



**INSTITUTE OF BRAZILIAN ISSUES**

**THE MINERVA PROGRAM**

**SPRING 2007**

**PUBLIC-PRIVATE PARTNERSHIP AND BANK OF BRAZIL'S ROLE**

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## **1 - Introduction**

In spite of presenting significant improvement in the macro-economic ratios in general, as country risk, inflation rate, country rating, relatively stable exchange rate, etc, Brazil has been presenting growth of the GDP below the world GDP, and much below the average of the emerging countries. This has been disappointing the people's expectations and provoking criticisms of the several sectors of society.

There is almost an unanimous belief (as much in the public sector as in private, whether in the left political tendencies or in the right ones), regarding the idea that massive investments in infrastructure are essential for the growth retaking, and also for its maintenance in sustainable bases. That's what all the Brazilians wish so much.

If we take an overview on development in the world, it's easy to figure out that South American countries are the ones that must decrease the existing gap between services and infrastructure demand and the capacity to accomplish them. That gap just tends to grow, if we consider the context of the strong fiscal restraints with which the governments are dealing in these countries. The search for new tools and models adoption are essential to increase the private contribution in the installment of such services.

On the other hand, in order to achieve GDP growth and increase welfare to transform Brazil into the country that everybody wishes, it is necessary that so many other things start to work, and well. A stable institutional structure is important in order to allow a reliable state of contracts to be accomplished, so that government and the society can be in the same boat and indeed row in the same direction.

In this meaning, the Public-Private Partnership arises as a great solution for some limitations of the public administration. Every day, we find in the Brazilian newspapers at least one issue that reinforces this idea, which also emphasizes figures of billions of Reals. In fact, we can say that the current condition, considering the extent of how much we developed in terms of foreseeable economy, points to a very favorable situation toward innovations in the public sector, including the PPP's. Thus, we cannot miss the opportunity of joining the public and managerial efforts in order to reach optimum results for both the parts and for the society.

Some economists and many politicians point to PPP's (whose law was enacted in 2004, but the projects are still floundering) as a good solution for the lack of public resources and the need for investments, in such a way that government and private sector can share costs, benefits and related risks.

Looking backwards at our history, we can figure out that the beginning of the country was the result of a great public-private partnership: the state, personified in the king of Portugal, united for agreement toward bankers and dealers that financed the great navigations and therefore the colonization, generating several benefits for them and the beginning of a new nation.

We will seek in this work to know better the Public Private Partnerships - PPP, and the role of Bank of Brazil in this context.

## **2 - Concept**

In a broad meaning, public-private partnership is an agreement that the public administration of whatsoever level (federal, state and local) contracts a partnership with a private initiative. This partnership has the goal to make possible programs headed for social and economic development of the country and its welfare, as they are the services concessions, services concessions preceded of public works and the public consortiums.

In strict meaning, in other words, based in PPP's' Federal Law, it can be said, that is an administrative contract of concession for right and compatible term with the return of the private investment. It is established by the public Administration with certain private entity, remunerating itself the private partner according to the modality of adopted partnership. It is destined to regulate the supply of public services or the supply of public services preceded of public works or, yet, by supply of services in which the Public Administration is its direct or indirect user. The inherent risks must be foreseen in the contract.

The second article of the federal law defines briefly the public-private partnership as the administrative contract of concession, in the patronized or administrative modality. Some understand that partnership as an administrative contract of management, since the unique paragraph of the sixth article of the Federal Law of PPP's says that the contract must foresee the variable remuneration, which is related to its performance, as quality, availability goals and standards defined contractually.

The public private partnerships were born in England, almost three decades ago, where had been analyzed (according to data of the end of 2003), more than 600 projects, being 450 accomplished, involving 55 billion sterling pounds. Portugal, Holland, Canada, Chile, Mexico and United States, among others, are countries that have, with good results, this experience that

now starts in Brazil. The experience with the services concessions and public works are similar to PPP's, but not quite the same. In Portugal, Odebrecht and Andrade Gutierrez, Brazilian companies, have partnerships with the Portuguese government. We will talk about some international experiences a little further on.

PPP Project is:

- Usually a public work, like a hospital, a government building, a sewage project, a school, an academic facility or a highway,
- In general, a project in which the private sector is the owner of the construction and maintains the project, in spite of some existing concessions of public services,
- A lasting contract between public and private sectors,
- A project in which the public sector makes payment during the contract period,
- Where the risk is faced by the sector most equipped to deal with it,
- Renewable at the end of the contract period or the project can be transferred to the public sector through sale without depending on the initial contract.

PPP Project is not:

- Only a concession of public services. The private sector in general builds, owns, operates and keeps the project for a long term and leases back services for the public service,
- A short term project. To allow financial return, only long term projects are viable,
- A method of getting public funds; Loans are obtained from the private sector. When the private sector is involved, the project should be transparent and overviewed. The investors are not going to lend or invest funds unless they are certain that the project is long term viable,
- A way of getting loan from government accounts. The risk should be transferred in an appropriate way to the private sector; if that does not happen, the loan will be seen as a government loan, with all consequences that would be faced by public finance.

In short, PPP is a partnership between the public sector and the private sector. The public sector hires the private sector to supply services, which receives, partially or totally, the payments from the public sector. Both partners are subject to a contract that specifies, in detail, what is expected of each other.

### **3 - International experiences**

Public-private partnership systems are used by several countries, such as South Africa, Canada, Chile, South Korea, Spain, France, United States, Ireland, Italy, Mexico, Portugal, the United Kingdom and Czech Republic. Among these countries, the most important, in terms of development and innovations, is the United Kingdom. Some surveys indicate that more than 50% of the PPP projects in the world are in the United Kingdom.

#### **United Kingdom**

In 1989, the government of the United Kingdom approved a new legislation concerning realty, that modified the financial regime for a new social housing providing – called Housing Associations, HA. Instead of borrowing money from the Loans Commission for Public Services, which is the organization that lends money to the public sector offices, HA had to borrow directly from the market, private banks, realtors and the capital market. At that time, it was a revolutionary idea that suffered many criticisms and was widely debated. However, the “private financing program” had a noisy success and, almost twenty years later, HA has gotten bigger and today lends great quantities of long term private capital and uses financial instruments that are, over time, more sophisticated.

The success of this simple concept resulted in that other government constructions could be financed by the private initiative. Thus arose the Private Finance Initiative (PFI) as part of the public-private partnership program, which is the model that is being followed most closely by Brazil.

PFI in the United Kingdom had duration a little longer than the regime of private financing for social housing, which happened quickly and successfully. The critics of the program were angrier and, in general, qualified



PFI as a camouflaged privatization of public services, usually offered free to the public, such as education and healthcare. Actually, the services are still offered free of charge to the public.

Although PFI has become a political dispute among center-right parties, the dominant party (Conservative Party) and the ones of the center-left (Labor Party), which the latter had a negative vision of the process, there was some progress in the middle of the 1990's. The true push, however, came in 1997, when the Labor Party won the general elections and dedicated itself to the PFI Policy, and it started to use the expression "public-private partnerships" (probably for disguising the subject) to describe the agreement between public and private sectors.

PPPs were already used in transportation projects, the subway of London, sewage, garbage maintenance, healthcare, hospitals, prisons and education. In the United Kingdom they are not just limited to huge projects, such as those of transportation and great infrastructures, as comonly seen in other countries.

It is interesting to notice that PPP projects of sewage and basic sanitation belong to Scottish origin. When the water industry privatization program was introduced into the United Kingdom there was a powerful lobbying against the privatization in Scotland and, as a result, water in that country remained under the domain of the public sector. The rest of the United Kingdom, meanwhile, continued having cleaner water in because of relatively limitless access to the capital market. However, Scottish authorities were forced to remain with the aged sanitation systems, obsolete in some cases, without access to private funds to modernize them. According to Laws of the European Economic Community and sanitation legislation, they had to make some improvements, so the Scottish consumers had to face weighed taxes and fees. It was this very moment when PPPs came to help them and allow the accomplishment of modernization, faster than it would have ocurred if they were just counting on public funds.

The development causes of PPP in the United Kingdom have origins in budgetary squeezes. The pressures on the government's finance were intense between the late 1970's and beginning of the 1980's. That situation pushed them to the privatization and to the social housing programs from the middle of 80's to the end of them. More pressure arose by the acceleration of Euro introduction, which tried to regulate the limits of countries-members public finance, according to Maastricht's Treaty of 1993. The countries-members were not allowed budgetary deficits of more than 3% of the GDP a year, what placed a limit to the government loans and, therefore, to the expenses programs. As long as the loans of PFI were not included among government debts, the public sector could delegate public services without the construction costs appearing as debts in its accounts. Logically, the service payments had to cover the cost and the loan capital reimbursement of the private sector, but were not the public sector that truly borrowed the money. When withdrawing these loans from the governmental accounting demonstratives, the programs could be carried on and the scarce public funds could be allocated in other projects that did not belong to PFI.

This way, PPPs developed in an extraordinary way in the United Kingdom, becoming a model for other countries.

## **Chile**

According to IMF (International Monetary Fund) report, Chile is one of the most successful countries in PPPs' development. Begun in that country in 1994, and since then always increasing, PPPs are taking on projects in the transport areas, airports, prisons, water reservoirs, etc. In the early 90's Chile was presenting a gap of some decades in infrastructure investments, thus, PPP projects helped them to close that gap, pushing de growth of the country.

The main bases for the success in Chilean PPPs are mostly, institutional solidity, procedures well developed to identify, evaluate and to define projects, adequate sharing of risks between partners, adequate

legislation (with clearness in the rights definition and contractual obligations), and conflict solution mechanisms. Moreover, Chile's historic of institutional stability and respect for contracts have been essential for PPPs' growth.

Not only the government, but also the private sector can identify and propose Public-Private Partnership projects, which demonstrates the development of this kind of mechanism in that country.

The exchange risks and demand risks are shared between the government and the private sector, the rest of risks are taking over by the latter. In the case of the exchange risk the government guarantees a fixed exchange rate. In the case of demand risk, the government guarantees a minimum value of revenues, complementing if this declines below this amount. On the other hand, each contract also establishes a ceiling, from which the government shares the gains. These guarantees offered by the government have been attracting several international investors for the Chilean PPPs.

The public bank "Banco Del Estado" has been financing several PPP's projects, beside the funds coming from international investors. Because Chile has a strong tradition in fulfilling contracts and a very developed finance market, there are no difficulties in finding interested investors to enter into the business, making the PPPs an excellent tool for the country's development.

### **United States**

The concept of Public-Private Partnership in United States is extremely broad. We have to admit that partnerships between government and the private sector in this country has been going on for a long time, so much that some scholars claim the United States began such partnerships (the French also call themselves the parents of PPPs).

The "National Council for Public-Private Partnership" affirms the following: "Public-Private Partnerships have been in use in the United States for over 200 years". This not only demonstrates the amplitude of performance of PPPs in the United States, as well as of the definition of PPP in this country. According to the National Council, 23 out of 65 basic local services are done through partnerships.

We list below some among several kinds of PPP in the United States.

- Build/Operate/Transfer (BOT)

The private partner builds according to the specifications set by the public entity, operates the service for a period predetermined in contract and, so, transfers the property of the asset to the public entity at the end of the term.

- Build-Own-Operate (BOO)

The private partner builds and operates the enterprise without transferring the property to the public sector.

- Buy-Build-Operate (BBO)

It constitutes in the sale of some asset to the private sector, for accomplishment of necessary improvements to its operation in a profitable way.

Several other modalities are found in the American model, but that will go moving away itself of the restricted meaning taken by the Brazilian Law. We can, thus, see in the United States as Public-Private Partnership the concessions, contract of public services, privatizations, financing, etc.

Among projects are highways, lines by subway, water and sewage treatment, schools, public safety, public works in general, etc.

As in Chile, the tradition in honoring contracts and the low risk for the investor have been essential points in PPPs success in the United States, even with the broad concept of PPP in this country.

## **4 - Brazilian PPP**

### **Legislation**

Our study focus is closely linked to the Brazilian Federal Law number 11.079, of December-30th-2004, whose discussion initiated in the National Congress, being sent to the Chamber of Deputies (or House of Representatives), by the Executive, the Bill number 2.546/03, therefore in 2003. However, we have to mention the state initiatives, which took place before the federal legislation. Anxious for harvesting the fruits of the Public-Private Partnerships, Minas Gerais State and Sao Paulo State went forward creating the Laws 14.868/03 and 11.688/04, respectively. With the advent of the Federal Law, those states have to adapt to the instituted general rules. Other states can start PPP's Projects without the need of enacting their own law.

Some scholars of the public right say that PPPs' New Law comes to give focus and direction to the subject, however the existing legislation a priori (biddings, concessions, public contracts, etc) would already allow the accomplishment of a Public-Private Partnership's project, in the same way now enacted.

Through the Decree 5.385, of March 04<sup>th</sup> 2005, was created CGP (Comitê Gestor de Parcerias) – Public-private Partnership Manager Committee, organism that will be in charge for PPP projects overview, identification, evaluation, etc. It had to choose the financial institution to manage the Guarantor Fund of Partnerships: the Bank of Brazil.

The Brazilian legislation had as its main inspiration the British model, included the general concept.

## **Risks**

Some PPPs' discordant voices point some weaknesses as argument at its rejection. That also occurred in the United Kingdom, regarding the Labor Party, which, afterwards, in the power, got the idea as it belonged to itself. However these weaknesses should be faced as risks to be managed and, mostly, foreseen by the public administration at the time of modeling projects, biddings, contracts, inspections, etc. Here we list the most important:

A – Technological Risk – the enterprise can get obsolete for unforeseen innovation initially, staying the public without the quality service and without receiving the benefits of decreasing in prices; That can also generate risk of decreasing in demand (and revenues).

B – Demand Risk – demand for the service may decrease, remaining the obligation of the government to remunerate the private entity, in case of this risk not be transferred to the private partner.

C – Risk of competition – Competitors, included the domestic ones, can offer better or cheaper services (perfect substitutes or not), that will not be able to be preferred by the government to offer to the public during the contract period of PPP.

D – Exchange Risk – The depreciation of the local currency can bring losses when the enterprise financing is in foreign currency.

E – Non Payment Risk – There can be great insolvency rate of consumers, remaining the obligation of the Government remunerate the private entity (according to the rules in contract). Also the risk, for the private partner, of the government's insolvency, in other words, the delay in the government payment can generate extra costs.

F – Regulatory Risk – The government can, in answer to the public asking (very common in periods of electoral campaign), reform the regulation of the

activities sector, what will bring about some government's responsibilities to reimburse the private entity, in case the financial equilibrium of the contract of PPP is injured.

G – Social and Environmental Risk – Many times, the public consultations or environmental licensing are not foreseen in contracts, remaining private and not transparent the decision procedures, with larger chances of the projects having environmental impacts as the services prices increase, the salary repression, the unemployment and the environmental degradation.

The article 5th of the Law 11.079, in the session III, sets that the public-private partnership contracts clauses must foresee “the risks sharing between parts”. Because of this, it is set in the Law the warranties possibility, of both the parts.

It weighs against Brazil the called out “Brazil risk”. Sometimes it is remembered as non honored contracts by the government, default in the foreign debt (in the 80's) and political instabilities of several types. At other times tied to the Brazilian Judiciary, which has many times been having political and ideological view in its judgments.

Trying to smooth such a non comfortable situation, PPPs' Law allowed, in its article 11, session III, the arbitration adoption: “the use of resolution mechanisms of disputes, even the arbitration”. It has for base the Law 9.307, of 09.23th.1996, with a condition: It should be held in Brazil and in Portuguese language.

Such device, a priori, removes any unfavorable discussion about private mechanisms adoption destined to solve controversies between public and private partners, admitting, even, explicitly, the arbitration. The measure, without doubts, is more than adequate and opportune. After all, the private partner as much as the public one has legal capacity to contract and, if the appeal to the arbitration is advantageous for the private, why could be considered disadvantageous for the Public sector while part in contract?



About the arbitration Law (9.307/96), the Supreme Federal Court of Justice has already recognized it definitely as constitutional. In this sense, we believe that was created in our country what could be called out a market of conflict resolutions, in which, of a side, we have the traditional institution called Judiciary and, of another, competing with this, now instituted arbitration. It is even a solution mechanism before the judiciary unquestionable inability of satisfying to the needs to managerial environment. However, we cannot say yet, in a broad meaning, the Brazilian Judiciary has definitely taken this competition for granted. Unfortunately, since our juridical system does not oblige the inferior courts to obey the precedents, it says decisions in superior courts, even before the declaration of constitutionality about the Arbitrations Law, by the Supreme Federal Court of Justice, still persist in our Country decisions, of several types and contents, contrary to the arbitration.

So, we have to recognize that there is still a long way to go through so that it can be said, of more definitive form, the arbitration is rooted in the national juridical institutions. We cannot make the common mistake of supposing that the judges in Brazil are neutral and limited to the law application. An important aspect is a question of the loss of power that the arbitration carries to the judges.

We could well think the opposite. That most judges would favor the arbitration, in the measure in which this could contribute for a relative decrease in quantity of processes. As there is a constant complaint that the number of processes by judge in our Country is very huge, automatically the arbitration would be welcome by this class, because it would be a tool to achieve the decrease in processes number. We do not believe that it is going to happen. The affirmation that the judges wish the processes number decrease is partially true, because in one hand there is the interest in reducing the legal actions quantity, in the other hand there is the important fact that the Judiciary is not willing, in general, to lose a substantial bit of its power, that directly involve these lawsuits that they say be willing to reduce.

In spite of those difficulties, since the moment in which it initiated the discussion on PPP's viability in Brazil, one of the most highlighted points was always the need of "armor" for these contracts against eventual interferences of politicized judicial or ideological decisions. The Legislation foresaw, in this clearly way, arbitration possibility as a form of reducing the risk for the private investor.

It is true that the arbitration could, theoretically, constitute itself an "armor" for the contracts of PPPs, against the judicial interference moved by political-ideological interests. Nevertheless, we believe that such a mechanism will face, at least, great difficulties.

It is also interesting to notice that the Brazilian government has been resisting agreeing with the institution of international forum for disputes solution. The bilateral agreements of free trade signed among South and Central American countries and the United States has contemplated clause in this sense, for initiative of the latter. Brazilian government has not been accepting this condition. On the other hand, Brazil has taken advantage of such a device to try to solve Petrobras' (Brazilian company of oil) dispute against Bolivia, in the gas issue.

The arbitration mechanism in Brazil, fully, and moreover, accepting the international forum, will bring, perhaps in the future, a considerable reduction in risks for the private partner, what it certainly will reduce costs for the public sector.

To conclude this topic, we must cite the report of the World Bank "How to Revitalize Infrastructure Investments in Brazil – Public Policies for Better Private Participation". That document points surprising numbers about government investments in infrastructure that should be, at least, 3.2% of the GDP a year to keep a minimum stock, up to 2010. Nowadays the country invests about 1% of the GDP a year. A very larger value, up to 9%, would be necessary so that Brazil catch up to the current level of Korea, adding four percentile points to the annual growth of the GDP.

The report goes on pointing to the public-private partnership as an adequate solution to the investment deficient amount, but it highlights the risk, mostly regulatory one, as a great hindrance in Brazil. To cite Paulo Correa, the main author of the report:

“The risk built-in in investments in infrastructure in Brazil is on an average twice larger than the projects of Mexico, Chile and the USA. In most countries, infrastructure projects are an option of safe investments. The level of risk in Brazil goes against this experience due instabilities in the public sector. With less available resources or more expensive ones, the private participation in the country is smaller than the Latin-American average and the infrastructure services price usually is larger. The challenge is to reduce the risk and to improve the stability of rules, for the long run, in the sector.”

We strongly believe that mitigation of risks is a success key factor for PPP in Brazil.

### **Guarantees**

Aiming towards a better mitigation of the involved risks for the partners, PPP's Law foresees the offering of warranties whether by the private partner or by the government. As following:

- Private partner – Article 5th “The public-private partnership contracts clauses will follow the Article 23 of the Law 8.987, of 02.13.1995, in what be proper, also foreseeing:”
- Session VIII: “the offering, by the private partner, of warranties of enough and compatible execution with the onus and involved risks”.

This device intends to reduce the risk, for the government and hence for the society, that the private partner comes to present performance below the expected one (signed in contract) or do not meet of contractual clauses.

- Public partner – Article 8th “The pecuniary obligations contracted by the Public Administration in public-private partnership contract will be able to be guaranteed by means of:”
  - I – revenues of federal government, observed the disposed in the session IV of article 167 of the Federal Constitution;
  - II – institution or utilization of special funds, according to the law;
  - III – contract of warranty insurance in companies that are not controlled by Government;
  - IV – warranty rendered by international organisms or financial institutions that are not controlled by Government;
  - V – Warranty rendered by guarantor fund or Public Company created for this purpose;
  - VI – Other mechanisms foreseen in law.

This device seeks to reduce the insolvency risk of the public partner or queries that take the case to the insolvency. In general, any non payment by the public entity, whether for rendered services, goods supply or pecuniary rights, requires lawsuit by the injured one. Such a procedure can drag the problem out for years, and after the conclusion, transform itself in a right (whose final document is called “precatório”) to be included in next budgets, awaiting payments.

Regarding the "precatórios", there is a bill of Project of Constitutional Amendment (12-2006), in course in the Federal Senate. If enacted, it will set a limit for this kind of payment, it says, a percentile of the government expenses (federal, state or local). OAB (Lawyers Organization of Brazil) and FIESP (Industries Federation of State Sao Paulo) have already manifested against the bill. Those institutions argue that, with the new rules, Sao Paulo State, for example, would take 45 years to pay the current "precatórios". This would represent a retrocession to the country and a general confiscation, what might discourage investors in PPPs.

PPP projects will be accompanied of an injection of financial resources of elevated sum by the private partner. Remaining the insolvency risk, the private partner would have to embed a risk rate in the costs, increasing the project costs.

In this way, the public entity decided to solve the problem (or try to) offering warranties that can be executed quickly. Rather than representing a burden for the government, such warranties represent costs reduction for it, thus for the society. For instance, in a certain public-private partnership enterprise, it can happen that the private partner takes over a commitment of such an amplitude and cost that, if there was not rendered warranty by the Public sector, the unique solution for the bidding private participants would be an overprice (related to the risk) in their proposals, in order to avoid probable future losses if the Public Administration does not honor its commitments. Therefore, if the Public Administration foresees in the proclamation, or in the rough draft of the contractual instrument attached to it, the warranty to be rendered by the Public Administration, this will be only executed in a non payment case. On the other hand, if there was not a foreseen warranty, overprice will weigh upon the partnership budget in any hypothesis, regardless of future non payment by the Public Administration.

When the referred article mentions “other mechanisms admitted in law” it can be understood that the mechanisms cited in the previous sessions are just exemplification, but also they represent focus and clearing by the public entity. The session V, that cites the possible types of warranty rendered by the guarantor fund, deserved special attention, which was detailed in the articles 16 to 22. Such fund itself represents an innovation in PPP Brazilian law, what we do not find in experiences of other countries. In this work we will be studying the Guarantor Fund of PPP, which is managed by Bank of Brazil, in more detail ahead.

## **5 - Bank of Brazil Role**

### **Guarantor Fund of PPP**

Here we come across a Brazilian innovation. Aiming to facilitate the warranty concession, foreseen in the Article 8 of the PPP Law, the GFP - Guarantor Fund of Partnerships (FGP - Fundo Garantidor de Parcerias) was created by the same law. We do not find this kind of fund in other countries that are developing PPP projects. We believe it has been a Brazilian need, aiming to give more safety to the investors, regarding the political and economic instabilities, somewhat common in recent decades in the country. Moreover, it is really often among these countries the acceptance of international forums for conflicts solution, what does not occur in Brazil yet.

The Law regulation of PPPs authorized BNDES (Banco Nacional de Desenvolvimento Economico e Social), the CEF (Caixa Economica Federal) and Bank of Brazil to be managers of this kind of fund. It has chosen Bank of Brazil for now to be only manager of guarantor fund of partnerships. As PPP projects take a long period of time for studying conclusion up until the final contract (which did not yet occur in the federal realm), it is likely that the need to create a new fund (in BNDES or in CEF) is going to take some years.

GFP has a private nature, as foreseen in the first paragraph, of the article 16, which simplifies all the procedures related to it, giving larger safety to the private investor. Besides the Federal, public offices and public foundations can take part in it.

Its purpose is to guarantee the payments due to private partners by the Federal Government, for obligations contracted by means of public-private partnership projects. The creation of such a fund presents, at least, two great utilities: it turns less unexpected and more controllable the onus of the public resources in the enterprises of partnerships that become contracted.

Moreover, when giving larger safety to the private partners, it allows them to bid smaller prices in their proposals, because they will not need to embed overprice related to the insolvency risks.

It was established a limit of R\$ 6.000.000.000,00 (six billion Reals), that the fund shareholders (the Federal, its offices and foundations) will supply by means of the utilization of any asset, in other words, money, securities of the public debt, any properties, stocks, etc.

Through the Decision 413, of 2005, of the Treasury Department (Ministerio da Fazenda), stocks of Bank of Brazil, Companhia Vale do Rio Doce and Eletrobras were transferred to GFP. In its last accounting demonstrative, the GFP detained patrimony in the total value of R\$ 4 billion. The assets administration was trusted to BB-DTVM (BB - Distribuidora de Titulos e Valores Mobiliarios), an integral subsidiary of the Bank of Brazil, which is the biggest administrator of finance assets in Latin America.

The fund shareholders are responsible for the obligations of the Fund, but just towards the Fund, with supplying assets for their quotas. In this sense, some law scholars understand that, for instance, the arising obligations caused for damages to someone, by the fund, belong directly to the responsibility of the Financial Institution that manages the Fund, in other words, the Bank of Brazil.

As determined by PPP Law, among tasks of the financial institution, the Bank of Brazil, it is the seeking of "profitability and liquidity maintenance", meaning the constant search of the better profitability and of the maximum liquidity, selecting the best options that combine these ideals.

The warranty modality to be rendered relatively to each partnership will be issue of the shareholders assembly discussion and deliberation, which will be able to choose between the bail, the pledge, the mortgage, the fiduciary alienation, other contracts with warranty effect, and also, the warranty represented by real assets that belong to the Fund. When there exists a

warranty rendered by a company of insurance, by a financial institution or by an international organism, the counter-guarantee will be able to be rendered by the Guarantor Fund of Partnerships .

If the public partner does not honor its obligations foreseen in the partnership contract, and the guarantee become executed by the private partner, the public partner's corresponding rights to each part of the payment will be transferred automatically to the Guarantor Fund of Partnerships, whenever the public entity pays.

GFP's regulation obliges the Manager of the Fund to receive all the guarantees execution requests, according to the command expressed in PPP Law. In other words, the Fund has to make the payments 45 (forty-five) days after the expiration of the accepted invoice and 90 (ninety) days after expiration of non contested invoice. It also establishes the maximum term of 15 (fifteen) workdays for the guarantee payment in case of the private partner request is right and the public administration has not payed or not contested the invoice in this period.

The Fund will not pay any returns to their shareholders. However any of the participant entities of the Fund can withdraw its quotas partially or totally. In this case, it is clear the withdrawn part can not be pledged in partnership contract guarantee.

The Bank of Brazil will receive the following remunerations, for the Fund administration services, as the manager of GFP:

I – Administration - Fee of 0.15% per year. It is incident on GFP's equity, which is calculated and appropriated daily and charged until the third workday of next month, regarding the administration of GFP assets portfolio;

II – In guarantees administration activity:



a) A percentile applied on the value of the total expenses incurred in support activities to the guarantees administration of GFP. This percentile will be established in Shareholders Assembly, allowing to remunerate the resources allocated by the Manager in a compatible way with the profitability pursued in its overall activities.

b) Two percent of the paid values to the companies or specialized consultants hired for subcontracted services, according to the GFP Regulation.

For these statements, the values paid to Bank of Brazil, depicted in the Losses and Profits Demonstrative of period January 27, 2006, to August 31, 2006, totalized R\$ 4,479,158.00. This sum is considerable, but it is important to highlight that the opportunity cost would be the revenues value generated by project financings of PPPs. The Bank almost totally gave up this opportunity when assuming the GFP administration, as we will see in a later topic.

GFP comes to partially supply the needs to mitigate risks for the private investor, related to the so called "Brazil risk".

## Legislation of GFP:

<b>Rule</b>	<b>Date</b>	<b>Content</b>
<b>Law 11.079</b>	12.30th.2004	PPP Law
<b>Resolution CMN 3.289</b>	06.03th.2005	Operation of the Guarantor Fund of Partnerships (GFP) – National Monetary Committee
<b>Decree 5.385</b>	03.04th.2005	Institutes the Public-private Partnerships Committee Manager - CGP
<b>Resolution CGP # 1</b>	08.05th.2005	Some rules about the Guarantor Fund Of Partnerships - GFP
<b>Decree 5.411</b>	04.06th.2005	Authorizes issue of quotas of GFP
<b>Resolution CGP # 2</b>	09.19th.2005	Creation of task forces for PPP projects implementation
<b>Ministerial Resolution MF 413</b>	12.14 <sup>th</sup> .2005	Authorizes to transfer the stocks of BB, CVRD and Eletrobrás to quotas of GFP.
<b>Instruction CVM 426</b>	12.28 <sup>th</sup> .2005	Portfolio administration rules of GFP – CVM Comissao de Valores Mobiliarios
<b>Instruction STN 614</b>	08.21th.2006	Consolidation of public accounts, applicable to PPP Contracts – Secretaria do Tesouro Nacional
<b>Statute of the FGP</b>		
<b>Regulation of the FGP</b>		

## ? **Financing**

PPP Projects will have funds from private investors, since the idea is that such enterprises should be auto-sustainable. In other words, it should provide compatible returns to the venture capital, which is supplied by entities of the private sector. However, the companies can borrow money from the banks in order to put the project in action, even using BNDES' funds (National Bank of Economic and Social Development), and limited to 70% on the foreseen total.

Considering the decrease in interest rate and bank spread, the long term loans turned to receive special attention by the banks. The financing for an acquisition of a house, for example, became very interesting for Brazilian banks recently, which was almost an exclusive activity of the CEF (Caixa Economica Federal) in the past. Even Bank of Brazil is entering itself in the business, applying for authorization in the Central Bank, in order to create its own saving accounts, aiming to use the funds for mortgage.

Therefore, the long term financing operations for companies, as they are the PPP projects, will be a great business for banks. It will be a great opportunity, whether for the low risk, with guarantees tied to the public entity, or for the long duration loans (5 to 35 years), or for the chain of business generated with the participating company. It is worth remembering the banks offer a wide range of services, which are usually brought about with the long term loan partnership: wages payment, drafts bank, several kind of insurances, and so on.

In this sense, Bank of Brazil could perform some business in this realm. However, as the Bank has been chosen to be the manager of GFP (Guarantor Fund of Partnerships), there are some limitations by the law regulation. Thus, the Bank of Brazil will only be able to take part, exclusively

with other financial institutions, in up to 10% of financed total, after 2009. In this case, it can not be the leader of such an operation.

The law regulation limits, or almost forbid, the action of Bank of Brazil in those businesses. Whereas there are not such a limitation in the local and state PPP, which can generate opportunities for the Bank of Brazil, mainly regarding the experience acquired in federal GFP.

## **6 - Main Ongoing PPP Projects in Brazil**

In January 2007, the government launched the Growth Acceleration Program - GAP (Programa de Aceleração do Crescimento - PAC), which became a bill in congress, conduct as urgent. The Program focuses on transportation, energy, sanitation, housing and water, and it aims to obtain total investments of R\$ 503.9 billion (Reals) from 2007 to 2010 with the foreseen tasks in the program. However, from this amount, just R\$ 67.8 billion (Reals) will come from the government's central budget. The other R\$ 436.1 billion (Reals) might come from the federal public companies and private sector. The private sector can invest by means of concessions or the Public Private Partnerships. The program was criticized by some economists, that classified it as "neokeynesian government". Nonetheless, it did not intimidate the federal government, which received support from many other economists, who are more atuned to participation of government in the economy.

The infrastructure investments foreseen in the GAP are organized in three axes: transportation, energy and social and urban infrastructure. The transportation axis includes highways, railroads, harbors and airports. The energy axis includes electric power generation and transmission, petroleum, natural gas and renewable combustibile. In other words, there is much space for PPP among government's federal projects.

In spite of taking advantage of the knowledge generated by international experiences, PPP projects have a high level of complexity, demanding a long time for its development and conclusion. Because of this, and also because we had presidential election last year, the government's initial ideas have not put in action yet, it says, the projects foreseen when th law was enacted. But it is not lack of attention by the government in take advantage of PPP to make its Growth Acceleration Plan (GAP) successful. The interest rate reduction trajectory is also a good component at this time.

The Committee of Monetary Policy established SELIC - or Intended Federal Funds - in 12.75% a year.

Therefore, several specialists believe that in 2007 PPP start to move forward, beginning with at least four prepared projects: the recovery and enlargement of road MG-050, the construction of a submarine pipe for sewage in Bahia state, the sewages service operation and expansion in the city of Rio Claro (Sao Paulo state) and the construction of a road to Paiva's Beach in Pernambuco state. This last project already had the signed contract with values that totalize R\$ 400 million (Reals) in 15 years.

Most of launched PPP biddings delayed, whether for contestations in court, or for decision of the Executive Power. The transport sector has been leading governments' option toward PPP, followed by sanitation. The winner has been chosen by the smaller public counterpart or, when the service is entirely paid by the government, by the minor price.

Of the 23 projects announced by the Federal Government in December 2003, only PPP of BR-116 and BR-324 – Bahia (highways adaptation and duplication) started to be put in action. The bid announcement was launched in September 2006, and the bidding might occur soon.

Other project, that did not consist in the initial list, but has already passed by public consultation, is the Data Center of Bank of Brazil and CEF (Caixa Economica Federal), in which the private partner will build the complex, and the banks, both public, will pay the rent for 25 years. The project, in the public private partnership model, involves investments between R\$ 250 million (Reals) and R\$ 300 million (Reals). If we include the maintenance, the contract can go through the nominal value of R\$ 850 million in 25 years. The Data Center will have 25,000 meters squares of area built in Brasília and will shelter about R\$ 2 billion (Reals) in information technology equipments, among new and old ones of Bank of Brazil, besides another R\$

600 million (Reals) of CEF. It is going to work as a redundancy for the bank's current infrastructure.

The only project that indeed started execution is the Line 4 (four) of the Metro in Sao Paulo City, which is a state project. The contract of Public Private Partnership for the Line 4 was signed in November 29th, 2006, between state government of Sao Paulo and Companhia de Concessões Rodoviárias (CCR). After some juridical hindrances that were petitioned by metro union, the work was initiated straightaway. However, it has been paralyzed because an accident occurred in January 11th, with a landslide in one of the stations under construction. The project had participation of the World Bank, which already received a request of chronogram revision, because the delay in the work.

It seems that 2007 will be likely the year of PPPs. Several states, cities, and mainly the Federal are working very motivated for this issue.

## **7 - Conclusion**

Projects of PPP in Brazil are actually delaying more than what was foreseen to be put in action. However, projects like these do have a long maturation period, including the selection, the study, the adaptation, the contracting and beginning of the construction. Moreover, Brazil is not just copying the experience of other countries, but creating its own model regarding the differences among the countries.

One of the great hindrances for the Brazilian PPP is the risk. The international experience has shown us that successful countries in PPP Projects have, in general, low risk, whether they are regulatory, political or exchange rate risks. Brazil has been improving its image as a good payer and winning the confidence as a country that respects contracts. On the other hand, its default in the 80's and the political instabilities are still a burden. As a consequence, a lot of private potentials partners are still afraid, waiting for the first projects to come out.

Exactly for that aggravation of the "Brazil risk", regarding other successful countries in PPP, Brazil decided to create the Guarantor Fund of Partnerships (GFP), aiming to attract private investors. Considering the difficulty to receive governmental payments in case of disputes and even insolvency, this mechanism became an extremely positive factor for PPP Projects in Brazil, giving more safety to the investor.

The arbitration mechanism as well as the acceptance of international forums for conflicts solution might become helpful to reduce risks in Brazil, mostly regulatory and political risks. However, it is not going to happen in short run. As Brazil is improving its image internationally, with rating (risk classification) pointing to "Investment grade" in near future, the consolidation of those mechanisms can, further on, make the Guarantor Fund of Partnerships becomes unnecessary.

The performance of Bank of Brazil as GFP's Manager has been satisfactory for the parts, which are the Bank and government. The profits are significant, representing a good new business for the Bank. Nevertheless,



Bank of Brazil should do a better study of the opportunity cost, which are the gains with the businesses that would be generated in financings and many other services rendered to the participant companies of PPP projects. As manager of the Guarantor Fund the Bank of Brazil is not allowed to take all the advantages of these businesses.

In Brazil, nowadays, there are several municipal and state projects in process, on which there are no limitations for Bank of Brazil's participation, whether as a manager of some Guarantor Fund, as a projects consultant, or as a lender. Therefore, Bank of Brazil should pay attention to these business opportunities, with the private partners (financings and selling products and services) and public partner (consultancy and Administration of Guarantor Funds, while they are still necessary in Brazil).

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