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PUBLIC-PRIVATE PARTNERSHIPS:

CONVENIENCE AND PECULIARITIES OF BRAZILIAN PPPs

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ABSTRACT

In the year 2004 Brazil improved its economic indicators, and there are consistent signs that the country will go into a growth period. In order to keep this tendency and allow a sustainable growth, heavy investments in infrastructure are necessary. Nevertheless, the public sector in Brazil is facing a fiscal crisis and does not have money to invest the required amount. This paper tries to show that public-private partnership is an instrument that can be used to supply, at least in part, the lack of infrastructure faced by Brazil. A public-private partnership assumes the participation of private money in the investments, complementing the public sector expenditures. So, economy can continue to grow with more adequate infrastructure and without compromising in excess the sparing public resources. The paper also shows other countries' experiences in public-private partnerships and the main differences among them and the Brazilians.

I INTRODUCTION

After the crisis faced in 2002, Brazil gives clear signals of recovery. The Brazilian economy goes to the end of the year 2004 with the best indicators of performance of the last years. According to the Brazilian Institute for Geography and Statistics - IBGE¹ in 2004 the Gross Domestic Product (GDP) grew 5,2%, the greatest result since 1995. The country-risk, main index that measures the confidence of the investors in Brazil, fell to about 400 points, the lowest level since October 1997. The most optimistic believe that the economy goes through a virtuous cycle.

However, some measures must be taken to give sustentation to this new cycle, and one of the main ones is to make possible investments in infrastructure. It is necessary to invest in the improvement of logistics and in the generation of energy to support the warming of the economy. If this does not happen, it will not be possible to market the goods. The ports are congested and are insufficient to give an account of an increase of movement, few river ways in operation exist and the highways are in precarious situation, causing considerable damages. The recklessness with the infrastructure of energy in 2001 generated a blackout that caused the loss of three percentile points in the GDP of that year. The concern of the entrepreneurs is to prevent the constrains in the infrastructure from leading to a kind of "logistics blackout".

These deficiencies make the internal circulation of merchandises, goods and services more difficult and expensive, increase the country-risk and reduce the competitiveness of the Brazilian products in the international markets.

A study made by the National Association of Capital Goods Industries (ABDIB²) estimated a necessity of investments of R\$ 40 billion per year (US\$15 billion), in the next eight years in Brazil, in order to recover the existing infrastructure, to give competitiveness to the country and to prevent bottlenecks in the economy. The

¹ In Portuguese, "Instituto Brasileiro de Geografia e Estatística".

² In Portuguese, "Associação Brasileira da Infra-Estrutura e Indústrias de Base".

biggest demand, according to this study, is in the energy sector, with R\$ 20 billion, followed by the sewage area, with R\$ 9 billion of investments required.

It is in this scene of enormous necessities of investments, at the same time that the public sector faces serious limitations to invest, that State governments have embraced PPPs as an important mechanism for financing infrastructure and services without having to increase taxation or run budget deficits which would be politically unacceptable.

The partnerships between the public and the private sectors may be capable of making investments that, if not carried through, would break Brazilian economic growth.

II PUBLIC PRIVATE PARTNERSHIP

A DEFINITION

PPPs may be broadly defined as financial arrangements between governments and the private sector, where the private sector provides financial and other forms of capital to fund the construction and maintenance of government services, including schools, hospitals, water supplies and road and rail networks³.

In the bill⁴ that had been directed to the National Congress in December of 2003, the PPP was defined as an adjustment celebrated between the public administration and private entities, that establishes legal ties for the implantation or management of services, enterprises and activities of public interest, with financial resources provided by the private partner

In the law approved and sanctioned by the Brazilian President in December 2004 (Law 11.079/2004), the public-private partnership came to be defined as the administrative contract of concession, in the sponsored or administrative modality.

³ Nick Blake, 2004.

⁴ PLC 10/2003.

In this law, sponsored concession is considered the concession of public services or public works which involve, beyond the charged tariff, pecuniary consideration of the public partner to the private one. Administrative concession, in turn, is the contract of rendering of services that the Administration is using directly or indirectly, even if it involves the execution of a public works project or the supply and installation of goods.

B HOW PPPs WORK

In a PPP, the private sector is responsible for the total financing of the public works project and only after it is finished, does it start to receive the amortization from the carried through investment. In other forms of contracts, the public sector contracts and pays according to its execution. The public administration will be able to establish performance goals as a condition for paying the remuneration of the private partner.

The public-private partnership allows an ample range of investments, supplying demands in areas such as public security, housing, sewage, road and or electric infrastructure. It can make possible projects ranging from roads and power plants to hospitals and penitentiaries.

A simple example is capable of illustrating the use of the public-private partnership to make possible an enterprise. Assume the construction of a railroad. If it was ready today, it would have a demand, let us assume, of 80 ton/day. However, with this demand the enterprise would not be viable, needing, for such, a demand of 100 ton/day. One could estimate that this level of demand would only be possible after 10 years. The private sector would not undertake such an enterprise, and the government would have financial difficulties investing.

Let us consider that the investment is good for the country, by bringing economic and social benefits⁵, besides making possible other enterprises. In this case, a partnership

⁵ Here, I am assuming that a railroad will bring economic and social benefits. This may not always be true. An economic benefit can easily be understood in a case of a railroad construction, since it is much cheaper to transport goods by railroad than by roadway. The social benefits could be the employment created during the construction, the reduction on the prices of the goods caused by the reduction on the cost of transportation and easier access to the areas near the railroad.

between the public and the private sector could be made, where the government would assume the annual payment equivalent to the difference between the real invoicing and the minimum invoicing necessary to make possible the investment (in this case, the equivalent of 20 ton/day). At the moment where the investment starts to be self-sustaining, the government would stop paying. At the end of the period of the contract, the railroad would become property of the public sector.

C MOTIVATIONS

The Federal Executive branch, in the “motives exposition”, when directing the first version of the bill to the National Congress⁶, pointed out that the proposal “represents an indispensable alternative for the economic growth, in face of the enormous social and economic lacks of the country, to be supplied by means of the positive contribution of the public and private sector”.

In the past, the private sector would invest in profitable ventures and the public sector would have to make investments even if they were not profitable. Currently, the public sector’s investments no longer cover the necessities of the society.

The capacity of the Brazilian State to finance public works projects of infrastructure and services to the population is reduced. Moreover, some services do not attract the private entrepreneur, because of the low return of investment. At the same time, the charged tariff cannot be raised, because it could make the service inaccessible to the majority of the population or uninteresting to the user. The PPP is a way to make the public interest (reasonable price) compatible with the private interest (yield). For the partnership contract, the public sector assures the private partner of a minimum yield.

The PPP was created to complement private capitals with the insufficient resources of the government. The partnership allows the construction of new equipment in all the sectors, substituting its administrative performance by the private segment, as much in the construction of public works as in the maintenance of the public services. The public works projects comes to be constructed by the private initiative, with its

⁶ This bill was sent to the National Congress in November 19, 2003.

resources and its management techniques, its more modern technology and its care to prevent wastefulness. They receive a reduction of cost and faster construction, functioning more in line with enterprise standards. In conclusion, the PPPs adjust the perspective of modernizing government action, giving it the support of the private sector. In other countries where the PPPs were adopted, even the governments that have resources to make investments opt for the partnership because the private sector uses to be a more efficient operator of public works projects.

D BENEFITS

The cooperation between the public sector and the private one can present diverse benefits, six of which stand out⁷:

1 Magnifying public services offers

With the use of the public-private partnerships the government is able to extend public services without excessively compromising its resources. This allows the continuation of projects even when the availability of public resources is restricted. At the same time, it makes possible public services whose private rate of return is lower than the rate of social return and in which, without the partnership, the private sector would not have interest in investing.

2 Technology transfer

The expertise and experience of the private sector encourages innovation, resulting in reduced costs, shorter delivery times, improvement in the functional design and construction processes and better facility management and operational processes.

With the use of new technologies brought by the private sector, it is possible to carry through investments that reduce the cost. Simultaneously, it will increase the quality of the services, since the private sector usually is a more efficient operator of public works projects and operates with more modern technology.

⁷ The first five benefits were cited by the European Commission in the document "Lines of direction for well-succeeded Public-private Partnerships" (2004). The sixth benefit was cited by Harris (2004).

3 Reduction of cost

Projects of PPP that demand the operational maintenance and rendering of services give the private sector strong incentives to minimize the costs throughout all of the useful life of the project, something difficult to get with the traditional restrictions of the budgetary process of the public sector.

4 Improvement in the quality of services

International experience shows that the quality of the service delivered by PPP is frequently better than the quality delivered through traditional contracts. In 2003, the United Kingdom Treasury made a study⁸ to check how far “overall performance of the private sector partner” was “matching up to expectations at the time of the contract close”. Over 75% of public sector clients described performance of the project as “as expected” or “better”, including a quarter that said performance was “far surpassing” their expectations. The main reasons⁹ for this are:

- The synergies from combining design, construction and operation ensure the private sector focuses on the whole life costs of the asset over the project life cycle because those responsible for the building of an asset are also responsible for long-term maintenance and operation;
- Private sector management techniques and staffing levels are usually better than the public sector's.

5 Faster implementation

As the public sector does not begin to pay for the asset until it is built and operational with the associated services being delivered, the private sector has a major incentive to complete the new assets on schedule or even ahead of time.

⁸ This study is reported in Harris (2004).

⁹ According to Harris (2004).

6 Better “value for money”

This is the most important justification for a PPP route and, in a certain way, embodies all the others. The role of the private sector is to provide the public services required. In doing so, it should maximize the utilization of innovative design, use the best construction methods and materials with quality control, the latest and most efficient operating systems, the best maintenance support, and with the lowest life cycle costs. The objective is to provide a public service that is “value for money”. In other words, a more efficient, lower cost, reliable public service than that of a comparable public service provided by the public sector. It should be emphasized, however, that “value for money” is not synonymous with “cheaper”. Public services can still be achieved by spending a little more than a conventionally procured solution but resulting in a far superior service.

E COMMON CRITICISMS OF PPP

Despite its wide acceptance, there are some criticisms of PPP. Some of the most common are discussed below¹⁰ :

1 Public finance is cheaper than private finance

Private financing is usually higher than public financing. Nevertheless, determining value for money is not just about comparing interest rates. Moreover, financing construction costs average only one third of the total cost of the projects. Additional costs of borrowing are more than offset to the private sector taking risk from the public sector in areas such as building time, cost overruns, more efficient operational practices and use of resources.

2 PPP leads the government to compromise future budgets

Contracting a great number of projects can aggravate liabilities of a long stated period. Each PPP project will generate an obligation for the government in the future. The resources the government will use to pay for its participation in PPP projects will

¹⁰ Based in Harris, 2004

come from its treasury. If a country contracts a great number of projects, its budget will have to foresee a great amount of resources for PPPs, which may compromise the budget for many years. In order to prevent this from happening, the Brazilian legislation established the limit of 1% of the annual net current revenue¹¹ for investments in PPP projects.

3 PPP use obsolete solutions

The long-term nature of PPP projects could mean the public sector is tying itself to present-day solutions for the next 35 years. This is also true for traditional public sector procurement. In order to avoid this, the contracts can have requirements such as benchmarking and market testing which enable the public sector to benefit from the emergence of improved methods of delivery for relevant services.

4 PPP projects are expensive to procure

PPP projects may be more costly to procure because of the high cost of formulating bids. However, the use of standardized procedures and contract forms reduces these costs considerably. PPP procurements do involve more technical work than conventional procurement and for this reason they may not be suitable for very small projects. It may be because of this that Brazilian law does not allow PPP projects costing less than R\$ 20million.

5 PPP projects can only be undertaken by large multi-national firms

Some people are concerned that only large firms are able to undertake PPP projects, leaving no opportunities for local small and medium enterprises. In other countries international PPP operators actually subcontract most of the activity involved to smaller firms. In United Kingdom, for instance, many large construction firms do not undertake any actual construction themselves, but just manage sub-contractors. There are plenty of opportunities for firms of all sizes to be involved in PPP projects.

¹¹ This limit is better explained in section IV *F - Net current revenue limit*.

F RISKS

Risks regarding PPP can be defined as any factor that threatens the successful conclusion of a project, in terms of stated period, cost or quality¹². One of the principles of the PPP is that the risk must be allocated to the sector better suited to manage it. The efficient allocation of the risk has a direct financial impact on the project, so it will result in lower global cost and will propitiate greater socioeconomic advantages.

The European Commission¹³ lists eleven categories of risk involved in a PPP project:

1 Income risk

The income flow is determined by the level of use of the services and by the tariff charged. If the demand is overestimated, for example, the real income received is lower than the foreseen income. If the PPP contract foresees complementation of tariff by the public sector, this could implicate an extreme responsibility. To minimize this risk, historical information must be analyzed, recording the levels of elasticity of the price and the demand of the sector.

2 Construction risk

This risk is associated with construction, maintenance and operation. It can be caused by failure to complete the construction of the works, suspension of service, failure to meet deadlines, cost overruns, etc. One of the basic factors on which the financing is based is the cost of capital for the construction of the project. When it is incurred into excess of costs, the financial viability can be jeopardized. Poorly defined specifications, for example, can have considerable effect on the construction cost. These potential problems can be reduced with the conduction of careful studies of engineering before the contract is signed. Delays in construction also present harmful effects on the capital costs. The construction risk is almost always allocated to the

¹² The European Commission, 2004.

¹³ In the document "Lines of direction for well-succeeded Public-private Partnerships" (2004).

private sector which probably will include in its contracts strong incentives for the prompt conclusion of the public works project.

3 Risk in the election of the private partner

This risk is associated with the formation of a partnership with strangers. This is highlighted during a process of public bidding, which does not allow periods of negotiation that would facilitate the creation of a certain degree of confidence. The private partner may not be capable of delivering the services according to specifications. The criterial evaluation of the proposals should try to identify such situations.

4 Exchange risk

When the resources for the partnership project are raised from external sources, the exchange fluctuations can threaten the viability of the project. The weaker the currency of the contracting country is, the greater the risk will be.

5 Normative or contractual risk

This risk is related to the refusal of the government to meet contractual obligations. Although the government negotiates with its partners the contractual terms and conditions, they are not always successful in the maintenance of its commitments. This happens particularly in the case of tolls and other tariffs of use, which tend to be politically sensible. The normative risk is more likely to happen in the countries where PPP projects are ruled by new laws or laws insufficiently tested.

6 Political risk

Such risks encompass possible changes in the political regime, government policy, or even the stability of the local political institutions. The country-risk is one of the indicators of this kind of risk. When the political risk increases, the same happens with the cost of financing attainment. The long duration of the majority of contracts and the aversion to the increase of the tariffs turn the PPP projects particularly susceptible to political risk. This is aggravated when new governments enforce projects initiated by

previous administrations. The political risks are usually supported by the public sector.

7 Environmental risk

Infrastructure projects present potential to provoke environmental concerns, and governments and citizens are becoming more and more vigilant in their efforts to mitigate the potential impacts. Unexpected environmental questions can greatly increase the costs and result in serious delays. The environmental risk usually is assumed by the private sector.

8 Risk of latent defects

The risk of latent defects can occur when the government grants to the concession holder the right to the already existing infrastructure systems as a way of helping to finance the construction of the new infrastructure. In exchange, the concessionaires generally assume the responsibility for the maintenance of these installations throughout the duration of the contract. This mechanism can cost a lot of money for the private partner when it inherits installations with unknown structural imperfections. The risk can be minimized with complete inspections of the installations to be transferred, before the signature of the contract.

9 Risk of public acceptance

Infrastructure projects can incite protests in the local communities. The construction of a prison near a city, for instance, can generate protests from the citizens living in the neighborhood. The submission of the draft of proclamation and contract in a public hearing minimizes this risk.

10 Sustainability risk

One of the main objectives of the public sector is to protect the public interest and to assure the attainment of socioeconomic advantages. The introduction of private operators can reduce the control of the contributors over the projects, in the case that efficient systems of control are not available. To prevent this risk, associations of

consumers can be created to enforce the projects and to make possible public consultations.

11 Hidden protectionism

The infrastructure supply generally is perceived as being a domain of the public sector. The population can present certain skepticism when there are private participants involved, especially when the investors are from more affluent countries and are more likely to profit from the investment. When this kind of reaction on the part of the population occurs, it can cause a reaction in the political area, making it more difficult for foreign investors and the local government to reach an agreement.

III OTHER COUNTRIES' EXPERIENCES IN PPP

About sixty countries around the world have already adopted or are introducing the instrument of public-private partnerships, moved by the necessity to face the increasing investments in infrastructure or aiming to increase the efficiency and effectiveness in the provision of the public services.

In the following, the experiences of the United Kingdom and Chile are discussed¹⁴. The United Kingdom was chosen because it is the pioneer in implementing PPP projects, and Chile because it belongs to Latin America, and therefore has some similarities with Brazil.

A UNITED KINGDOM

In the last decade the United Kingdom has revolutionized the delivery of its public services by using the financial, design, operational and management skills of the private sector. Using the lessons learned as a result of its revolutionary privatization experience in the early 1980's, the United Kingdom has developed a program of Public Private Partnerships (PPP) to deliver a wide range of services to the public.

¹⁴ Most of this information is available on the internet, in the Brazilian Ministry of Planning, Budget and Management site (www.planejamento.gov.br). Another part can be found in Stephen Harris, 2004.

The United Kingdom was a pioneer in the implementation of public private partnerships.

The UK model of PPP (originally known as the Private Finance Initiative - PFI) is a process whereby the public sector contracts with the private sector to deliver services on its behalf. A private sector firm is created to deliver these services, which often involves building new infrastructure, such as a road or a hospital. The firm is responsible for building, operating, maintaining and financing the asset and providing the service for the long term (often 25 years) in exchange for regular payments from the public sector. These payments are structured in such a way as to ensure high quality service provision for the whole life of the contract. At the end of the contractual period the operation of the asset reverts to the public sector.

In the United Kingdom, since the legislation about PPP was introduced in 1992, the British public sector had already signed 617 projects, 450 of which are still in operation. The signed contracts add up to 55 billion pounds (about US\$ 100 billion). Since the system was introduced, the public works with delivery delay or costs overruns had fallen from 75% of the total to 25%. The sectors of transport, health and defense had been the main beneficiaries. A report divulged by the English government in 2000 concluded that the projects executed under the PPP form had allowed, on average, an economy of 17% in relation to the conventional forms of public services offered.

In the United Kingdom, the great expenses recurrent of the partnerships are foreseen in the annual budgets of the responsible departments. There exists, moreover, a central agency with the attribution to monitor the budgetary impacts of the projects, which also assures the commitments are honored.

In this country, the evaluation of the PPP is widely favorable. Although there, the private financing of activities is more expensive than the public financing, it has consistent evidence that the transference of risks for the parts most apt to manage has allowed them to be more efficient. This is true in terms of quality and costs of a long stated period, in comparison with the services performed exclusively by the

government. This better efficiency is also observed in the maintenance of the standards agreed upon in the contracts, once the PPPs have brought a superior performance to the activities of the public sector regarding the budgetary limits and the schedule of rendering of services.

Although the majority of partnership projects was successful, it is important to remark that some have not given good results. But the government, as time goes by, is improving the processes, based in the accumulated learning.

B CHILE

Along with the great majority of Latin American countries, Chile has pledged to balance the necessity of investments in infrastructure with the strong demand of social services. So far, the results have been exemplary, according to a recent survey¹⁵ of the Inter-American Development Bank (IDB).

In this country, the model of concessions of public services and infrastructure started to be used in multiple sectors in 1990. Since then, 36 projects have already been executed, summing up to US\$ 6 billion. Among the projects in execution, there are 24 in the sector of transportation and 9 airports.

It is considered that the Chilean PPPs have allowed for a dramatic change in its roads. Concessions of long term periods, and the association with private investors, along with the guarantee of transparent and fair rules, have been the secret of Chile in modernizing its infrastructure and at the same time in allotting resources to social programs.

Chile has also developed a sophisticated method to manage the inherent financing risk to long term investments in infrastructure. The country offers the concessionaires special guarantees of minimum income and mechanisms to manage exchange fluctuations and bond emission to cover costs of construction.

¹⁵ This survey is cited on the Ministry of Planning, Budget and Planning web site (www.planejamento.gov.br).

Chile also transferred the risks to the most qualified sector. The construction risks, for example, are totally assumed by the concessionaire. But the risk of the solution of problems associated with the dispossession of private property before the construction begins is assumed by the government.

Finally, Chile prioritized the participation of the citizens in the program of concessions. The government instituted a formal process of communitarian consultation and forums of conflict resolution for each project of concession. These meetings allow potentially affected citizens to reveal their objections and to influence the final conception of the project.

C LESSONS LEARNED FROM OTHER COUNTRIES' EXPERIENCES

The implementation of public-private partnerships in other countries has a very positive evaluation. However, the other countries' experiences show that there are some basic requirements which should be observed in order to increase the likelihood of success of a PPP. The main ones are:

- To establish clear regulatory landmarks for each sector. To be a successful initiative, the PPP needs stability, clarity and transparency in sectorial regulatory frameworks, providing legal security to contracts. The elimination of uncertainties will result in a bigger capacity to attract investments.
- To clearly specify the terms of the contracts which the government will review periodically. This is valid mainly in the cases of unknown projects, where it is difficult to foresee some of the costs or estimate with precision the future income.
- To guarantee the equilibrium between the public and the private interests. If the legal mark is defective, partnerships will not occur, or bad governing and bad entrepreneurs will make partnerships at the cost of public interest.

- To make use of specialized knowledge in the drawing of the projects. Pioneering projects or very complicated ones must be avoided in the beginning, due to the difficulty in evaluating costs.
- To prioritize projects with bigger socioeconomic return. In the point of view of the State, there are important objectives to be pursued, amongst which are the satisfaction of the users and the continuity of the services.
- To correctly distribute the risks between the public and private sectors, in a way that stimulates the efficiency of the project and, at the same time, preserves its yield. The risks must always be assumed by the partner most apt to manage it.
- To define previously the required standard of quality and match the remuneration of the concessionaire with the quality level of the service.
- To create a managing agency of partnerships, in charge of giving flexibility to the management process, allowing the overcoming of eventual bureaucratic impediments, and the strengthening of the control and transparency systems.
- To establish transparent bidding, without political interference.
- To bear in mind that the main objective of a PPP is to offer better services to the society.
- To demand that the prioritization of the projects is made by the public sector. When the private entrepreneur is allowed to propose a partnership in a project of its choice, it takes over the public sector's obligation to formulate development policies.
- Never forget that a PPP does not make a bad project good. If a project which would be undertaken under a regular contract is not good, executing it through a PPP will not make it better.

IV MAIN CHARACTERISTICS OF BRAZILIAN PPPs

In each country where they are adopted, the PPPs are adapted to the local peculiarities, varying in accordance with the legislation in-force and with the local culture. In Brazil it is no different. Some legal mechanisms have been introduced in the Brazilian law aiming to increase the possibilities of success of the Brazilian public-private partnerships. Some of them have been based on lessons learned from other countries. Others have the objective of respecting the fiscal responsibility law.

The main characteristics of Brazilian PPPs, according to the Law 11.079, from December 30, 2004 are:

A CREATION OF A "SPECIFIC PURPOSE SOCIETY"

In Brazil, the law establishes that before the finalization of a contract of public-private partnership a Specific Purpose Society (SPE¹⁶) will have to be created. It will be in charge of implementing and managing the object of the partnership. In these societies, the public administration is forbidden to possess the majority of the voter capital.

B CREATION OF A MANAGING AGENCY

The Union will create a managing agency for federal public-private partnerships, with the ability to define the priority services for execution in the regimen of public-private partnership, to define the procedures for the signing of contracts, to authorize the opening of biddings and to appreciate the reports of the execution of contracts. The State and local governments which intend to contract through PPP will have to do the same.

C BIDDING

The act of contract of public-private partnership will be preceded by bidding in the modality "competition". The contract will be carried through between the sectorial

¹⁶ In Portuguese, "Sociedade de Propósito Específico".

Ministry and the Specific Purpose Society. In the cases of a sponsored concession, wherever the remuneration paid by the public partner to the private is bigger than 70%, it would be necessary to have specific legislative authorization.

D FORECAST IN THE MULTI-YEAR PLAN

The object of the partnership must be foreseen in the Multiyear Plan created by the Federal Union, State or Municipality where the contract will be signed. This requirement preserves the right of governmental planning, and prevents the private partner from dictating the choice of projects.

E FIDUCIARY FUND

Brazil does not have a reliable historical to present to foreign investors, being seen many times as a country that does not respect contracts. Although the image of Brazil is improving, in order to avoid virtual risks from moving away potential investors, the law has foreseen ways to guarantee the pecuniary obligations contracted by the public administration. The instruments can be the matching of incomes; the creation of special use funds; the insurance-guarantee act of contract; guarantees given to international agencies or financial institutions not controlled by the public power; guarantees given to fund guarantors or state-owned companies created for this purpose or other mechanisms admitted in law.

The Union, its autarchies and public foundations will be able to participate in a fiduciary fund for public-private partnerships, up to the limit of R\$ 6 billion. The fund's purpose is to give guarantees of payment of pecuniary obligations assumed by the federal public partners in partnerships. In the short term, the fund constitutes the main guarantee to the private initiative, because of the discredit in the public power.

The danger of giving governmental guarantees is that it does not provide sufficient incentive for the private sector to get their sums right and deliver the contracted service. In essence, it does not transfer sufficient risk to the private sector.

In developed countries the PPPs do not use a fiduciary fund, and the contract constitutes the only security to the private partner.

F NET CURRENT REVENUE LIMIT

The law of the PPP says that "the Union will only be able to contract public-private partnership when the sum of the expenditures of continued character due to the set of the already contracted partnerships will not have exceeded, in the previous year, 1% of the net current revenue¹⁷ of the year and the annual expenditures of effective contracts in the ten subsequent years do not exceed 1% of the projected net current revenue for the respective years¹⁸".

Similarly, the PPP cannot compromise more than one percent of the net current revenue of the states and municipalities. The states and municipalities which exceed this limit will have suspended volunteer transfers of resources from the Union.

The value of the net current revenue (RCL¹⁹) of the Federal Government in 2003 added up to R\$ 224,92 billion²⁰. One percent of this value is equivalent to R\$ 2,25 billion. Adding up the RCL of all the Brazilian States in 2003, the value rises to R\$ 158,3 billion. One percent of this sum is equivalent to 1,58 billion. Beyond these values, one could add the RCL of the local governments. The RCL of the six main capitals (São Paulo, Rio de Janeiro, Belo Horizonte, Porto Alegre, Curitiba and Salvador) is R\$ 23,22 billion, one percent being equivalent to R\$ 232 million.

Adding up one percent of the RCL of the Federal Government, of the 26 States, the Federal District and the six main Brazilian cities, the sum goes up to the value of R\$ 4,06 billion. The real value must be bigger, since other cities exist, beyond the six cited, with the capacity to invest. Considering that the annual necessity of investment in the country is of about R\$ 40 billion, and considering an average hypothetical

¹⁷ The net current revenue is calculated by reducing the deductions from the total revenue. The main reductions are the legal and constitutional transfers and the contribution for social security.

¹⁸ Free translation of Article 22 of the Brazilian Law 11.079/2004.

¹⁹ In Portuguese, "Receita Corrente Líquida".

²⁰ The source for these data is the Brazilian Secretary of National Treasury – STF web site (www.stn.gov.br).

participation of the public sector in 25% of the projects, the PPP will give an account of about half of the necessary investments. Each government will have to continue to designate part of its budgetary resources to the investments, otherwise the country will not acquire all the investments that it needs.

G MINIMUM VALUE OF THE PROJECT

The law of the PPP prohibits the finalization of a contract of public-private partnership with values lower than R\$ 20 million. Brazil has more than five thousand municipalities, but only in 155 of them is the net current revenue higher than R\$ 100 million. To this value of net current revenue corresponds the value of R\$ 1 million to invest in PPP. In a project of R\$ 20 million, R\$ 1 million would represent only 5% of the total investment. The establishment of this minimum value will mean that more than 90% of the Brazilian cities cannot use PPPs.

The combination of the maximum limit of 1% of the net current revenue and the minimum value of R\$ 20 million will dictate that PPPs will only be used by the Union, some states and the richest municipalities of the country.

H FINANCING BY PUBLIC COMPANIES

With the objective to prevent the private partner from taking resources of governmental entities to finance all of its part of the partnership project, the Brazilian law established that the operations of credit accomplished by public companies or societies of mixing economy controlled by the Union cannot exceed 70% from the total sources of financial resources of the Specific Purpose Society²¹. When the SPE also includes entities of private social security sponsored by the public sector, the limit rises to 80%. These limits have been established so that the partnership, even involving private partners, cannot be possible exclusively with public resources. Despite this, the limits of 70% and 80% are quite generous, allowing the private sector to finance with public resources most of the investment required. In a project of R\$ 100 million, for example, the private partner will be able to finance up to R\$ 70

²¹ This limit rises to 80% for areas of North, Northeast and Central-west, where the Human Development Index (HDI) is lower than the average index of the country.

million to the BNDES – the National Bank for Economic and Social Development²²., which is a public company. If the state where the project will take place belongs to the Northeast, the amount financed by the BNDES would rise to R\$ 80 million.

I MINIMUM PARTICIPATION OF THE PRIVATE SECTOR

The law also fixed a minimum requirement of 30% of its own capital for the private partner to invest in the PPP project. Some people believe that if it there was not a minimum requirement, the companies would not enter with their own capital in order to avoid risks, and they would not make efforts to improve the efficiency of the venture.

J LEGAL CONTEXT

The Brazilian PPP law is the Law 11.079/04. The related laws are Law 8.987/95 - Concessions, Law 8.666/93 – Biddings, and the Complementary Law 101/2000 – Fiscal Responsibility.

1 Public-Private Partnerships Law

Law 11.079/04 establishes general norms for bidding and act of contract of public-private partnership. The law defines public-private partnership as the administrative contract of concession in the sponsored or administrative modality. Sponsored concession is considered the concession of public services or public works which involve, beyond the charged tariff, pecuniary consideration of the public partner to the private one. Administrative concession, in turn, is the contract of the rendering of services that the administration is using directly or indirectly, even if it involves the execution of a public works project or the supply and installation of goods.

2 General Law of Concessions

The General Law of Concessions - Law 8.987/95 makes use of the regimen of concession and permission of the public rendering of services. Utility concession is

²² In Portuguese, “Banco Nacional de Desenvolvimento Econômico e Social”.

considered the delegation of its rendering by means of bidding, in the modality “competition”, to the legal entity or trust of companies that demonstrate the ability to perform the object of the concession for its risk and for a stated period. It can be preceded or not by the execution of public works.

In the general concession, the remuneration occurs for the exploration of the service, and the tariff payment is owed by the final user of the service.

The main difference between the traditional concession and the PPP is that the second involves pecuniary payment from the public partner to the private partner. Another difference refers to the stated period. While in the traditional concession the stated period is from 30 to 35 years, extendable for equal periods, the PPP contracts lasts from 5 to 35 years. A third important difference relates to the distribution of risks. The risks in a traditional concession are integrally supported by the concessionaire, whereas in PPPs there is a distribution of risks between the public and the private sectors. Moreover, the traditional concessions do not define the minimum value of a project, while the public-private partnership requires minimum value of R\$ 20 million for each project.

3 General Contract Law

The administrative contracts which can not be characterized as common concession, sponsored or administrative, continue being ruled by the law 8.666/93, the General Contract Law (or Law of Bidding). In accordance to this law, the remuneration occurs exclusively with budgetary resources, matched with the execution of the contract. The private sector is seen essentially as a supplier of the State, and cannot charge tariffs. The period of these contracts is limited to 5 years.

4 Fiscal Responsibility Law

The Law of Fiscal Responsibility - LRF²³ (Complementary Law nº 101/2000) establishes norms of public finances addressing the responsibility in fiscal management. The law dictates actions in a mean to prevent risks and correct

²³ In Portuguese, “Lei de Responsabilidade Fiscal”.

shunting lines which could affect the balance of the public accounts. The basic premises highlighted in the law are the planning, the control, the transparency and the responsiveness in the public fiscal management.

The LRF defines two types of control: control of the stock of public assets, through the limits of debt, and a control of public cash flow, by requiring that the contract of a service of a long term period can only be carried through if there is a reduction in another expenditure or if there is an increase in income.

The Brazilian PPP law establishes that the new or increased expenditures that result from the partnership contracts cannot affect the goals of fiscal results foreseen in the Fiscal Responsibility Law. It also demands that the government demonstrates in the public budgets the impact of the contracts signed with the private sector.

The Secretariat of National Treasury - STN²⁴ has the responsibility for the accompaniment of the accomplishment of the limit of one percent of the net current revenue in expenditures in PPP contracts. For each contract of public-private partnership the state or local government intend to sign, they will have to inform the STN of the projection of the expenses for the next 10 years.

Regarding the issues discussed above, one can conclude that the PPP is fully compatible with the Law of Fiscal Responsibility, maintaining its advances in the fiscal area.

L MAIN RISKS IN BRAZILIAN CASE

A discussion of the main risks involved in a project made through public-private partnership can be seen in section F. For the PPP which will take place under Brazilian law, the most important risks that can occur are:

²⁴ In Portuguese, "Secretaria do Tesouro Nacional".

1 Exchange risk

Exchange risk occurs in the cases where external resources are raised in order to make possible the PPP venture. The variation or volatileness in the ratio of exchange for conversion of the local currency can compromise the performance of the project, burdening the cash outflow and disbalancing the cash flow. If significant depreciation of the national currency occurs, the viability of the project can be jeopardized.

2 Normative risk

Normative risk, also called contractual risk, may occur because the Brazilian legislation of PPP has not been tested so far, and some imperfections in its formulation can be figured out in the future. To reduce the contractual risk, it must have a commitment by the country in keeping effective agreements and contracts in spite of government changes. The contractual risk will be bigger the more complex the contracts are. An example of contractual risk is what happened with the collection of tolls in the highways transferred to concessionaires. With each proposal of tariff increase, the population questioned and pressured the government, trying to avoid the increase, even though a revision in tariffs was foreseen in the contract. This factor can diminish the private interest for future projects.

3 Political risk

The political risk is one of the most important variables in the analysis of investments and directly affects the prices of the debt of a country, and the prices of the stock options of a company. This risk correlates with the political stability of the country and its institutions. So, in order for a country to move significantly towards a better position, it is necessary to have a long period of concomitant improvement of indicators in the economic, political, social and legal area.

4 Regulatory risk

Besides these three kinds of risk, I would add one more, different from the classification made by the European Commission, but that deserves concern in Brazil: the regulatory risk.

The regulatory risk is related to the stability and transparency of the legal landmark applicable to each project and can be considered as a variation of the political risk. However, this kind of risk encloses also the form of the application of the regulatory mark by the regulator. It considers in its determination the experience of the regulator and the degree of regulatory culture. In Brazil, the regulatory culture is quite incipient. Recently created, the regulatory agencies are still in search of their real identity. Although they are, legally, independent autarchies, the agencies have had difficulty in defining their role. In some cases, sectorial indefinitions have driven the agencies to assume greater responsibilities than those they should have, some of them incompatible with the primordial function of regulating and enforcing. The existing mistakes can be attributed to the embryonic phases of its history. The maturity of the regulating agencies will only be acquired with the continued practice of regulation.

V OPPORTUNITIES FOR PPP INVESTMENT IN BRAZIL

The Federal Government and some of the Brazilian States have already defined their priority projects. Here, I will cite just the projects from the federal government, and São Paulo and Minas Gerais.

A FEDERAL GOVERNMENT PROJECTS PORTFOLIO

The Ministry of Planning, Budget and Management outlined the "Brazilian Guide of Investment", a set of projects that adds up to R\$ 13 billion in investments, in areas like transportation, water resources and irrigation. The investments appear in the Multy-year Plan of the Union for the period 2004-2007. The President of the Republic has presented the projects for potencial national and foreign investors.

Table 1: Projects with the possibility of execution or conclusion through public-private partnership

Project	State	Total Cost (R\$ million)
Enlarging and restoring Itaqui Port	MA	160
Construction of North – South Railway from Estreito to Balsas	MA	480
Construction of the Transnortheastern Railway, Ramal do Gesso (Plaster lane)	PE	346
Construction of the Transnortheastern Railway, section between Petrolina/Parnamirim – Salgueiro – Missão Velha	PE/CE	364
BR – 101, Improvement of the section Natal – Alagoas/ Sergipe border	RN/PB PE/AL	1.591
BR – 101, Duplication of the section Alagoas/Sergipe border – cross-section BR – 324	SE/BA	381
Construction of the Railway Bypass of São Félix	BA	40
BR – 381 Duplication of the Belo Horizonte – São Paulo section	SP/MG	1.500
Building the Metropolitan bypass BR 493	RJ	250
Implantation of Logistical Support Zone in the Port of Sepetiba	RJ	100
Building São Paulo's Rail Ring (North Section)	SP/RJ	200
Adaptation of the Transportation Complex of the Port of Santos	SP	500
Building Curitiba's Rail Bypass	PR	150
Building the Rail Section Ipiranga – Guarapuava	PR	220
BR – 116 (Regis Bittencourt) Duplication of the São Paulo – Curitiba section	SP	970
Road-Ring of São Paulo – South section	SP	1.900
Building Railway between Alto Taquari (MT) – Rondonópolis (MT)	MT	400
Pantanal Tourist Train	MS	200
Irrigation in Jaíba	MG	1.324
Irrigation in Salitre	BA	362
Irrigation in Pontal	PE	256
Irrigation in Irecê River-Bay	BA	750
BR – 163, Building the section between the Pará/Mato Grosso border and Santarém	MT/PA	623
Total (R\$ million)		13.067

Source: Ministry of Planning, Budget and Management

From the total of the investments above, it is expected that 20% to 30% will be financed with public resources, and the remaining with private resources.

B STATE OF SÃO PAULO

The São Paulo Government has announced some of the priority PPP projects for the State²⁵. Among them, are:

- The construction of the south section of the Rail ring and the Road ring. The rail ring and the road ring are railroad rings and roads - respectively - that surround the metropolitan region of São Paulo. In terms of logistic of transports, the two public works projects are considered basic for the Port of Santos.
- The construction of the “Agroporto” in the Port of Santos, which is important to industrial processing agricultural products.
- The construction of the Barnabé-Bagres Terminal, in the continental area of Santos. The infrastructure would be financed by the private sector, and the companies would be repaid through the collection of port tariffs. The total investment for this project is calculated at R\$ 2 billion (US\$ 740 million).

C STATE OF MINAS GERAIS

The governor of the Minas Gerais State determined priority for the implementation of five projects²⁶ under the PPP regimen:

- Recovery and modernization of the roadway MG-050, that connects the Metropolitan Region of Belo Horizonte to the Southwest of Minas Gerais, with an extension of 370 km. The objective of the project is to reduce transportation costs and to increase the security of the traffic.

²⁵ For further information concerning São Paulo PPPs , see the web site www.planejamento.sp.gov.br.

²⁶ Information available on the web site www.ppp.mg.gov.br

- Construction of six penitentiaries, with an ability to house a total of 2400 prisoners vacant in Ribeirão das Neves, in the Metropolitan Region of Belo Horizonte.
- Construction and management of the campus of the University of the State of Minas Gerais, in Belo Horizonte.
- Projects of sewage, which will be managed by the Copasa (São Paulo sewage company) and implemented in regions with a low index of human development.
- Construction of a new state administrative center, with a cost of R\$ 250 million. In the new administrative center, certain areas will be explored by the company that will invest in the construction of the complex. The project foresees the construction of a shopping center, apart-hotels, snack bars and restaurants. Projected to contain all of the structures of the direct and indirect administration, the administrative center will occupy about 500 thousand square meters, becoming the greatest administrative center in Latin America.

VI CONCLUSION

Brazil has a demand for investments virtually impossible to be supplied only by the public sector. A great enough lack of investments can jeopardize the sustained growth of the Brazilian economy. To prevent the lack of infrastructure from becoming a restriction for the consolidation of the cycle of development in Brazil, the public sector is searching for new alternatives, one of which is partnerships with the private sector.

The experience in other countries indicates that the public-private partnerships are an efficient and effective way to increase investments and to modernize public services. In comparison with the traditional forms of public contracts, the PPP usually represents a significant economy of resources and an improvement in the price-quality relation of the services. For the Brazilian industry, the partnerships can

generate productivity profits that can lead to a greater competitiveness of the Brazilian products in the international market.

The PPP contracts, nevertheless, can present some risks, like over-estimation of income, imperfection in the project specifications, delays in the construction, exchange risk, and political risk, among others. With careful studies, clear specifications of the projects, and good regulatory landmarks, these risks can be minimized.

Brazilian PPPs have some differences in relation to the model used in other countries. One of the main ones is the creation of a Fiduciary Fund, with the objective of honoring the pecuniary obligations assumed by the public partners.

Another difference of the Brazilian PPP in relation to the other countries' refers to the limit in the net current revenue invested in PPP projects. Neither the Union, nor the states and local governments can use more than 1% of its RCL in the set of the contracted partnerships. This limit, along with the requirement of a minimum project value of R\$20 million, will mean that the majority of municipalities will not be able to contract PPP projects. On the other hand, the one percent limit maintains the advances brought by the Fiscal Responsibility Law in relation to the fiscal management.

There are strong reasons to consider that the partnerships between the public and private sectors constitute a basic step for the attraction of investments of a long term period which the state, by itself, cannot implement with the required efficiency and quality. PPPs are not a panacea, but there is a tremendous amount to be gained going through this process.

Appropriately applied, the PPPs have the potential to meet many of the community demands, but it is incumbent on governments to ensure that the interests of taxpayers, the community and public sector workers are protected. The underlying principle for PPPs must always be the delivery of transparent and efficient services which benefit the community.

Nevertheless, the PPP will not be able to provide all the necessary investments in infrastructure the country needs. The governments will have, besides allocating a more significant parcel of its budget to the accomplishment of investments, to continue introducing innovations in the public administration, in order to improve the public sector efficiency.

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