

Public-Private Partnership: challenges and opportunities

Paulo Bernardo Silva

The federal government is undertaking a series of reforms in the legal framework that disciplines the procurement of public goods and services in Brazil. Among them, the following should be noted: the updating of Federal Decree n° 3.697, of December 21, 2000, that regulates the electronic reverse auction, the reform of the law of public procurement and administrative contracts (Law n° 8.666, of June 21, 1993), the alteration of the law of concessions (Law n° 8.987, of February 13, 1995) and the regulation of the recently approved law of public-private partnerships – PPP (Law n° 11.079, of December 30, 2004). Such initiatives are in progress and are aimed at conferring to the Administration instruments to increase efficiency, competition and transparency in the procurement of public goods and services.

Law n° 11.079 brought important innovations to the legal framework that rules administrative contracts, starting with the definition of public-private partnership as a service concession contract, rather than the mere acquisition of assets. This implies a change in the scope of contracting and the control of contracts. The rationale becomes based on results and the control of contracts is done by means of performance standards and targets, in contrast with the physical-financial control of works. The public power, when bidding a highway under the PPP modality, is less concerned about the type of pavement or the thickness of its base. Most important, and this will be the object of specification in the contract, is the standard of the service to be provided. In the case of the highway, for example, the pavement must have a certain degree of roughness, it must not allow accumulation of water on the road, and the length of time to respond to emergencies or repairs on the road must comply with previously established reference standards. The focus of the contracting is, therefore, the quality of the service provided to the user.

This change in the contracting rationale poses a challenge to the Public Administration, which has to adapt and qualify itself for results-based management. The public manager, when drawing a PPP contract, must partially abandon the old habit of specifying how the works is to be constructed, and focus on how the service should be provided. This is a fundamental change and not a simple one to implement. The key to a good result in these contracts is the choice of indicators and adequate service parameters which in most cases are more strongly linked to the perception of the user than with the engineering involved in the work.

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The PPPs are contracts where the private partner is responsible for the construction, financing, maintenance and operation of assets that, later, can be transferred to the public power. Such characteristics, together with their long-term contractual nature (5 to 35 years), introduce in the PPPs an intrinsic mechanism of incentive towards efficiency: the optimization of the cost/quality ratio along the life cycle of the project. Since the same agent will be responsible for the construction and maintenance of the enterprise throughout the contractual period, it will be encouraged to use construction materials and techniques that optimize maintenance costs and that meet the pre-established quality standards. Moreover, this integration represents an opportunity to incorporate the technical innovations and managerial skills of the private sector, making room for greater efficiency in the provision of services.

The transfer of this efficiency to the user and to the public power will be greater to the extent that the procurement process is more competitive. On this point, the PPP law brought an innovation to the procurement procedure, by enabling the inversion of the qualification phases and judgment of proposals, which will allow saving up to 60 days in the PPP bidding processes in relation to common concessions. It also incorporated the possibility of correcting flaws in the proposals of the bidders, which reduces the formality of the bidding procedure and facilitates the ample participation of companies.

Another important instrument for ensuring efficiency is that the payment can only be made to the private partner after the service is made available. Thus, the risks of cost increase and delay in the construction are entirely borne by the private partner. The public power does not disburse any amount until the necessary works for the rendering of the service are concluded and the service is operational. The Law of PPP also brought another important innovation, that is the objective sharing of risks among the parties, risks that were previously entirely borne by the public power in the public works and common concessions, such as those related to force majeure and extraordinary events. This means that the distribution will be made in each contract, and must always respect the rule of allocation of risk to the agent that is best fit to manage it.

Since the PPP contracts are long term and the commitments resulting from them will last several governments, one of the great concerns of the private sector in relation to these projects was the guarantee that the public power would honor all the payment commitments throughout the contractual period. In the federal scope, Law nº 11.079 authorizes the Union, its agencies and public foundations to participate in the Guarantor Fund of Public-Private Partnerships (FGP), which provides guarantee to the payment of the public consideration. The FGP is, therefore, a reserve that covers only the risk of default by the public partner in PPP contracts, not guaranteeing any other risk. It is important to make this exception and to point out that, in PPP contracts, the private partner will bear a larger portion of risk than in the contracting of traditional public works and services.

The definition of the degree of risk transfer to the private partner is the result of a rigorous analysis, since the transferred risk results in a risk premium and, therefore, increase of the return demanded by the investor. The solution of this equation is not trivial and this is why the decision to contract a PPP must be preceded by comprehensive technical studies that demonstrate the viability of this modality for the provision of the service.

The decision to invest in PPP requires, therefore, caution and must be based on the pursuit of efficiency in contracting public works and services. This need imposes another challenge to the Public Administration, which is to be prepared to analyze investments from an integrated perspective, including the technical viability, the economic-financial and the fiscal viability of the enterprise.

This requires the strengthening of the capacity of the technical bodies of the Administration in project evaluation and often requires seeking specialized consultancy in the market. The analysis of the international experience shows that the structuring of PPP projects involves high transaction costs, which, however, tend to decrease with the standardization of procedures and contracts and the consolidation of the process. Moreover, new skill need to be developed, mainly related to management of long-term contracts.

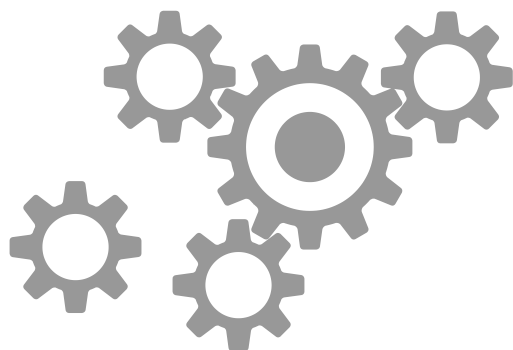
On this point, it is worth pointing out the importance of establishing a central unit, responsible for defining guidelines for selection, analysis and implementation of projects, consolidating and disseminating the knowledge related to PPP to the various agencies of the Public Administration. For the PPP program at the federal level, Decree no. 5.385, of March 4, 2005, institutes the Managing Committee of Federal Public-Private Partnerships – CGP, that has the competence to define the services to be contracted by means of PPP, to establish norms, procedures and requirements of the projects, to discipline and authorize the bidding process, besides approving bidding announcements and evaluate contract execution reports. The CGP is made up of representatives from the Ministry of Planning, Budget and Management (MP), Ministry of Finance (MF) and Civil House of the Presidency of the Republic, under the coordination of the MP. The CGP will rely on technical and administrative support provided by a Technical Commission and an Executive Secretariat (Economic Advisory Office of the MP).

A great concern in relation to the PPP contracts, and that was intensely debated during the process of legislative approval, is the guarantee that these contracts will not result in fiscal indiscipline. On this point, it is important to highlight that Law no. 11.079 did not remove the applicability of Complementary Law no. 101, of May 4, 2000 (Law of Fiscal Responsibility – LRF). In contrast, Law n. 11.079 reiterates the observance of the limits and conditions of application of articles 29, 30 and 32 of the LRF, subjecting, therefore, the PPP commitments to the expenditure and debt controls debt already established by this legal document. Moreover, the PPP Law provides a limit of 1% of the net current revenue (RCL) for the annual commitments with partnership contracts. To guarantee that this limit is respected, each project must have its long-term fiscal impact analyzed and new contracts can only be signed when the sum of the public considerations in PPP contracts in each year does not exceed the limit of 1% of the RCL.

This limitation imposes to the Public Administration the need to make investment decisions based on long-term horizons. With contracts that can reach 35 years, the PPP can become an important instrument for sectoral planning, where the definition of strategic investments is conditioned to the availability of resources in the long run. In fact, in countries with consolidated partnership programs, this form of contract enabled the implementation of investment programs that were structured within a time horizon of more than fifteen years. This was, for example, the case of the hospitals and secondary schools in the United Kingdom.

One of the challenges to be faced to enable the public-private partnership program in Brazil is the supply of long-term financing in national currency. The financial structure of a PPP project follows the rationale of a project finance where a substantial portion of the funding comes from bank loans (or debt issuance in the stock market) that rely on the project's revenue flows to guarantee debt service. A very small share of these investments is financed by means of the capital of the shareholders (internationally, the debt/shareholders' capital ratio is around 90/10).

The greater leverage of these projects allows the reduction of the financing costs, but requires a financial and capital market that provides financial instruments in a period of time compatible with the amortization of the investments. In Brazil, the role of long-term financier has been played almost exclusively by the Brazilian Economic and Social Development Bank (BNDES). The challenge here is to foment a private market for long-term project financing. In many countries, the PPP was an instrument that induced this process and Brazil may follow a similar path.



The challenge posed to the success of the PPP program in Brazil involves adaptation, both in the public and the private sphere, to a new form of long-term contracting, based on performance parameters in the rendering of the service to the user.

Inspired by the international experience, Law no. 1.079 introduces a provision that will contribute to the increased participation of private financial institutions in the financing of PPP projects. It is the possibility of foreseeing in contracts the so-called step-in-rights of the financiers. This provision allows the financiers to take over the control of the specific purpose society that holds the concession when the service falls to levels that can undermine its continuity and, consequently, the payment of the debt. The entry of the financiers – who usually contract professional managers to manage the process – is aimed at reorganizing the business, normally in a period of some months. This protection to the financiers also contributes to the reduction of the spread charged in the financings.

Under Law no. 11.079, the federal government plans to implement an investment program primarily aimed at leveraging the country's infrastructure. In an initial stage, the aim is to focus on projects that have a positive impact on the competitiveness of the domestic production and contribute to eliminating logistical bottlenecks in the transport corridors used in exportation. The priority projects are being selected according to the following criteria: (i) integration with exportation corridor and impact on national development; (ii) capacity to generate tariff revenue; (iii) interest of private investors; (iv) level of development of the project. In other words, the project must structure a strategic logistical corridor, enable collection of tariff from the user, raise the interest of the private sector and have a technical study already developed (analysis of demand, technical viability, economic-financial or environmental impact study).

The public-private partnerships represent an additional modality for contracting public services and a chance to leverage investments that have a positive impact on the development of the country. The transport sector is considered a priority at this stage of the program and the technical studies for the bidding process of the first projects are in progress. In the international experience, a PPP contract can take about two years from the technical studies technician to contract award. Since this is a type of contract with long-term fiscal impact, it is necessary to address all the technical, economic and legal issues that affect the project. Moreover, many PPP projects will be in regulated sectors and, therefore, the contracting can also involve some degree of tariff regulation and definition of new sectoral frameworks by the agencies. Thus, besides allowing an increase in the investment level, the implementation of a public-private partnership program also represents a chance to modernize sectors and to introduce innovations in the sectoral regulatory frameworks, as long as the models are clear, technically based and, once defined, remain stable.

The challenge posed to the success of the PPP program in Brazil involves adaptation, both in the public and the private sphere, to a new form of long-term contracting, based on performance parameters in the rendering of the service to the user. This will cause a change in the relationship pattern between the public and private sectors and will require that contracts be drawn with mechanisms to encourage the efficiency and the quality of the service, in addition to the strengthening of the planning and management functions of the State. ■