



School of Business and Public Management  
Institute of Brazilian Business and Public Management Issues  
Minerva Program – Fall 2004

**PUBLIC-PRIVATE PARTNERSHIPS  
IN BRAZIL**

*Anderson de Sa Almeida*

*Advisor: Prof. Stephen Smith*

## **I – Introduction**

## **II – An Analytic View on PPPs**

### **II.1 – Characteristics of PPPs**

### **II.2 – The Economics of PPPs**

### **II.3 – Institutional Framework for PPPs**

### **II.4 – Fiscal Accounting and Reporting**

## **III – The Brazilian Planning for PPPs**

### **III.1 – The Proposed Legislation**

### **III.2 – The Planned Framework**

### **III.3 – Controversies in Relation to the Proposed Legislation**

## **IV – Perspectives for PPPs in Brazil**

## **V – References**

## **VI – Annexes**

### **VI.1 – The Chilean Experience with PPPs**

### **VI.2 – Variants of PPP Schemes**

### **VI.3 – Evolution of the Federal Government Investment**

### **VI.4 – Portfolio of Prioritized Projects (in Portuguese)**

## I - Introduction

The Brazilian economy once again has shown signs of recovery. With an average 1.6% growth over the last quarter of 2003 and the two first quarters of 2004, or 6.6% at annualized rates, the country has just demonstrated its potential to overcome the many restraints it has to face in search for a higher level of economic development. It's interesting to notice that the recent growth movement in Brazil has been propelled such by the increasing net exports as by the influence of its internal demand; the latter fruit of investment and household income growth. Hence the growth forecasts for 2004 and 2005 have been revised upwards to 5.2% and 3.8%, respectively.

The supply of credit for the productive sector continues to grow in real terms, although the impulse of the decline in real interest rates at the end of last year weakens. Exports keep their fast upward path, enjoying the favorable moment arisen with the warming in the international demand. Lastly, industrial capacity utilization is high in historical terms, and growing fast.

Together with this increase in capacity utilization, the expansion of production capacity has proceeded apace. The causes can be found in exports opportunities, agribusiness expansion, consolidation of the present economic policy framework, growing confidence inspired by the sharp balance of payments adjustment and, more recently, in the growth of domestic demand. After 12 consecutive quarterly declines, construction finally grew during the second quarter of this year.

Nevertheless, the low level of investment in the past few years warns it must be intensified in order to sustain the present growth levels. The rate of investment, as Gross Fixed Investment (GFI), at current prices, fell from the 19.5% of GDP around which it had hovered during the second half of the 90's until the year 2002, to 18% of GDP in 2003. This year, though, it will probably reach or even surpass 20% of GDP. Significant part of this increase in the investment/GDP ratio can be attributed to an increase in the price of capital goods and construction industry inputs, relative to other goods in economy, meaning, in other words, an increase in the cost of investment.

During the last five years the economy's capital stock has grown at around 2% a year. For the economy to grow near the rate of 5% a year, though, it is necessary for the capital stock to grow 5.6% a year, with the investment rate reaching 25% of GDP.

Considering this economic outlook, provided by the Institute of Applied Economic Research (IPEA), the question that remains is whether this growth impulse now verified in the Brazilian economy can be sustained for longer periods. It is consensual among the entities and authorities responsible for the economic and development policies in the Brazilian Federal Government that to maximize the growth possibilities it is essential to accelerate the expansion of the production capacity. And it shall be done by means of policies with incentives to investment, productivity and diversification and increase of exports.

The resources of the public sector for investment, on the other hand, are limited and its expansion would accuse relevant fiscal impact. A major concern that comes up in this context is about the required investment to restore, build up and maintain the necessary infrastructure for a sustainable trajectory of the economic growth. Thus, the objective of the government is to increase the investment share in the total of the public expenditures, by making the public investments to grow faster than the current expenditures along the next years. In spite of this direction, however, due to the rigid complexion and the said limitations of the public budget, it will be certainly impossible to bear the demanded expansion and improvement in infrastructure only by means of the public investment.

Therefore it becomes indispensable that the private sector to partake on the required investments, especially in infrastructure, either through direct investment or by joint ventures with the government. In this latter particular possibility, several countries around the world, since the 80's, have developed new paths for partnerships between the public sector and the private initiative.

Recently, the Brazilian Government has demonstrated strong interest in these public-private partnerships, in order to provide, at least in part, with the necessary infrastructure to foster a sustainable economic growth.

My desire with this research paper is to contribute with the discussions currently promoted in the Brazilian Federal Government, especially at the National Treasury Secretariat/Ministry of Finance, about this subject.

## **II – An Analytic View on PPPs**

It is relevant to begin with a conceptual approach to the matter, such as how the Public-Private Partnerships (PPPs) have been conceived and applied around the world, and what main issues have been raised as consequence. This overview is based upon the International Monetary Fund – IMF, the World Bank and the Inter-American Development Bank – IDB studies and prospects on PPPs.

**PPPs refer to arrangements where the private sector supplies infrastructure assets and services that traditionally have been provided by the government.** PPPs are involved in a wide range of social and economic infrastructure projects, but they have been mainly used to build and operate hospitals, schools, prisons, roads, bridges and tunnels, light rail networks, air traffic control systems, and water and sanitation plants. PPPs can be attractive to both the government and the private sector. For the government, private financing can support increased infrastructure investment without immediately adding to government borrowing and debt, and can be a source of government revenue. At the same time, better management in the private sector, and its capacity to innovate, can lead to increased efficiency; this in turn should translate into a combination of better quality and lower cost services. For the private sector, PPPs present business opportunities in areas from which it was in many cases previously excluded.

**PPPs offer similar benefits to privatization.** However, privatization went furthest where the public sector was heavily involved in supplying goods and services to private individuals and firms, and competition was both feasible and desirable. The tendency of the private sector to undervalue social infrastructure, and the large sunk costs associated with providing much economic infrastructure, have been obstacles to competition, and hence to privatization, in these areas. Thus, there was extensive privatization of trading establishments, local transportation, and small and

medium enterprises during the 80's and 90's. By comparison, the privatization of large public enterprises engaged in key areas of infrastructure (electricity, gas, water utilities, oil and airline companies) was, on a global scale, not as widespread, because of the monopoly position and/or the strategic importance of many of the companies involved. The principal exception in this regard has been in the area of telecommunications, where technological progress has significantly increased opportunities for competition across the world, especially to provide cellular phone services.

**By the late 90's, however, privatization was losing much of its earlier momentum, yet concerns about infrastructure remained in many countries.** At that time PPPs began to emerge significantly as a means of obtaining private sector capital and management expertise for infrastructure investment, both to carry on where privatization had left off and as an alternative where there had been obstacles to privatization. After a modest start, a wave of PPPs is now beginning to sweep the world. Yet it is doing so against a background where, as in the early days of privatization, the driving force behind PPPs may be not only a quest to increase economic and social efficiency, but also the ability to bypass expenditures controls, and to move public investment off budget and debt off the government balance sheet, by exploiting loopholes in current fiscal accounting and reporting conventions.

A number of advanced OECD countries now have well-established PPP programs. For sure, the best-developed program is the United Kingdom's Private Finance Initiative (PFI), which began in 1992. The PFI is currently responsible for about 14% of public investment, with projects in most of the key infrastructure areas. Other countries with significant PPP programs include Australia (in particular, the state of Victoria) and Ireland, while the USA has considerable experience with leasing. Also, many continental European Union (EU) countries, including Finland, Germany, Greece, Italy, the Netherlands, Portugal and Spain, now have PPP projects, although their share in total public investment remains modest.

Reflecting a need for infrastructure investment on a large scale, and weak fiscal positions, a number of countries in Central and Eastern Europe, including Czech Republic, Hungary and Poland, have embarked on PPPs. There are also recent PPP programs in Canada and Japan. PPPs in most of these countries are dominated by road

projects. Similarly, the announced EU Growth Initiative envisages the use of PPP-type arrangements primarily to develop a trans-European road network (European Council, 2003). In the rest of the world, PPPs have made fewer inroads, although Mexico and Chile have pioneered the use of PPPs to promote private sector participation in public investment projects in Latin America. PPPs are just beginning to take off in Asia as well, especially in Korea and Singapore. Despite the quantity of countries that have developed PPP programs, it is still considered to be too early to draw meaningful lessons from their experiences. More comments on the Chilean experience with PPPs can be found in the Annex VI.1.

## II.1 – Characteristics of PPPs

There is no clear agreement on what does and what does not constitute a PPP. **A PPP** has just been defined as “**the transfer to the private sector of investment projects that traditionally have been executed or financed by the public sector**” (European Commission, 2003). But in addition to private execution and financing of public investment, PPPs have two other important characteristics: **there is an emphasis on service provision, as well as on investment**, by the private sector; **and significant risk is transferred from the government to the private sector**. Other ways in which the role of government in the economy has been reduced over the last 20 years, including privatization, joint ventures, franchising and contracting out, share some or all of these characteristics. However, in their typical form, PPPs are distinct from these in that **they represent cooperation between the government and the private sector to build new infrastructure assets and to provide the related services**.

**A typical PPP takes the form of a design-build-finance-operate (DBFO) scheme**. Under such scheme, the government specifies the services it wants the private sector to deliver, and then the private partner designs and builds an asset dedicated for that purpose, finances its construction and, subsequently, operates the asset and provides the services deriving from it. This contrasts with traditional public investment, where the government contracts with the private sector to build an asset but the design and financing is provided by the government. In most cases, the government then operates the asset once it is built. The difference between these two approaches reflects a belief that giving the private sector combined responsibility for designing,

building, financing and operating an asset is a source of the increased efficiency in service delivery that justifies PPPs.

**The government is in many cases the main purchaser of services provided under a PPP.** These services can be purchased either for the government's own use, as an input to provide another service, or on behalf of final consumers; a prison, a school and a free-access road would fall into these respective categories. Private operators also sell services directly to the public, as with a toll road or railway. Such an arrangement is often referred to as a concession, and the private operator of a concession (the concessionaire) pays the government a concession fee and/or a share of profits. Typically, the private operator owns the PPP asset while operating it under a DBFO scheme, and the asset is transferred to the government at the end of the operating contract, usually for less than its true residual value (and often at zero or a small nominal cost).

**The term PPP is sometimes used to describe a wider range of arrangements.** In particular, some PPPs exclude functions that characterize DBFO schemes. Most common in this respect are schemes which combine traditional public investment and private sector operation of a government-owned asset. This arrangement sometimes takes the form of an operating lease, although in cases where the private operator has some responsibility for asset maintenance and improvement, this is also described as a concession. Operating leases and similar arrangements are typically regarded as PPPs. However, private sector involvement in asset building alone, which can take the form of a design-build-finance-transfer (DBFT) scheme or a financial lease, is not strictly speaking a PPP, since it does not involve service provision by the private sector. While this paper does not seek to explicitly exclude any type of arrangement from the definition of PPP, including cases where the public sector partner is a public enterprise, rather than the government itself, it pays most attention to PPPs which involve both investment and service delivery by the private sector, and private financing and ownership. Hence, the focus is on DBFO schemes. The Annex VI.2 describes some of the many variants of PPP schemes.

**The private sector can raise financing for PPP investment in a variety of ways.** Where services are sold to the public, the private sector can go to the



market using the projected income stream from a concession (e.g., toll revenue) as collateral. Where the government is the main purchaser of services, shadow tolls paid by the government (i.e., payments related to the demand for services) or service payments by the government under operating contracts (which are based on continuity of service supply, rather than on service demand) can be used for this purpose. The government may also make a direct contribution to project costs. This can take the form of equity (where there is profit sharing), a loan, or a subsidy (where social returns exceed private returns). The government can also guarantee private sector borrowing.

**PPP financing is often provided via special purpose vehicles (SPVs).**

An SPV is typically a consortium of banks and other financial institutions, set up to combine and coordinate the use of their capital and expertise. Insofar as this is their purpose, an SPV can facilitate a well-functioning PPP. However, an SPV can also be a veil behind which the government controls a PPP, either via the direct involvement of public financial institutions, an explicit government guarantee of borrowing by an SPV, or a presumption that the government stands behind it. Where this is the case, there is a risk that an SPV can be used to shift debt off the government balance sheet. Private sector accounting standards require that an SPV should be consolidated with an entity that controls it. By the same token, an SPV that is controlled by the government should be consolidated with the latter, and its operations should be reflected in the fiscal accounts.

**Where a government has a claim on future project revenue, it can contribute to the financing of a PPP by securitizing that claim.** With a typical securitization operation, the government would sell a financial asset, its claim on future project revenue, to an SPV. The SPV would then sell securities backed by this asset to private investors, and use the proceeds to pay the government, which in turn would use them to finance the PPP. Interest and amortization would be paid by the SPV to investors from the government's share of project revenue. Since investors' claim is against the SPV, government involvement in the PPP appears limited. However, the government is in effect financing the PPP, although recording sale proceeds received from the SPV as revenue masks this fact.

## II.2 – The Economics of PPPs

**PPPs themselves have not been subject to extensive economic analysis.** However, there is a good deal of analytical work that can be brought to bear on the issues that are raised by PPPs.

**The standard arguments for and against government ownership are relevant to PPPs.** As a general rule, private ownership is to be preferred where competitive market prices can be established. Under such circumstances, the private sector is driven by competition in the product market to sell the goods and services at a price that consumers are willing to pay, and by the discipline of the capital market to make profits. However, various market failures (natural monopoly, externalities, etc.) can justify government ownership, although government failure can simply substitute for market failure. At a fairly general level, these arguments can be used to motivate PPPs as a means of combining the relative strengths of government and private provision in a way that responds to market failure but minimizes the risk of government failure.

**Recent advances in the theory of ownership and contracting provide a more specific analytical justification for PPPs.** The trade-off facing a government seeking to arrange for the provision of a particular service is between quality and efficiency. The government has the capacity to achieve a desired quality standard, but it may have difficulties doing so while also containing costs. The private sector can use its better management skills and capacity for innovation to more actively pursue opportunities to reduce costs, but service quality may be compromised in the process. However, private provision may be workable if the government can write a fully specified, enforceable contract with the private sector. Hence PPPs would be well suited to situations where the government can clearly identify the quality of services it wants the private sector to provide, and can translate these into measurable output indicators. The government can then enter into a contract with the private sector which links service payments to service delivery that can be duly attested. This being the case, PPPs tend to be better suited to cases where service requirements are not expected to vary substantially over time and technical progress is unlikely to radically change the way in which the service is provided.

**The case for PPPs is weaker where the government cannot write complete contracts because service quality is non-contractible.** In general, services for which overall quality is inherently non-contractible (e.g., national defense, public law and order, diplomatic missions) are not candidates for PPPs, although contractible elements of these services are (e.g. building and maintaining military bases, police stations and courts, and embassies). However, even if service quality, or elements of quality, is non-contractible, the normal presumption should probably be that private ownership is to be preferred because of the potential efficiency benefits it offers. The onus should then be on that favouring government ownership to make the case in its favour, by reference to the considerations that argue against private ownership.

**Even if the quality of service is contractible, build quality may be more problematic.** The main concern in this connection is that shortcuts in construction can be hidden for many years, which creates future liabilities for the government and can necessitate costly renegotiation. Non-contractible build quality provides compelling justification for combining asset creation and operation, which is the defining feature of a typical PPP. This is because the private operator has clear interest in the quality of an asset, given its influence on the capacity to deliver a service effectively and efficiently.

**PPPs involve a range of different risks.** These can be usefully divided into five, somewhat overlapping, main categories: **1) Construction Risk**, which is related to design problems, building cost overruns, and project delays. **2) Financial Risk**, which is related to variability in interest rates, exchange rates, and other factors affecting financing costs. **3) Performance Risk**, which is related to the availability of an asset, and the continuity and quality of service provision. **4) Demand Risk**, which is related to the ongoing need for services. **5) Residual Value Risk**, which is related to the future market price of an asset. These risks are present in public, private and PPP projects. PPPs seek to transfer risk from the government to the private sector. While an inflow of private capital and a change in management responsibility alone can be beneficial, significant risk transfer is necessary to derive the full benefit from such changes. Then, the impact of risk transfer on financing costs and the pricing of risk to ensure efficient risk transfer have to be addressed.

**Transferring project risk from the government to the private sector should not affect the cost of financing a project.** This follows from the Modigliani-Miller theorem, which says that the cost of capital depends only on the risk characteristics of a project, and not on how it is financed. However, the source of financing can influence project risk. With complete markets in risk bearing, project risk is independent on whether it is borne by the government or by the private sector. With incomplete markets in risk bearing, project risk depends on how widely that risk is spread. Since the government can spread risk across taxpayers in general, the usual argument is that this gives the government an advantage over the private sector in terms of managing risk. But the private sector can spread risk across financial markets, which may not put it at a significant disadvantage, and private sector risk managers may be more skilled than those in government. The outcome is likely to be that project risk is lower in the private sector.

**This result may appear to rest somewhat uneasily with the fact that private sector borrowing generally costs more than government borrowing.** However, this mainly reflects differences in default risk. The government's power to tax reduces the likelihood that it will default on its debt, and the private sector is therefore prepared to lend to the government at close to the risk-free interest rate to finance risky projects. This being the case, when PPPs result in private borrowing being substituted for government borrowing, financing costs will in most cases rise even if project risk is lower in the private sector. Then the key issue is whether PPPs result in efficiency gains that more than offset higher private sector borrowing costs. The impact of PPPs on efficiency is taken up below.

**When considering the PPP option, the government has to compare the cost of public investment and government provision of services with the cost of services provided by a PPP.** Since risk transfer is a key to the increased efficiency of PPPs, the government wants to relieve itself of risks that it believes the private sector can manage better than the government. To do this, the government needs to price these risks, so that it knows what it has to pay the private sector to assume them. In this connection, it is important to distinguish between project-specific risk and market risk. Project-specific risk reflects variations in outcomes for individual projects or groups or related projects. Thus, for a road project, for instance, specific risk could derive from

interrupted supply of building materials, labour problems, or obstruction by environmental groups. Project-specific risk is diversifiable across a large number of government or private sector projects and does not need to be priced by the government. Market risk, which reflects underlying economic development that affects all projects, is not diversifiable and therefore has to be properly priced.

**The government and the private sector typically adopt different approaches to pricing market risk.** The government tends to use the Social Time Preference Rate (STPR) or some other risk-free rate to discount future cash flows when appraising projects, while private bidders for PPP projects will include a risk premium in the discount rate they apply to future project earnings, like in the Capital Asset Pricing Model (CAPM). Given this mismatch, the government may reject reasonable bids by the private sector for a PPP project. As a consequence, the choice between public investment and PPPs may be biased in favour of public investment, which is counterproductive if the objective is to promote PPPs as a more efficient alternative to public investment and government provision of services. Moreover, even if the PPP route is chosen (maybe because of political preference), the allocation of risk between the government and the private sector may not be efficient, since the private sector may choose techniques of production or other project design features which are less efficient, simply because they carry lower risk. Also, the private sector may respond to the underpricing of risk by compromising on the quality of construction and service supply to the extent possible, without obviously violating its contract with the government. On the other hand, it is also possible that the government overprices risk and overcompensates the private sector for taking it on, which would raise the cost of PPPs relative to direct public investment. Finally, there may be incentives for the government to compensate for an underpricing of risk by extending guarantees, which may also end up costing the government more over the longer term.

**Much of the case for PPPs rests on the relative efficiency of the private sector.** While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed. But if a common theme emerges, it relates to the importance of competition as a source of efficiency in both the private and public sectors. This explains the use of franchising as means of having the private sector engaged in repeated competition for a market which is inherently monopolistic yet still

contestable (as distinct from having continuous competition in a market). However, the scope for competition in the activities undertaken by PPPs is more limited, because they tend to be less contestable for reasons mentioned before – social infrastructure is undervalued and economic infrastructure involves large sunk costs. But an area where competition is clearly feasible is in bidding for the award of construction and service contracts, and this is crucial if PPPs are to benefit from having the private sector put its capital at risk, and from its management skills and capacity to innovate.

**Incentive-based regulation is also important.** Where a private operator can sell to the public, but there is little scope for competition, the government usually regulates prices. However, the challenge is to design well-functioning regulation which increases output (towards the social optimum), holds down prices, and limits monopoly profit while preserving the incentive for private firms to be more efficient and reduce costs. Of the two most common forms of regulation, rate of return regulation suffers from the problems involved in establishing appropriate cost benchmarks in a monopolistic situation. It is therefore weak on incentive grounds. The main alternative, price regulation, caps price increases, and therefore has potential for success on both counts. However, the fact that caps are often adjusted to reflect rate of return considerations means that rate of return and price regulation tend to be quite similar in their effects. Yardstick competition, in which rate of return regulation is based on costs in closely related domestic or in international firms, or a hypothetical efficient firm, has more promise, although it demands information. Finally, profit sharing between the government and the private partner is an alternative form of regulation which preserves incentives, although it could still lead to excessive profits. This being the case, it tends to work better where the government is the main purchaser of services.

### **II.3 – Institutional Framework for PPPs**

**Successful PPPs deliver high-quality services to consumers and the government at significantly lower cost than would be the case with public investment and government provision of the same services.** The preceding discussion suggests that PPPs are more likely to result in efficiency gains that offset higher private sector borrowing costs if they have the following characteristics: 1) the quality of services is contractible; 2) there is adequate risk transfer to the private sector;

and 3) there is either competition or incentive-based regulation. These features should be reflected in the policy framework for PPPs. However, an appropriate institutional framework is also needed if PPPs are to succeed. While the challenges in this connection are greater in emerging market economies and developing countries, and a PPP program should proceed with caution when such a framework is not in place, advanced OECD countries also face challenges in this regard. Although not exhaustive, the following are elements of such a framework.

**Political commitment and good governance are prerequisites for success.** A PPP is a major commitment on the part of the private sector, which needs to know that politicians are also committed to private involvement. Uncertainty in this regard gives rise to political risk that is not conducive to making long-term business decisions. At the same time, potential private partners need to know that the government is fair in its dealing with the private sector, and will meet the commitments it makes under PPPs. It is also important to establish clear channels of responsibility and accountability for government involvement in PPPs. Widespread corruption in government would be a serious obstacle to successful PPPs, in the same way that it prevented successful privatization.

**An appropriate legal framework can provide reassurance to the private sector that contracts will be honoured.** In some cases this will require changes or additions to existing laws. For example, Italy and Spain have recently revamped legal frameworks that for many years have been an obstacle to PPPs. In the case of Italy, the 1994 *Merloni Law* (the Italian law for concessions) has undergone a number of changes designed to facilitate private participation in infrastructure investment, while the 2001 *Legge Obiettivo* established a fast-track system for strategically important infrastructure projects. In the case of Spain, the 2003 Concessions Law supplements a number of laws that already allow PPPs, by extending private financing options. In both Italy and Spain, the new laws have also sought to secure creditor rights, and this has also been emphasized in Brazil and Chile, where reassuring investors that government will honour its future commitments is judged crucial. In Brazil, a draft law has been presented to congress that shall govern all aspects of PPPs. The provisions of this law are commented in the part III.1 of this paper. The legal framework for PPPs should be supplemented by clear, credible and efficient

dispute resolution mechanisms. Finally, it is important that PPPs should face nondiscriminatory taxation and regulation regimes.

**PPPs require the development of expertise in the government.** This covers the full range of skills required to manage a PPP program. One common complaint about PPPs from the private sector is that bidding and contracting take much longer than in the private sector. Thus one of the functions of Partnerships UK, a specialized government agency in the United Kingdom, is to promote PFI projects within government by providing financial, legal and technical advice and assistance to support contract negotiations and procurement. The *Unità Tecnica per la Finanza di Progetto (UTPF)* in Italy is by name a project financing unit, but in practice has a wider advisory and consultative role. However, in both these cases, the focus is on facilitating new PPP projects, while managing a large stock of ongoing projects could represent an equal or more demanding challenge. Particular attention will also need to be paid to skill development by sub-national governments, since in many countries the responsibility for spending in areas that are likely candidates for PPPs is devolved to them.

**The government will also have to refine its project appraisal and prioritization.** First and foremost, the decision whether to undertake a project, and the choice between traditional public investment and a PPP to implement it, should be based on technically sound value-for-money comparisons. It is particularly important to avoid a possible bias in favour of PPPs simply because they involve private finance, and in some cases generate a revenue stream for the government. The PPP Unit of the National Treasury of South Africa provides detailed guidance and technical assistance to agencies related to the feasibility and management of PPPs. In Chile, project evaluation and prioritization involves a number of interested ministries and government agencies, including the Ministry of Finance, which ensures that the future fiscal implications of PPPs are consistent with medium-term debt sustainability. More generally, PPPs should not complicate fiscal management, an objective which places a premium on proper accounting and reporting.



## II.4 – Fiscal Accounting and Reporting

**There is not yet a comprehensive fiscal accounting and reporting standard specifically for PPPs.** While the accounting profession is taking steps to develop an internationally accepted standard, the eventual features of such a standard are not yet clear. In the meantime, the current lack of a standard makes it difficult to close loopholes that enable PPPs to be used to bypass expenditures controls, and to move public investment off budget and debt off the government balance sheet. Moreover, resort to guarantees to secure private financing can expose the government to hidden and often higher costs than traditional public financing. An internationally accepted accounting and reporting standard could promote transparency about the fiscal consequences of PPPs, and in the process make increased efficiency rather than a desire to meet fiscal targets their main motivation. In any event, as PPPs become more commonplace, market analysts and rating agencies are developing the expertise to assess the fiscal risks they involve, and in particular the consistency of future commitments under PPPs and contingent liabilities with debt sustainability. Thus any misuse of PPPs is unlikely to escape market scrutiny for long.

**Existing standards provide a starting point to address the accounting and reporting treatment of PPPs.** The 1993 System of National Accounts (1993 SNA) and the 1995 European System of Accounts (ESA 95) cover some operations that characterize PPPs, including leases, while ESA 95, supplemented by the ESA 95 Manual on Government Deficit and Debt, covers public infrastructure built and operated by the private sector. The Government Finance Statistics Manual 2001 (GFSM 2001) fiscal reporting framework, which integrates flows and stocks, and shifts the emphasis toward accrual reporting and balance sheets, is also well suited to reporting on PPPs, although it does not currently provide comprehensive coverage of such operations.

Eurostat addresses the accounting treatment of the following PPP operations: 1) operating contracts; 2) concessions and operating leases; 3) financial leases; and 4) transfer of PPP assets to the government. This treatment is described below using the GFSM 2001 fiscal reporting framework:

- 1) **Operating contracts**– Where a PPP asset is owed by the private operator, payments under operating contracts for services provided to the government are recorded in the government operating statement as an expense.
- 2) **Concessions and operating leases**– Concession fees and other payments by private operators of concessions to the government (e.g. profit shares) are recorded in the operating statement as revenue. When the government leases an asset it owns to a private operator, lease payments to the government by a private operator are also recorded as revenue.
- 3) **Financial leases**– The acquisition of an asset under a financial lease would be recorded in the operating statement at cost, together with incurrence of a lease liability to the private sector. The asset and liability would also be recorded on the government balance sheet. Subsequent depreciation of the asset and interest and amortization payments on the lease would then be recorded in the operating statement. As the lease liability is reduced, the PPP net asset value will build up on the balance sheet (provided that the liability is reduced at a faster rate than that at which the asset is depreciated). When the lease concludes, the asset will be recorded on the government balance sheet at its residual value.
- 4) **Transfer of PPP assets to government** – If there is provision for a PPP asset to be transferred at zero cost to the government, the asset transfer is recorded in the operating statement at the acquisition of a non-financial asset at its residual value, balanced by a capital transfer from the private owner. Any purchase price involved would be an expense and the capital transfer is reduced by the corresponding amount. The asset would also be recorded on the balance sheet at its residual value at the time the transfer takes place, and subsequent depreciation of the asset would be recorded in the operating statement.

The Eurostat treatment of the preceding PPP operations is a straightforward way to record them in the fiscal accounts.

It should be noted, though, that many countries are still working with the cash-based predecessor of GFSM 2001, A Manual on Government Finance Statistics 1986 (GFSM 1986). Under this framework, which is the basis of traditional fiscal

accounts, only cash flows are recorded. However, with the exception of depreciation, other non-cash transactions could be recorded in adjusted cash accounts. Since balance sheets are not part of GFSM 1986, PPP assets are not recorded as such, but the liability under a financial lease is recorded as government debt.

**When PPP projects involve limited risk transfer to the private sector, the practice of Eurostat and in a number of countries is to classify PPP assets as government assets.** This is done with a view to recognizing that the government plays a role in the economy and conducts fiscal policy through PPPs. For accounting purposes, Eurostat treats PPP investment that exposes the government to significant risk as public investment, while the state of Victoria in Australia and the United Kingdom assume that the government is acquiring the PPP asset through a financial lease (thus, 57% of PFI assets, in the UK, have been classified as government assets, according to the HM Treasury, 2003). These two approaches are formally the same. It is likely that accounting for limited risk transfer will be paid considerable attention by the accounting profession as it seeks to develop a general accounting and reporting standard for PPPs. In this connection, the focus is likely to be on refining the approach to accounting when assessment of risk transfer suggest that the government bears the balance of risk and, as a consequence, PPP assets are treated as government assets.

**It is questionable, however, whether classifying PPP assets as either government or private assets is an appropriate way of reflecting the extent of risk transfer.** PPPs involve a range of risks, and government exposure to PPP risk will vary widely across projects. Ideally, an attempt should be made to gauge the risk to which the government is exposed under each PPP contract, and to assess the fiscal consequences of such risk. This, however, is extremely difficult to do, even in the relatively straightforward case of explicit guarantees. But classifying PPP assets as either government or private assets instead is insensitive to the extent of risk sharing, and could discourage PPPs where the private sector is prepared to bear significant (but not most) risk and cover a sizable share of project costs. This being the case, the accounting profession, rather than refining the current approach to accounting for limited risk transfer, should seek to develop a workable approach to assessing and quantifying PPP risks borne by the government, and to disclosing these risks. Countries will then have to develop their own capacity to assess risk transfer under PPPs.

**With many PPPs, the government has a contractual obligation to purchase services from a private operator.** These payments have fiscal implications over the medium to long term which should be disclosed. At a minimum, the stream of future contract payments under agreed PPP contracts should be reported. This is done in the United Kingdom, to indicate the extent to which these payments limit fiscal policy flexibility in the future. Nevertheless, there is an issue as to whether future contract payments should also be capitalized and counted as a liability. The argument for not doing so is that these payments are contingent on the satisfactory delivery of a service, and can anyway be changed over the life of an operating contract as service needs and demands, supply technology, etc., change. The counterargument is that taking on a contractual obligation does more than limit fiscal policy flexibility in the future. In particular, assessment of debt sustainability are affected in the same way as if the government had incurred debt to finance public investment and provide the service itself, in that larger primary surpluses or smaller primary deficits (exclusive of the PPP payments) have to be generated to ensure a desired debt path. This being the case, the net present value of future contract payments under PPPs less any contractual receipts from the private sector (e.g., concession fees), both discounted using a risk-free interest rate, should be added to government debt when assessing debt sustainability. Notwithstanding, this should be an interim arrangement pending development of an internationally agreed approach to assessing, quantifying and disclosing PPP risks, and to reflecting them in fiscal analysis (including debt sustainability analysis), as called for above.

It should be noted that there is no basis to record the present value of future contract payments as a liability under GFSM 2001, given that a commitment to pay for a service cannot be accrued until the service is delivered. Rather, an ad hoc adjustment has to be made to the nominal debt measure reported as a memorandum item to the balance sheet.

**Government guarantees provided in connection with PPPs are a major source of fiscal risk.** The risks incurred by the private sector in connection with PPPs can be reduced or eliminated through explicit government guarantees. Most commonly in connection with PPPs, financing risk is reduced through loan guarantees,

demand risk is reduced through guaranteed minimum payments for services sold to the public, and residual value risk is reduced by the government guaranteeing the price at which it will purchase an asset when the operating contract ends.

**The disclosure of government guarantees is widely called for.** Thus, the IMF's Code of Good Practices on Fiscal Transparency and the related Manual on Fiscal Transparency require statements as part of the budget documentation that describe the nature and significance of all contingent liabilities. However, compiling the information required to comply with this practice presents a considerable challenge for most countries that currently lack a framework for managing guarantees. Good disclosure practice is to publish detailed information on guarantees. This should cover the public policy purpose of each guarantee or guarantee program, the total amount of the guarantee classified by sector and duration, the intended beneficiaries, and the likelihood that the guarantee will be called. Information should also be provided on past calls of guarantees. Best practice is to publish quantitative estimates of the potential fiscal impact of guarantees that, based on past experience, are likely to be called (i.e., the expected value of guarantee payments). For example, the United States requires systematic estimates of the potential costs of loan and pension guarantees, deposit and other forms of insurance, and most other contingent liabilities.

**Where the cost of calls on guarantees is potentially of fiscal policy significance, allowance should be made in the budget to meet the expected cost.** In other cases, this can be handled through the general contingency appropriation. The expected value of guarantee payments should also be reflected in any discussion of the medium-term fiscal outlook, and taken into account when assessing debt sustainability. However, reflecting the difficulties involved in measuring the expected value of guarantee payments, this should not be treated as an expected liability which is added to the debt. Rather, the larger the expected liability associated with guarantees, the less favourably a particular debt path will be viewed. The formal incorporation of this liability into debt sustainability analysis should again await development of an approach to assessing, quantifying and disclosing PPP risks and to reflecting them in fiscal analysis. To reduce the fiscal risks associated with guarantees, in addition to full disclosure, countries should take steps to control these risks (e.g., through careful screening of

requests for guarantees, limits on individual and overall exposure and charging risk-related fees).

**The accounting treatment of those guarantees that are called is straightforward.** There are two possibilities: either the government assumes the liabilities concerned and there is no financial claim on the original borrower, or the government lends to the borrower on the assumption that the borrower will repay at a later stage. In the first case, the government records the full cost of called guarantees as an expense, and the assumption of a loan as a liability. In the second case, the government has a claim on the borrower, which is recorded as the acquisition of a financial asset. When the loan is repaid, interest is recorded as revenue, and amortization as a financial transaction.

### **III – The Brazilian Planning for PPPs**

Every time Brazil grows at an annual rate between 3.5% and 4% (as GDP growth rate), around US\$20 billions should be invested in infrastructure civil works, in order to increase and modernize the transportations, water, sewage and energy networks. The surprising performance of the Brazilian exports throughout these most recent years has brought the chaos to the country's ports, for instance. This way, the absence of compatible infrastructure threatens to become the main obstacle for a sustainable growth in the next years.

If the supply of goods and services in the country does not grow, following the increasing demand, the result will be inflation, aborting the possibilities of a stronger development for a longer period of time. On the other hand, to foster the private investment for the expansion of the production capacity, the modernization of the infrastructure in the country is also a required step.

In addition, considering that the eventual impossibility of a sustainable economic growth also reduces the fiscal solvency for the country, the government has reached a consensus about the urgency to take effective measures so as the private sector significantly increases its participation in important public infrastructure projects.

The charts included as Annex VI.3 demonstrates the evolution of the federal government investment as percentage of GDP and as percentage of the primary expenditures, from 1991 to 2003.

For the National Treasury Secretariat, the main challenge is to increase the efficiency of the public expenditures, especially concerning about investments. In this pursuit, several opportunities can be envisaged with the PPPs. Besides being a way to perform concessions of public services not totally self-financed, the PPPs allow to obtain the participation of private financial resources, to increase the efficiency of infrastructure investments and to create fiscal space.

On the other hand, PPPs carries relevant risks as well. Under the Ministry of Finance approach, they would be: 1) to formalize commitments incompatible with the future fiscal solvency, by contracting future expenditures and contingent liabilities; 2) to increase the budget rigidity; and 3) to loose the credibility of the fiscal authority.

This way, for the National Treasury, the mission would be to allow that the PPPs broaden the infrastructure investments demanded for the sustainable growth, but avoiding the fiscal policy loosening, by selecting economically viable projects, with positive impact on the future fiscal solvency.

Hence, the Brazilian Federal Government submitted to the National Congress, on 19<sup>th</sup> November of 2003, the bill **PLC 10**, which was approved by the Chamber of Deputies, in the form of a substitute draft of its special commission, on 17<sup>th</sup> March of 2004.

The Federal Senate received the proposed legislation on 24<sup>th</sup> March of 2004, for the previous appreciation of its Services of Infrastructure Commission (CI), Economic Issues Commission (CAE) and Constitution, Justice and Citizenship Commission (CCJ).

The opinion of the CI, issued on 4<sup>th</sup> May, was favourable to the approval of the PLC 10, in the form of a new substitute draft. In the realm of CAE, the first opinion was issued on 18<sup>th</sup> May. The CAE document recommended the approval of the PLC 10,

in the form of a new substitute draft. Due to forty four proposed amendments, however, a second CAE opinion was issued, approving in whole or in part seven of those amendments, on 3<sup>rd</sup> June. In fact, a third CAE opinion was issued, on 8<sup>th</sup> June, with a new substitute draft, including in its text half of new twenty proposed amendments.

Recently, on 18<sup>th</sup> November, the final CAE opinion was issued, approving the subject with a new substitute draft, after a long period of discussions focusing on several controversial aspects of the PPP bill. Then the bill was submitted to the CCJ, where the process remained until the end of the period for elaboration of this paper. CCJ hasn't issued an opinion up to the present time.

### **III.1 – The Proposed Legislation**

The goal of the proposed law (PLC 10) is to institute the PPP modality of contracting in Brazil. By that, the public sector would contract the private sector to render services and to build up infrastructure facilities of economic or social interest, by means of private financing and sharing of risks. In this sense, the bill proposes adaptations to the current legal marks for government procurement, the Law 8.666/93, and for concession of services, the Laws 8.987/95 and 9.074/95.

The main argument reported to the Congress in favour of the PPPs is that its use shall make feasible infrastructure enterprises that otherwise wouldn't be executed, due to the fiscal limitations of the State and the insufficient returns for the private initiative. Thus, the intention is to create a regulatory mark that provides the private sector with reliable conditions to build and operate enterprises of public interest, especially those with projected lower financial return.

The official justification for the bill PLC 10 informed that the PPPs represent an indispensable alternative for the economic growth, allowing a wide range of investments, from public safety, habitation, water and sewage systems to transportation and energy networks. It was mentioned, in addition, that the Federal Government's Project of Multi-annual Plan (*PPA*), for the period 2004/2007, estimates the necessity of investments of at least 21.7% of GDP, as a pre-requisite for the sustainable growth of the country throughout those years.



Following are presented and commented the issues covered by the bill. The draft used herein is the one dated 8<sup>th</sup> June, approved by the third CAE opinion. The version dated 18<sup>th</sup> November will be used in the part III.3 of this paper, for comparison with this one and comments in relation to the major controversies arisen during the debates occurred in the Senate up to the present time.

- 1) **Scope** – The bill intends to constitute a general rule, a national law, to be applied by all federated entities (Federal Union, Federated States, Federal District and municipalities), which shall complement it by means of State or local laws. By the way, it is relevant to remember that the States of *Minas Gerais*, *Sao Paulo* and *Goiás* have already advanced some steps, by approving their PPP state laws even before the approval of the correspondent federal law (State Laws 14.868 and 14.869, both of 16<sup>th</sup> December, 2003, in *Minas*; State Law 11.688, of 19<sup>th</sup> May, 2004, in *Sao Paulo*; and State Law 14.910, of 11<sup>th</sup> August, 2004, in *Goiás*).
- 2) **Definition and Duration of Contracts** – The 2<sup>nd</sup> Article of the bill defines what is the PPP contract, what shall be its maximum duration, who can celebrate it, which is its object, as well as sets the role of the private partner. One of the most controversial aspects about this article relates to the term of execution of the contracts. The idea is that the PPP contracts may have enough time to mature the long term investments, so that it may be sufficiently attractive to the private initiative. In the draft dated 8<sup>th</sup> June, the execution of the contracts can last from five to forty five years.
- 3) **Objects of Partnership** – The 3<sup>rd</sup> Article defines the possible objects for PPPs, consisting of (i) the total or partial delegation of the delivery of public service, with or without previous public civil work; (ii) the delivery of service to the public administration or to the community, with or without previous public civil work, except the activities exclusive of State; (iii) the execution of civil works for the public administration; and (iv) the leasing to the public administration of civil work to be built. According to the draft of 8<sup>th</sup> June, the minimum amount for PPP contracts shall be of R\$20 million.
- 4) **Public Administration Counterpart** – In the 5<sup>th</sup> Article, the bill allows the public administration to offer to the private partner a counterpart, in

complement to the revenue obtained from the public by means of tow, and, in some duly justified cases, even to bear in whole the private partner revenue. This counterpart shall be due for a limited period of time, as part of the period of effectiveness of the contract. The 6<sup>th</sup> Article determines that the counterpart shall only be due after the availability of the contracted object. No payment by the public administration shall be due during the building period.

- 5) **Precedence of Payments** – According to the 6<sup>th</sup> Article, still, the payments relative to the public counterpart in PPP contracts, in case the contracting entity has financial availability, shall have precedence to the payments connected to liabilities contracted as traditional public investments, by means of the Law 8.666/93. It shall not violate the Fiscal Responsibility Law, because this priority to the PPP payments would not be attributed in the budget, but only in the financial execution.
  
- 6) **Guarantees/Fiduciary Fund** – In order to make the PPP option duly attractive to the private initiative, the bill allows the inclusion of guarantees for the contracted partner. That is a sensitive issue. If the guarantees are regarded as insufficient, the private initiative will not be interested. If they are exceeding certain amount, the State will not celebrate the partnership. The 7<sup>th</sup> Article of the bill allows the following guarantees: (i) public revenues, taking into account the provisions of the 167<sup>th</sup> Article (IV) of the Federal Constitution; (ii) institution or use of special funds permitted by law; (iii) contracting of insurance as payment guarantee; or (iv) the subscription or purchase of shares in fiduciary fund. In addition, the contract of partnership shall be allowed to include the possibility of issuance, directly in favour of the project lender, of the commitments of payment owed by public administration to the private partner, as well as the possibility to legitimate the project lender to receive payments out of the special funds and/or the fiduciary fund. The Article 17 of the bill authorizes the Federal Union to subscribe or purchase shares in a fiduciary fund of private nature and right, which shall be managed by one or more financial institutions directly or indirectly controlled by the Federal Union, in order to provide the private partners with guarantee of payment in relation to the financial obligations under PPPs contracted by the public administration. Moreover, the bill allows the PPP contract to determine that, according to the provisions of the applicable regulation, in case of default of payment by the public administration, the fiduciary fund manager,

upon due notification, shall transfer to the private partner the ownership of shares in a sufficient amount to satisfy the outstanding balance.

- 7) **Special Purpose Vehicle (SPV)** – The SPVs shall be created to implement and manage the partnership projects, with clear rules to work. The Article 8 of the bill details the requirements and intended characteristics for this kind of organization, including: a) the ownership of the assets resulting from the investments during the effectiveness of the contract belongs to the SPV; b) the SPV control shall not be assigned without previous consent of the public administration; c) The SPV can open its capital; d) The SPV can offer in guarantee to its lenders its payment credits deriving from the PPP contract, limited not to jeopardize the operation and the continuity of the civil works and services. Furthermore, the SPVs shall adopt standardized accountancy and financial statements, according to the rules to be established by the Federal Executive Branch. Such provision derives from the concept of corporative governance, which assumes that the accounts and how the company is managed must rely on transparency for the stakeholders and the State, avoiding mismanagement and frauds.
  
- 8) **Procurement** – The bill establishes that the PPP shall be contracted through bidding (Article 9 and followings). However, the intended bidding modality is not the defined in the Law 8.666/93, but actually a new modality, combining bidding and auction, with its own rules for qualification. According to the Federal Government, the goal of this innovative model is to add flexibility to the guarantee of delivery of the contracted services.
  
- 9) **Manager Entity** – The Article 15 of the Bill establishes a multi-ministerial manager entity, whose responsibilities shall be: a) the definition of the procedures for contracting of PPPs in the realm of the Federal Executive Branch; b) the selection of the activities, civil works or services to be regarded as priorities; c) the consent for launching of the procurement procedures and to ratify the terms of the respective announcing instrument. The manager entity shall be made up upon nomination of representatives (one titular and one substitute) by the Ministry of Planning, Budget and Management; the Ministry of Finance and the Civil Household of the Presidency of the Republic.

### III.2 – The Planned Framework

As highlighted in the item II.3 of this paper, a successful PPP program, which results in efficiency gains for the consumers and the government, delivers high quality services at lower costs. However, for these efficiency gains to come true, the policy framework for PPPs in the country shall provide either competition or incentive-based regulation and shall result in the selection of projects whose quality of services is contractible, and where there is adequate risk transfer to the private partner. The public managers responsible for selecting projects and regulating the PPP program in Brazil should pay attention to these issues, which are commented in the item II.2.

Besides, an appropriate institutional framework is highly recommended for the PPP program to succeed. The previously commented proposed legislation, while adapting the federal laws for public procurement (Law 8.666/93) and concession of services (Laws 8.987/95 and 9.074/95), constitutes a serious attempt to address the main questions concerning the political commitment and the good governance, to reassure to the private sector that the provisions stipulated in the PPP contracts will be duly honoured.

The key point concerning the attractiveness of PPPs under the private sector approach is the so desired and really necessary safety that the government will not intervene on the contracted partnerships, and eventually harm the private partners' rights, by seizing the proceeds available in the fiduciary fund, for instance, to pay compulsory legally approved debts.

A safer juridical protection was always requested by the representatives of the private investors while the subject was being analyzed at CAE and CCJ. Their main proposal for the protection of the guarantees of the federal government's payment obligations was the constitution of a separated company, instead of the creation of the fiduciary fund, to look after and manage those public financial resources. By the way, this solution was chosen by the State of Sao Paulo in its PPP State Law.

On the other hand, the preference of the federal government for the fiduciary fund figure relied on the assurance that the private nature of that fund is

effective to prevent the seizure of values to pay compulsory legally approved debts, or the financial limitation of the budget for fiscal management purpose, whereas the constituency of a new company would result in incidence of taxes and problems of governance.

In relation to the development of expertise in the government, the creation of the multi-ministerial Manager Entity shall speed up a deeper comprehension on the relevant and necessary related issues among the civil servants designated to directly work with PPPs on a routine basis, whether they are going not only to select new projects, but to manage a large stock of ongoing projects as well. The same should happen in the Federated States and municipalities, as long as their State and local legislation also constitute non-transitory teams, whose members are accomplished with strong technical skills, rather than nominated just for political reasons.

Special attention should be paid to the refinement of the project appraisal and prioritization skills, which are commented in the item II.3, by the members of the Manager Entity at the federal level and the correspondent entities at the sub-national levels. As should never be forgotten, PPPs shall not complicate fiscal management.

### **III.3 – Controversies in Relation to the Proposed Legislation**

After the third CAE opinion was issued, on 8<sup>th</sup> June, 2004, the subject of the PPPs went on intensively debated in the Senate. One hundred and two new amendments to the previously approved substitute draft were presented and many public audiences were held. With the permanent participation and contribution of representatives of the Federal Executive Branch, private investors and Senators, a newly modified version of the substitute draft was agreed, resulting in the issuance of the fourth CAE opinion, on 18<sup>th</sup> November, 2004.

The new version of the bill intended to meet the main worries presented by the parliament members, government representatives, and sectors of the civil society. Their concerns were linked to the indispensable balance between the public and the private interests, the fairness in the share of risks between those parts, the proper fiscal

management, the honesty and transparency of the procurement procedures, as well as the respect for the end users of the public services.

The substitute draft of 18<sup>th</sup> November, hence, is useful for the general comprehension of several of the major controversies connected to the PPPs affair. Its provisions were rearranged in chapters.

- 1) **General Provisions (Chapter I)** – This chapter, including the scope and definition of the contracts, was substantially changed, in order to better define and limit the range of application of the PPPs. Now the bill defines PPP as the administrative contracting of concession, either in the financially supported or the managerial modalities. The former modality refers to the contracting of public services or public civil works when it is foreseen, besides the toll which the end users will be charged, the financial counterpart of the public partner. The latter refers to the contracting of services in which the public administration is the direct or indirect user, even when there is involvement in civil works or goods to be installed. It was added that the common concession of public services and civil works, treated under the Law 8.987/95, in which it is not foreseen the financial counterpart of the public partner, will not constitute a PPP. It was prohibited, in addition, the contracting of PPPs whose value is lower than 20 million Brazilian Reais, whose term for delivery of service is shorter than five years, or which has as only object to provide with workers, the supply and installation of equipments or the execution of civil works. By July, it had already been agreed between the CAE and the Executive Branch to eliminate the possibility of PPP just for civil works, without the delivery of service. For these cases, the current rules for public procurement shall apply.
- 2) **PPP Contracts (Chapter II)** – In this chapter, it was determined the application, when possible, of the provisions established in the Article 23 of the Law 8.987/95. Such provisions relate to the essential clauses of a concession contract. It was agreed the minimum and maximum terms for the projects to be eligible for PPP contracts, between five and thirty five years. A new clause was added, concerning the share of risks between the partners, including those deriving from , *inter alia*, force *majeure*, fact of the prince and extraordinary economic events. This protection is relevant to provide the contracting parts with reasonable safety. Very important as well, it was

included a provision determining the contracts to include objective criteria to evaluate the private partner performance. The precedence for the PPP counterparts over the payments related to other procurement modalities was deleted. One of the most controversial aspects of the bill was related to the permitted term for the PPP contracts. The basic idea has been to allow enough duration for the contracts to have the maturity of its long term investments, making them attractive for the private initiative. For the projects of shorter duration, of lower than five years, the provisions of the Law 8.666/93 shall apply. In relation to the maximum term, the Law 9.074/95 also establishes thirty five years as limit for the concessions for delivery of services and installations of electricity and the exploration of energy on the water flows.

- 3) **Guarantees (Chapter III)** – It was included in the bill that the eventual guarantee-insurance shall be contracted with private insurance companies. It was added the possibility of international multilateral organisms or private financial institutions also guarantee the PPPs. While the bill was appreciated by CCJ, the controversy about the use of the fiduciary fund or a separated company for the protection of the public guarantees remained in the plan of discussions.
- 4) **Special Purpose Vehicle (Chapter IV)** – It was prohibited, in the bill, that the public administration be the main voting shareholder of the SPVs, with an exception in case of the acquisition of the majority of the voting share by a financial institution controlled by the State due to default in loan agreements.
- 5) **Procurement (Chapter V)** – Some adjustments were included, in order to guarantee more transparency and honesty in the procurement procedures. The technical opinion that will subsidize the permission of the competent authority shall indicate the convenience and opportunity of the contracting, identifying the justifications for the choice of the PPP modality. Such study shall also inform whether the obligations derived from the desired contracting respect the limits and conditions established in the Fiscal Responsibilities Law. Moreover, the calling document for bidding and the contract minutes shall be submitted to public consultation, announced in the official and regular press, informing the justification for the contracting, its object, duration and estimated value, determining a thirty days term for eventual

suggestions. An important change in this chapter was the provision so that the financially supported concessions in which more than 70% of the private partner's revenue shall be provided by the public administration must be approved by the National Congress.

- 6) **Provisions Applicable to the Federal Union (Chapter VI)** – Important changes were included in this chapter. A limitation of 1% of the net current revenue of the year for the continued expenses derived from the PPPs was added to the bill. It was also included a provision with the competence of the Manager Entity of PPPs. The decision of this entity shall be based on the previous opinions of the Ministry of Planning, Budget and Management, about the relevance and characteristics of the project, and of the Ministry of Finance, relatively to the risks for the National Treasury and the respect for the limit of 1% of the net current revenue of the year with the PPPs. The competence to submit the calling instrument for bidding to the Manager Entity of PPPs, execute the procurement procedure, monitor and control the PPP contracts was transferred for the interested ministries and regulatory agencies, according to their respective areas of competence. It was established a global limit of 6 billion of Brazilian Reais for the Federal Union, its autarchies and public foundations to partake on the Guarantee Fund of PPPs (the Fiduciary Fund). This fund will be of private nature and will have its own assets separated from the shareholders ones, and will be subject to its own rights and obligations. New provisions detailing the characteristics of this fiduciary fund and how it shall work were included, including the rules for its dissolution.
  
- 7) **Final Provisions (Chapter VII)** – Many changes were included in this part as well. The National Monetary Council shall not only establish the directions for the concession of credit for the financing of the PPP contracts, but also for the participation of the pension funds of the State owned companies' employees in the partnerships. In order to avoid that all the financing for the project remains under the public sector control and influence, it was set a limit of 70% of the contract value for the participation of public companies and companies partially controlled by the Federal State in the credit operations of the private partners. Furthermore, it was set the limit of 80% of the financial resources required for the execution of the project for the participation of the pension funds supported by the public administration, or



by company or entity directly or indirectly controlled by the Federal Union, States, Federal District or municipalities. Finally, the Federal Union was forbidden to guarantee or to effect voluntary financial transfers to the States, Federal District and municipalities if the respective total expenses derived from the PPP contracts surpass, in every year of its effectiveness, 1% of the net current revenue of the contracting entity. The National Treasury Secretariat shall verify the respect to this limit previously to the contracting of PPPs by the States, Federal District and municipalities.

## **IV – Perspectives for PPPs in Brazil**

The acceptance of the new role of the Brazilian State as inductor and co-participant of growth, as well as of priority allocation of public resources for the implementation of public policies, entails the design and development of funding mechanisms that coordinate this new reality with the infrastructure investment needs that are essential to the sustainable economic growth.

In this context, the importance of developing and implementing innovative models that encourage the provision of public interest services by the private sector, in compliance and methodologies pertaining to PPPs, are yet to be fully explored in Brazil, mainly due to the absence of appropriate legal and institutional framework. Such blank tends to be fulfilled soon, with the approval of the PPP Bill by the National Congress and the consequent implementation and regulation.

In Brazil, the public-private partnership represents a key alternative for economic growth, in view of the country's huge social and economic insufficiencies, to be addressed through positive collaboration between the public and private sectors .

The remuneration and guarantee provisions of the PPP Bill aim at strengthening the confidence of the private organization that undertakes full responsibility for the investment in the project that is the object of the partnership, as well as at maximizing the potential of PPPs for the development of new financing mechanisms and of the Brazilian capital market. On the other hand, the public

administration shall be able to establish performance goals as a condition for providing the remuneration of the private partner, what is a crucial element in the partnership relation.

The Social and Economic Development National Bank (the Brazilian BNDES), besides multilateral organisms and other institutions of the financial market are expected to play an important role to finance the private partners in the Brazilian PPPs.

According to the Ministry of Planning, Budget and Management, investments of around 36 billion Brazilian Reais, only considering the federal level, are expected after the final approval of the PPP Bill by the National Congress. A previous portfolio of prioritized projects for PPPs was made, addressing the major demands on energy supply and infrastructure (see Annex VI.4). Such opportunities have been presented to potential national and foreign investors, even during the international travels of the President of the Republic and his ministers.

The forecasted 36 billion Brazilian Reais have been officially included in the *PPA* Bill (multi-annual plan) for the period 2004/2007, to allow that PPP projects up to that amount may be duly included in the federal budget. Best efforts have been made in the Brazilian framework and legislation, however, to avoid that the intended partnerships bypass the Fiscal Responsibilities Law, which is currently one of the most important pillars of the national economic policy.

## V – References

- Acereite, Jose Basilio, 2003, “Financiacion y Gestion Privada de Infraestructuras y Servicios Publicos. Asociaciones Publico-Privadas”, (Ph.D. dissertation; Zaragoza, Spain: University of Zaragoza);
- Arrow, Kenneth J., and Robert C. Lind, 1970, “Uncertainty and the Evaluation of Public Investment Decisions”, *American Economic Review*, Vol. 60 (June), pp.364-78;
- Arthur Andersen and Enterprise LSE, 2000, *Value for Money Drivers in the Private Finance Initiative* (London: HM Treasury, Treasury Task Force). Available via Internet: <http://kenniscentrumpps.econom.i.com/nl/pps/pdf/value.pdf>;
- Brix, Hana Polackova, and Allen Schick, eds., 2002, *Government at Risk: Contingent Liabilities and Fiscal Risk* (Washington: World Bank; New York: Oxford University Press);
- Chalk, Nigel A., 2002, “The Potential Role for Securitizing Public Sector Revenue Flows: An Application to the Philippines”, IMF Working Paper 02/106 (Washington: International Monetary Fund);
- Cruz Lorenzen, Carlos, Maria Elena Barrientos, and Suman Babbar, 2000, “Toll Road Concessions: The Chilean Experience”, *Project Finance and Guarantees (PFG) Discussion Paper n. 124* (Washington: World Bank). Available via Internet: [http://www.worldbank.org/html/fpd/guarantees/assets/images/TollRoads\\_0514.pdf](http://www.worldbank.org/html/fpd/guarantees/assets/images/TollRoads_0514.pdf);
- De Pierris, Luigi, 2003, “Improving the Infrastructure”, *PFI Journal*, Vol. 40 (January), pp.44-45;
- Donaghue, Brian T., 2002, “Statistical Treatment of ‘Build-Own-Operate-Transfer’ Schemes”, IMF Working Paper 02/167 (Washington: International Monetary Fund);
- Engel, Eduardo M.R.A., Ronald D. Fischer, and Alexander Galetovic, 1997, “Privatizing Highways in Latin America: Fixing What Went Wrong” *Economia*, Vol.4 (Fall), pp. 129-164;
- Eurostat, 2004, News Release n. 18, February 11, “Treatment of Public Private Partnerships”; Available via Internet: <http://europa.eu.int/comm/eurostat/Public/datashop/print/product/EN?catalogue=Eurostat&product=2-11022004-EN-AP-EN&mode=download>;
- Fourie, Frederick C.v.N., and P.Burger, 2000, “An Economic Analysis and Assessment of Public-Private Partnerships (PPPs)”, *South African Journal of Economics*, Vol. 68 (December), pp. 693-725.
- Fourie, Frederick C.v.N., and P.Burger, 2001, “Fiscal Implications of Public-Private Partnerships (PPPs)”, *South African Journal of Economics*, Vol. 69 (March), pp. 147-67;
- Grout, Paul A., 1997, “The Economics of the Private Finance Initiative”, *Oxford Review of Economic Policy*, Vol. 13 (Winter), pp. 53-66;
- HM Treasury, 2000, “Public Private Partnerships: The Government’s Approach” (London: HMSO);
- HM Treasury, 2000, “PFI: Meeting the Investment Challenge” (London: HMSO);
- International Monetary Fund, 2000, “Limits on External Debt or Borrowing in Fund Arrangements – Proposed Change in Coverage of Debt Limits”, EBS/00/128 (Washington);

- International Monetary Fund, 2001, "Government Finance Statistics Manual" (Washington);
- International Monetary Fund, 2003, "Assessing Public Sector Borrowing Collateralized on Future Flow Receivables" SM/03/210 (Washington);
- International Monetary Fund, 2004, "Public-Private Partnerships" FAD (Washington);
- Kay, John, 1993, "Efficiency and Private Capital in the Provision of Infrastructure", in *Infrastructure Policies for the 1990s* (Paris: Organization for Economic Co-operation and Development);
- Montesinos, Vicente, and Bernardino Benito, 2000, "Private Financing of Infrastructure: The Spanish Experience", paper presented at the European Institute for Advanced Studies in Management International Conference on Accounting, Auditing, and Management in Public Sector Reforms, Zaragoza, Spain, September;
- Shleifer, Andrei, 1998, "State versus Private Ownership", *Journal of Economic Perspectives*, Vol. 12 (Autumn), pp. 133-50);
- Spackman, Michael, 2002, "Public-Private Partnerships: Lessons from the British Approach", *Economic Systems*, Vol. 26 (September), pp. 283-301;
- Torres, Lourdes, and Vicente Pina, 2001, "Public-Private Partnership and Private Finance Initiatives in the EU and Spanish Local Governments", *European Accounting Review*, Vol. 10 (September), pp. 601-19;
- Victoria, Australia, 2000, *Partnerships Victoria* (Melbourne: Department of Treasury and Finance);
- Victoria, Australia, 2001, *Practitioners' Guide, Partnerships Victoria Guidance Material* (Melbourne: Department of Treasury and Finance);
- Wolfe, Charles, 1993, *Markets or Governments: Choosing Between Imperfect Alternatives*, A RAND Research Study (Cambridge, Massachusetts: MIT Press, 2<sup>nd</sup> ed.);
- World Bank, 2003, *Private Solutions for Infrastructure in Mexico, Country Framework Report for Private Participation in Infrastructure* (World Bank and Public-Private Infrastructure Advisory Facility), February;.

## **VI – Annexes**

Ps. The Annexes VI.1, VI.2, VI.3 and VI.4 shall be sent soon, from Brazil.