activities. Moreover, more work remains on better defining intended results and ensuring infrastructure impacts have measurable impacts. Moreover, while MIF projects were effective in mobilizing private participation, the contribution of private efforts to infrastructure quality, access and affordability must be better measured.

New Strategic Approach to Infrastructure: Public-Private Partnerships (PPP)

Latin America and the Caribbean are experiencing strong economic growth and a resurgence of private investment. Drawing from important lessons learned, such as the need to better coordinate with other members of IDB Group and to ensure equitable access to infrastructure for lower-income groups, MIF has developed a new generation of support for infrastructure that moves away from lines of activity and a diverse set of regulatory and institutional reforms, to a more strategic focus on improved public private partnerships.

In 2006 MIF launched *Supporting Competitiveness through Public-Private Partnerships*, a program or “cluster” of related projects in order to promote public-private partnerships in infrastructure.[3] Projects financed under this program promote greater transparency in infrastructure projects and more public consultation, as well as better indicators and the public dissemination of results. A basic principle underlying this approach to PPP is that both the public and private sector should share defined risks based on their relative abilities and interests, thereby making deals more attractive for private investors and providing more fiscal sustainability for governments. At the same time this approach stresses greater efficiency in service provision.

MIF PPP projects aim to achieve the following objectives:

- To contribute to increased capital investment in infrastructure via public-private partnerships that are more mutually beneficial than traditional concessions;

- To support regional infrastructure projects, such as the Initiative for the Integration of Regional Infrastructure in South America (IIRSA) and the Plan Puebla Panama, which aim to improve physical infrastructure and the development and integration of logistics platforms;

- To promote greater transparency, predictability and competition in the market for infrastructure services, with projects that both attract private investment and win back public trust; and,

- To improve service delivery, social tariffs and policies for low-income consumers, and to enhance the participation of small and medium-sized enterprises in the provision of goods and services.

As of September 2008, MIF has approved 10 PPP projects in Brazil, Colombia, Mexico, and Peru. All stress access to infrastructure and affordability for the poor.

- In Brazil, MIF is working at both the federal and state level to expand infrastructure with private participation, to improve the efficient allocation of public funds, and to increase capacity for structuring PPPs. A $575,000 MIF grant enabled the state of Minas Gerais to finance the first PPP road project in the country, with a value of approximately $300 million. MIF is also working at the municipal level in Brazil, allowing small businesses and local communities to participate in the design and execution of the PPP projects.

- In Colombia, MIF is structuring a transport project to facilitate regional integration using a results-based model in which the public sector pays for services over time, without exclusive reliance on tolls or user charges. MIF

[3] MIF PPP Cluster Action Plan: http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1660978

assistance also allows governments to implement new procurement methods for infrastructure projects, based on this model. Additionally, MIF is partnering with the Colombian Ministry of Finance to build public capacity to establish harmonized standards and regulations for the analysis and oversight of PPPs and to manage fiscal aspects of these transactions transparently and sustainably.

- In Mexico, MIF assistance is helping to strengthen the legal and institutional capacity of Mexican states to implement PPPs through the *Program to Promote Public-Private Partnerships in Mexican States* (PIAPPEM). The program includes a competitive selection process for executing pilot projects in states that are committed to harmonizing the legal and institutional environment for PPPs. So far, the program has approved pilot projects for Mexico City, Yucatan and Guanajuato.
- In Peru, MIF is funding a municipal program to facilitate access to adequate water and sanitation services in poor communities throughout the country. The project aims to build local level capacity to implement more efficient and sustainable models for expanding these essential services.

To help MIF promote PPPs in the region, the Spanish government approved a $1.36 million *Regional Fund to Promote PPPs* in March 2008. Among the objectives of this program are to map PPP opportunities in the region, give countries policy advice on identifying and managing PPPs, support the preparation of MIF technical assistance projects, and disseminate knowledge and methodologies in PPP implementation to government and private sector organizations involved in infrastructure development. MIF aims to introduce PPP models in countries and regions that have little or no experience in implementing PPP programs, but have expressed demand for information on how these models can support their development priorities.

Within this focus on knowledge management, MIF will also be collaborating with other institutional partners, including the World Bank Institute (WBI) and the Asian Development Bank (ADB), to create practical, cross-country PPP learning materials and courseware based on global best practices.

Moving Forward

MIF is now moving beyond activities associated with earlier waves of privatization and regulatory reforms. Going forward, the scalability of MIF assistance is a major goal of all projects, and will require the use of lessons learned and measurable results to ensure that successful demonstrations are widely adapted. This in turn, will require greater *partnership* with the IDB Bank Group, private sector associations and firms, government, NGOs, foundations, etc., from project design through implementation and demonstration effect.

Working closely with the IDB Bank group, and other partners, MIF is developing PPP economically sustainable infrastructure projects that encourage private sector participation, build institutional capacity to design and implement PPP projects, allocate risk fairly among stakeholders, engage local affected communities and are accessible and affordable for the poor. Moreover, with a new focus on measurable results and knowledge management under MIF II, the PPP cluster of projects will share lessons learned and project execution experience among stakeholders in PPP projects.

List of MIF Projects in Public-Private Partnerships

Approved projects as of September 2008[4]

Year approved	Country	Project Title	Executing Agency
2004	Brazil	Public-Private-Association (PPA) Minas Gerais	Economic Development Department of the State of Minas Gerais (SEDE)
2005	Brazil	National Program for the Institutional Development of Public-Private Partnerships	Unidade de Associações Público Privadas [*PPP Unit*] of the Ministry of Planning, Budget and Management (MPPG)
2005	Colombia	Public-Private Partnership Program in IIRSA	Instituto Nacional de Concesiones (INCO) [*National Concessions Board*]
2007	Mexico	Program to Promote Public-Private Partnerships in Mexican States (PIAPPEM)	IDB/MIF
2008	Brazil	Program to Support Structuring & Development of Micro PPP Models	Brazilian Institute of Municipal Administration (IBAM)
2008	Colombia	Support MHCP in Identification and Selection of Public Private Partnership Project	El Ministerio de Hacienda y Crédito Público (MHCP) [*Ministry of Finance*]
2008	Mexico	Federal District: Promotion of Public-Private Partnerships (PIAPPEM)	Secretaría de Finanzas del Gobierno del Distrito Federal a través de su Subsecretaría de Planeación [*Federal District's Department of Finance, Office of the Deputy Secretary for Planning*]
2008	Mexico	State of Yucatan: Promoting Public-Private Partnerships (PIAPPEM)	Secretaría de Planeación y Presupuesto del Estado de Yucatán [*State of Yucatan Planning and Budget Department*]
2008	Mexico	State of Guanajuato: Promoting Public-Private Partnerships (PIAPPEM)	Coordinación General de Programación y Gestión de la Inversión Pública del Gobierno de Guanajuato [*Office for the Coordination of Public Investment Programming and Management of the State of Guanajuato*]
2008	Peru	Improved Access to Water and Sanitation Services in Small Municipalities	Agualimpia (NGO)

[4] For more information visit the MIF PPP webpage:
http://www.iadb.org/mif/subtopic.cfm?language=English&SUBTOPIC=PPPA&TOPIC=INF

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