Challenges for Sub-national Governments to Implement PPPs: 
the Brazilian experience

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Why PPPs at Sub-national level?

- Responsibility to provide infrastructure services
  - Brazilian law establishes a division of attributions between Federal, State and Municipal governments regarding the provision of utilities and infrastructure services:
    - Interstate roads, power, telecom - Federal Gov
    - Gas distribution - State Govs
    - Water and Sanitation - Municipal Govs

- PPPs helped Brazilian sub-national governments to improve delivering of public services
  - Transfer financing to private sector, freeing sub-national government resources to invest in other areas
  - Improve service quality and expand coverage
  - Increased efficiency in the provision of service
  - Most active states: Minas Gerais, Sao Paulo, Bahia
  - Sectors covered: Roads, waste, water - health & education

- However, it also entailed additional challenges
Challenges for Sub-national PPP projects

- Need for sub-national legal and institutional framework for PPPs
- Capacity building to identify, select and implement PPPs
- Funding of transaction costs
- Support for financial strength
- Availability of market for relatively smaller projects
- Need for political commitment and communication strategy
Legal and Institutional Framework

• Brazilian sub-national governments lack adequate legal and institutional framework to do PPPs
  ▪ Creation of a PPP market requires knowledge and confidence in the legal and institutional framework to implement PPP
  ▪ Federal government created PPP framework which could be adopted by sub-national governments reducing transactions costs. It allows for:
    • Creation of PPP units
    • Government payments in long term contracts
    • Setting up of back stop facility
    • More flexible bidding processes
    • Fosters output based contracts
    • Lenders’ step-in rights, arbitration

• Development of uniform legal/institutional frameworks
  ▪ Federal government is helping subnationals creating standard legal documents for PPPs
    • Making available model laws (acts, decrees etc), contracts or provisions for State or Local Governments
    • Provides assistance in the use of these models
Capacity building

• Brazilian sub-national governments did not have experience in structuring PPPs
  ▪ Improve planning, identification, selection and structuring of projects
  ▪ Difficulties to hire experienced people with Government salaries
  ▪ Training of officers requires time and on the job experience
  ▪ No strategy in place to retain trained public officers

• Federal government is helping specially with training
  ▪ Two federal facilities to advise on feasibility studies and structuring of PPPs, including on the job training:
    • Partnership IFC/BNDES/IDB: US$6 million - for innovative PPPs
    • EBP (commercial banks): - US$ 18 million - for repetitive PPPs
  ▪ Since there is some expertise in managing public works procurement, training is focus on:
    • creating culture of contracts based on output service specifications
    • developing financial and legal expertise on PPPs
Transaction Costs

• PPP projects are complex transactions, therefore transaction costs could be high. More critical when:
  ▪ Underdeveloped procurement practices
  ▪ Insufficient domestic consultancy market
  ▪ Relative smaller projects

• Federal government assists sub-national governments by:
  ▪ Reducing transaction costs by developing model projects for key sectors
    • Transaction documents are enhanced by incorporating international best practices adapted to domestic context
    • Replication increases efficiencies on both sides: public and private
    • Facilitates knowledge transfer
  ▪ Defining minimum project size to implement PPPs
    • Federal assistance for PPPs subject to a minimum project scale of R$ 20 million, sensitive political issue.
    • Scale can be obtained by bundling projects (ex. Belo Horizonte schools)
Financial Strength & Fiscal Responsibility

- Some Brazilian sub-national governments did not have enough credit rating to support financing of PPPs
  - Sub-national governments setting up backstop facilities to guarantee government payments to private sector
  - Payment/backstop mechanism may involve:
    - Revenues such as oil royalties (Rio), infrastructure lease payments (Sao Paulo, roads) or tariff receivables with good credit profile (Sao Paulo, water)
    - Assignment to the private partner of federal transfers
  - Federal government support guaranteed by federal back stop facility

- Fiscal responsibility is encouraged by establishing limits on the sub-national governments capacity to enter into PPPs
  - Maximum of 3% of the net current revenues of the sub-national governments can be spent on PPP payments.
  - There is current a lot of pressure to raise this limit.
Market for the Sub-national PPPs

- Sub-national projects may not have enough scale to attract big infrastructure investors
  - Big infrastructure players are focused on large projects
  - Mapping of investors early on is critical for project structuring and promotion strategy to generate competition for the project. Target the right kind of investors
  - Listen to the investors concerns during promotion and address them seriously

- The case of the BA093 road network in Bahia is an example of changes in the transaction structure to generate more competition in the bidding process.
  - 8 out of 12 players that participated in the promotion disagree with regulation system proposed by the State Gov.
  - The State Gov changed the contractual regulation system and got 9 bidders, the highest ever in a road concession in Brazil. Discount over the base tariff was 23%.
Political Commitment & Communications

• Successful Brazilian sub-national governments in implementing PPPs are characterized by:
  ▪ Strong political commitment to overcome public and internal resistance to PPPs
  ▪ Stakeholders mapping and involvement of the highest Government officials in the definition of the strategy to deal with resistance is a key for success (BA093 in Bahia)
  ▪ Development and implementation of communication strategy
  ▪ Use of highest social and environment standards (Equator principles and WBG social standards)